

Medium Term Export Finance

European Problems and Experiences *

SUMMARY: I. The Significance of Medium Term Credit in International Trade, 113 - II. The Economics of Medium Term Export Credit, 129 - III. The Problem of Risk Bearing in Export Finance, 146 - IV. Medium Term Export Credit in Great Britain, 168 - V. Medium Term Export Credit in France, 188 - VI. Medium Term Export Credit in Germany, 207 - VII. Potentialities and Prospects, 227 - *Tables*, 240 - *Appendices*: I. The export credit insurance systems of Great Britain, France and Germany - II. Insurance premiums and interest rates applying to export credits - III. The financial record of export credit insurance systems - IV. The Statistical information available on insured export business and export credit outstanding. - *Bibliography*, 267.

CHAPTER I

THE SIGNIFICANCE OF MEDIUM TERM CREDIT IN INTERNATIONAL TRADE

1. The Structure of Trade and the Supply of Finance

The revival of international trade in the postwar years has been characterized by a process of intense transformation in the nature of demand on world markets and in the traditional organization

* The first part of this study, Chapters I-III, is devoted to the background, the characteristic problems and the general institutional features of medium term export finance. Its emphasis is rather with economic analysis than with description.

Later, however, Chapters IV-VI present three case studies: Great Britain, France and Germany offer a variety of approaches introducing problems which it would have been idle to discuss on purely theoretical lines. The busy reader may therefore wish to turn at once to these chapters, where he will find most of the factual material he is interested in, as well as to the appendices, which complete the presentation of the available information.

The last Chapter is designed mainly to stimulate discussion, by presenting what I believe to be a consistent set of views on the goals of export finance and on the means for achieving such goals.

In view of the paucity of the published material, the method adopted has been that of relying on personal interviews whenever possible. My debt to the many bankers, industrialists and officials who were kind enough to give me of their time is very great indeed. Yale University, for whom this study was originally prepared as a doctoral dissertation, deserves my gratitude for a generous Research Fellowship.

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of facilities for financing the international movement of goods. Both developments have their roots as far back as the early 'twenties but have greatly accelerated in the past decade. In fact only quite recently, as far as financial organization is concerned, have practical measures followed the long-standing recognition that new solutions must be sought to meet the changed trade situation. It is this process of adaptation and particularly its most characteristic feature, the emergence of organized systems of medium term export credit, that forms the object of this study. This first background chapter, to be exhaustive, would have to go over much well-trodden ground; but I have considered this unnecessary. Some points will therefore be only briefly sketched, while more space will be devoted to the many controversial points on which there does not yet exist either an established body of opinion or a satisfactory literature.

It is almost a commonplace to remark that by 1914 the London money market and capital market had achieved a unique equilibrium with the trade currents that conditioned them and were in turn conditioned by them. It is also a commonplace to add that this equilibrium was broken after the war and never quite restored. When we turn to the quantitative evidence, these impressions take a more definite shape for both sides of the problem, demand for and supply of international finance.

Evidence on the first aspect is gathered indirectly by looking at shifts in the commodity composition of trade. For international trade in manufactures as a whole, Prof. Cairncross' elaboration of Tyszynski's data (1) shows a remarkable increase in the share of capital goods (machinery, vehicles and electrical equipment) over the first half of this century, from 12.5% to 37.7% of total exports (Table 1). This is also true, singly, for each of the ten leading exporters, with the exception of Canada (Table 2).

Data for later years show an accentuation of the tendency of engineering products exports to gain in importance (Tables 3 and 4). This is not surprising in view of the nature of the process of industrialization in less advanced countries, where the establishment

(1) See: H. TYSZYNSKI, "World trade in manufactured commodities, 1899-1950", *The Manchester School*, Sept. 1951, pp. 272-305; A. K. CAIRNCROSS and J. FAALAND, "Long term trends in Europe's trade", *Economic Journal*, March 1952, pp. 24-35. A. K. CAIRNCROSS, "World trade in manufactures since 1900", *Economia Internazionale*, November 1955, pp. 715-41.

of manufacturing industries tends to lead, in the early stages, to gradual self-sufficiency in consumer goods and to increased needs for imported capital goods. This shift can be observed quite clearly in most Latin American republics and in India, where the share of capital goods in total imports showed a remarkable increase over the second quarter of this century (Table 5).

Finally, while it is true that most of the trade of advanced industrial countries in manufactures takes place among these countries themselves, this is least true in the case of engineering products. Indirectly evidence to this effect is given by the ratios of imports to exports of various types of manufactures for industrial countries as a whole. The ratio for engineering products is considerably below the general average (Table 6). This fact can be taken as an indication of the interest that trade in such goods with developing countries presents for traditional exporters of manufactures.

Such evidence on the changing structure of trade does not tell us much, of course, about the demand for international finance; but, together with the absolute growth of trade in capital goods, it is important as an indication of the investment effort which is going on in countries previously content with a low or even negligible rate of economic growth. What is particularly revealing is the apparatus of controls necessary to restrain the pent-up demand for imports in most countries in process of industrializing; when essential needs for raw materials, foodstuffs and fuel have been met, they appear short of foreign exchange for the desired imports of capital goods, not to speak of consumer goods. The fact is that, except for occasional spurts due to exceptionally favorable terms of trade, the import capacity (export proceeds plus capital imports, minus external debt service) of semi-industrialized countries — Argentina, Brazil, Pakistan, Australia, India, Finland, for example — seems to have lagged behind the development of their import needs (2).

Certainly these are not objectively determinable, and they may be artificially increased by inflationary policies of expansion; it is not, however, for the developed countries of the West to decide

(2) For Latin America in particular this tendency has been discussed extensively in the annual "Economic Surveys" of the Economic Commission for Latin America. The 1956 issue (Chapter V) has some specially interesting comments on the effect of the foreign exchange shortage on the pattern of imports.

whether the industrialization goals of other countries have been set too high. There are instead two other considerations that are relevant: first, the cooperation of the former group of countries could make the goals of the second group more easily attainable, with mutual advantage, secondly, the alternative to the availability of sufficient finance is often an intensification of the present restrictive practices, leading to bilateral bargaining and policies of self-sufficiency. The foreign exchange necessary to pay for capital goods is already being obtained in many cases by drastically suppressing consumer demand for imported goods. It would be a high price for the Western countries to pay for the maintenance of their trade in machinery and equipment with the newer countries if the cost were a serious decline in their exports of the more traditional manufactures. On the other hand, were the importing countries to sacrifice capital goods to consumer goods, trimming their investment programs, the long term growth of these economies and hence of some of the most promising outlets for Western machinery exports might be jeopardized.

These observations bring us to the second aspect of this background survey on the origins of medium term export credit, the adequacy of the postwar supply of international finance in general. The phenomena just discussed suggest that it was insufficient to meet the demand. It is perhaps more convincing, however, to look at the progress (or regress) of the supply of capital in its various institutional forms, keeping in mind the more than fourfold increase in the dollar value of world exports since 1938 — or 1913 — (threefold since 1925).

2. Short Term Credit and Long Term Capital Movements

It is no secret that forms of short term credit — the bankers' acceptance and the reimbursement credit — have often served, through informally granted renewals, to finance transactions with extended payment terms. Moreover short term credit, as an addition to the resources available to the importing country, has indirectly always played a role in supporting trade in capital goods. The postwar years have however given little sign that the facilities available before 1931 on the money markets of London and New York have made much of a recovery from the blow inflicted by

the world financial crisis. The volume of resources available in New York, has, despite recent progress, remained far below that of the 'twenties. There are two further important details. The use of acceptance credits in New York by foreign traders is today very limited (whereas in 1931 Germany alone was estimated to owe some 300 million dollars in acceptance credits extended by American banks). Also, a sizable share of the credit outstanding at present does not really represent a contribution from the United States to international finance. This is due to the fact that New York acceptances are being bought to a large extent by foreign banks which find them an attractive investment for dollar balances, because of the exemption of their yield from the Federal withholding tax on foreign interest earnings (3). Interesting developments seem to have taken place recently in short term credit facilities other than acceptances, such as credit lines granted to foreign banks; but there is not much precise information available yet.

As for the London market, the willingness of the City to resume its former role of world banker has unfortunately been largely frustrated by the realities of the British balance of payments situation. These have compelled the Government to limit the use of London credits for financing deferred payments even for British exports, not to mention the trade of third countries. The restrictions have been particularly tight in times of crisis, when acceptances were liable to misuse for speculation against the pound. The trouble is that not only "bears" but also bona fide traders have been hard hit on these occasions and have come to consider the London facilities unreliable (4). It goes without saying that transactions involving the renewal of acceptances have become extremely hazardous and in practice all but impossible.

The concentration of reserves in the New York market is certainly one of the principal factors helping to make the present situation unsatisfactory. The Macmillan Committee's hearings had shown the importance of foreign short term funds for the finance

(3) Cf.: "Bankers' acceptance financing in the United States", *Federal Reserve Bulletin*, May 1955.

(4) In March 1952 for instance the maximum length allowable for acceptances was reduced from 120 to 90 days and refinance credits were suspended (see "The Government and overseas credits", *The Banker*, September 1953, pp. 140-44); in September 1957 the latter were again forbidden and the use of acceptance facilities for trade among non-residents was also banned (*The Times*, September 21, 1957).

of international trade through the London market: today the New York market is not performing the same function on any significant scale, especially for the account of other countries. This means in practice that European countries, barred from using what was once the cheapest and most flexible form of finance — acceptance credit on the international money markets — have been compelled to organize national systems of export financing: this has in turn opened the way to the development of the new forms of medium term export credit that are discussed in the present study.

Long term international lending operations, have provided, in the postwar years, only a limited stimulus to the export of capital goods from Europe. Their magnitude has been modest (5) and their form unsatisfactory; "tied loans" by the United States, an important fraction of the total, while beneficial to European trade because of the addition they made to the borrowers' resources, have probably meant the loss of much interesting business in the capital goods sector. Freely spendable loans have been practically limited to those made by the International Bank, rare issues on the New York market by foreign governments and some Swiss lending. French and British exports, on the other hand, have been helped by loans and direct investments by their nationals in their own currency areas. But even the field of direct investment appears to have contracted, especially if we abstract from the oil industry; today there is not for instance much scope for investment in public utilities by foreign financial groups — largely on account of the policies pursued by industrializing countries — a type of investment which had been a powerful engine for the promotion of European capital goods exports in days gone by (6).

Intergovernmental transfers on grant and loan account also deserve mention here, because of the addition to the import capacity of other countries implied by the disbursement of very substantial dollar "aid" by the United States. This "aid", however, given

(5) There is no way of arriving at a meaningful estimate of the total of long term capital movements; the closest thing to it is the analytical study presented by the United Nations, *The International Flow of Private Capital 1946-52*, New York, 1954, brought up to date by subsequent studies also by the U.N. Even when public loans (exclusive of "aid") are added, the impression remains that they still amount to a much smaller percentage of world trade than in the twenties or before 1914.

(6) This point is illustrated with convincing examples drawn from the Swiss experience in: ZAUGG, SCHULTHESS and BACHMANN, *Die Finanzierung und Risikotragung im Schweizerischen Exportgeschäft*, Zürich, 1956, pp. 3-4.

the purpose of the programs themselves, was dispensed on such terms and in such circumstances as to make only an indirect contribution to the expansion of European exports (7).

The availability of foreign exchange resources accumulated in wartime by raw material producers had a more direct, if quantitatively less substantial effect. The dollar balances of Latin American countries and the sterling holdings of Commonwealth countries were heavily drawn upon to satisfy pent-up demand for goods that had been unobtainable during the war years, subject in the latter case to the consent of the British Treasury to the release of such balances.

3. Credits under Payments Agreements and the Problem of Commercial Arrears

There is no clearer sign of the insufficiency of postwar arrangements for the finance of international trade than the abuse of facilities granted under payments agreements and the accumulation of commercial arrears by some Latin American countries, by Turkey, Indonesia and others. In effect "forced credit" was extracted from both Europe and the United States through the freezing of clearing balances in excess of the "swing credits" originally agreed upon to take care of short term fluctuations in trade, and through virtual default on commercial debts. I shall try to deal not with the direct causes of such developments (8) but rather with their implications.

The first point that emerges is that governments, central banks and commercial banks in the exporting countries have often been under strong pressure to permit continuation of business by extending further credit, even in cases where this clearly implied committing resources for a longer period than was officially admitted. Not forgetting the many faults of the importing countries, we may still say that such pressure, and the sometimes disastrous consolidation agreements that had to be negotiated to prevent the complete paralysis of trade could have been avoided or limited, if the need for medium term credits had been recognized from the start instead

(7) The fact that in some countries (Germany and Italy in particular) ERP counterpart funds are now being used to finance exports on medium term cannot of course be considered a result of American "aid".

(8) A thorough treatment of this topic can be found in: MICKSELL and TRUED, *Post-war Bilateral Payments Agreements*, Princeton, 1955.

of only after the event. For the creditors, these settlements have generally implied lower interest rates and slower amortization than might otherwise have been necessary, little control over the quantity and quality of credit, and hardship to individual traders on account of the unexpected illiquidity of their credits and sometimes of exchange losses (9).

For debtor countries too, payments crises of this type have proved disastrous, despite the apparently favorable terms on which settlement of the debts could be negotiated. The capital thus obtained from abroad had often not been invested productively but dissipated in increased consumption, so that repayment implied a net additional burden on the economy. Worse still, the credit-rating of the country was seriously affected and the decreased confidence was reflected in the exorbitant interest rates charged to it for any transactions involving credit. The premium included in the rates explains why exports to certain Latin American countries can now be financed in New York only at rates between 12% and 18% p.a. even when the credit periods do not exceed 120 days.

Barring a recrudescence of bilateralism in a worldwide depression, this method of financing by the accumulation of frozen balances without a schedule of amortization precisely agreed in advance should become the exception: in a multilateral system it would in fact be impossible in the absence of outright default

(9) I can only quote the most important examples of such settlements. Brazil had become indebted by 1953 to the extent of roughly \$175 million to Great Britain, \$95 million to Germany, and over \$500 million to the United States. The first debt was consolidated with a complex variable repayment schedule lasting probably some 9 years, with interest at 3½% (*The Economist*, October 16, 1953, p. 122); the second was liquidated with heavy exchange losses for German exporters (Bank deutscher Länder, *Geschäftsbericht 1952*); and in the third case the Export Import Bank and private United States banks had to grant credits aggregating over \$500 million between 1953 and 1955 to "bail out" American exporters (ECLA, "Survey for 1956", *op. cit.*, Ch. III, 5).

Argentina recently signed agreements with six countries for repayment to governmental and private creditors of trade debts aggregating over \$442 million, on very favorable terms as to length and interest payable (*Financial Times*, November 26, 1957).

Turkey also had to arrange for consolidation of its arrears to Britain and Germany on terms that could hardly be considered favorable to the creditors; in fact it is known that even after the first and the second consolidation agreement with Britain (1955 and 1957) arrears continued to pile up, in spite of a number of unorthodox semi-barter deals (*Financial Times*, December 2, 1957).

Finally, Colombia accumulated trade debts during 1956 to the extent of more than \$200 million; here too a credit was forthcoming from a consortium of United States banks, while debts to other countries were to be settled on terms quite favorable to Colombia, as compared with normal commercial credits.

on commercial debts. The central banks have hastened this transition by refusing to commit themselves to finance the accumulation of such balances and have taken steps to shift the burden of granting medium and long term credit to the exporters, their banks and specialized institutions created for the purpose. In consequence the rates charged have come better to reflect the cost of the operations, and these undergo much stricter scrutiny (10).

Concurrently, the provisions typical of postwar payments agreements have been radically modified in a number of cases: instead of providing for intergovernmental credits within given limits, they stipulate that the government of one country "will not oppose" or "will favor by granting credit insurance" the concession of medium term credit for the importation of capital goods in the partner country (11). The implication is that the agreement will take practical effect in this direction only insofar as the exporters are able to grant credit and secure finance from banks and specialized institutions.

All these considerations point to an evolution of the mechanism of international finance towards organized forms of export credit directed toward supplementing the inadequate facilities provided by the traditional money markets, as well as the insufficient volume of long term capital, and direct investments. Such credits, granted for periods up to a maximum of seven years or so, but much more frequently for four or five years, appear to meet the need for foreign capital in the appropriate form. It used to be common practice for a foreign firm to establish plants in an underdeveloped area and operate them on its own; now instead, Governments and local firms often import capital goods on credit terms and operate the plants under native management.

(10) This transition can be observed directly from the decline of credits on bilateral account held by central banks and the parallel increase of foreign credits outstanding in the books of the other institutions. The reports of the Banque Nationale de Belgique and of the Bank deutscher Länder offer particularly interesting examples. Nevertheless, special credit operations with the financial support of the government or of the central bank are still being conducted in many countries in the case of contracts requiring unusual credit terms.

(11) Among such agreements are one between Italy and Yugoslavia (1957), several concluded by Germany with Greece, Argentina and others in less recent years, and one for some \$25 million between France and India (January 1958).

The most recent of all, announced after this study had been completed, commits the German Government to granting insurance for exports to Egypt up to an annual value of DM 400 million.

The growth of medium term export credit thus has three main causes: the increase in the volume of trade, the inadequate progress of other forms of finance, and structural changes in the industrialization process.

4. Credit Competition and the Buyers' Market

Unfortunately, medium term export credit, besides being a powerful stimulus to the development of trade in capital goods is also a very effective weapon of commercial warfare. The existence of capital rationing in most countries makes the international market for investment goods a peculiar one: it is a market for capital *and* for goods linked together. For the importer, suppliers' credit may often be the only available source of finance and the payment terms may consequently be as important a part of the contract as are price and quality. This means that the scope for non-price competition — in this case credit competition — is enormously increased. In a market such as this, if the suppliers could, with the assistance of their governments, easily manipulate credit terms so as to compensate for unattractive prices or quality, the worst distortions of trade would reappear, and importers would find themselves dependent on a highly unstable source of capital.

This situation has given rise to pessimistic interpretations of the development of export credit. The competitive aspect has been stressed and the other factors discussed above under-emphasized. A discouraging picture was for instance drawn in 1954 and again in 1955 by a most authoritative observer, the President of the International Bank. Addressing the Board of Governors, Mr. Black dealt at length with the problem, expressing his concern for the turn things were taking:

"The situation is becoming serious... too much credit given, under the pressure of competition, sometimes on inappropriate terms and for the wrong purposes... So a race is developing, a race in which none of the competitors can win because the faster each one goes, the faster will all the others go. Under the goad of export competition... credit has been offered at medium or even short term to induce purchases of capital goods which can only be amortized at long term. As a result, some countries have so heavily committed their foreign exchange to medium and short term debt

as to seriously diminish their capacity to attract long term investment... " (12).

There are reasons for believing that this picture may have been unduly influenced by factors that had by that time already lost importance or later proved to have been inaccurately reported. Among these was the belief of American exporters that a competitive credit war was being waged "even when the European suppliers did no more than restore the credit terms that were customary before the war and which the more seasoned international trading community considered sound and equitable" (13). The situation described also seems to reflect the impression created by the success of the German trade drive in Latin America and the Middle East, a success that many believed to be mainly due to the offer of generous credit facilities. Reports to this effect, encouraged of course by importers desiring to secure credit from Germany's competitors, often turned out to be grossly exaggerated or to be unwarranted generalizations from the experience of a few conspicuous contracts. Mr. Black himself points out that "in each of the exporting countries governments hear the complaint that other governments are being more liberal" with regard to export credits, but he fails to draw the conclusion just presented. He did not at that time, however, possess the statistical information on export credits which the International Bank proceeded later to collect in the form of a quarterly survey (14).

These observations are not meant to deny that abuses of export credit systems have occurred and are still occurring. Their purpose is only to point out that such abuses are mainly phenomena of a period of transition; in any case, the "competitive credit race" was certainly slowing down by 1954. This may be inferred from

(12) International Bank for Reconstruction and Development, *Report, 1954*, pp. 9-11; 1955, pp. 6-7.

(13) H. G. AUBREY, "Credit competition in international trade" (an unpublished memorandum written in June 1956, while the author was on the staff of the Federal Reserve Bank of New York), p. 7.

(14) The data refer to credits with an original maturity from one to ten years, granted with the financial help or the insurance of official institutions, excluding compensation agreements credits, IBRD loans, EPU credits, credit to colonial territories. They are communicated to Governments and central banks only and are strictly confidential: they only present the indebtedness of the various debtor countries and not the credits granted by lending countries. There is reason to believe that the exclusion of purely private credits results in an undervaluation of the total.

the decline of the most typical instrument of aggressive commercial penetration, the concession of credit facilities within bilateral payments agreements. For reasons which we shall examine, the institutional devices that partly took over from the latter the medium-term finance of exports were far from biased in favor of an easy credit policy towards importing countries. It should not be forgotten that the exporting countries themselves were fully aware of the dangers which a "credit race" held for them, and they proceeded to organize consultations concerning export credits, within the framework of the Union d'Assureurs des Crédits Internationaux (better known as the Berne Union). This organization, in which all credit insurance institutions participate, serves mainly as a clearing house for the exchange of information; although no formal agreements are negotiated within it, the members are enabled to align their policies and in case of need, to form a common front against excessive requests for credit from importing countries.

The information obtained through the Berne Union and, since June 1955, through the quarterly surveys of the International Bank (15) about the evolution of medium term indebtedness, also helps the exporting countries better to appraise the commitments of prospective borrowers, and hence their possibilities of regularly amortizing further debts.

Finally, the monetary authorities, particularly in Germany, have in recent years exercised a moderating influence on export credit, and have tried to keep length of credit and interest charges at the levels informally recognized as appropriate by the main exporting countries. All these factors taken together explain why by 1956 the Chairman of a bank with extensive connections in Latin America could declare in his annual speech that, in the field of credit facilities, "competition between European countries presented much less of a problem than formerly" (16). The word "European" is worth stressing in this context: "... it seems that greater competition must now be expected from United States sup-

(15) Also, since May 1947, the Federal Reserve Bank of New York compiles a monthly survey of collections paid, collections outstanding and confirmed letters of credit outstanding concerning credit extended by the main United States banks to Latin America. Although it is limited in scope, this survey is of great help in detecting at a very early stage the symptoms of balance of payments difficulties and other economic distress in the countries covered.

(16) Bank of London and South America, *Address by the Chairman*, 1956, p. 19.

pliers, who, with the assistance of the Export-Import Bank, have in some cases been able to offer much longer payment terms than European exporters" (17). This then is the real problem, the possibility that the United States, taking advantage of its immense lending potential, may set a pace which would be unsustainable for the European countries. It has to be remembered that the rates charged, the allowable duration of the loans and the flexibility of administration for the facilities of the Export Import Bank and of the American Overseas Finance Corporation are beyond anything the European exporters could ever hope for. The responsibility for keeping order in the market for capital goods, and preventing ordinary commercial competition from degenerating into credit competition, rests primarily on the United States, as the world's leading lender and investor.

The need for coordination of the main exporting countries' credit policies is emphasized by the tendency among capital goods importers to exploit their strong position in the buyers' market by extracting credit from suppliers of capital goods. This tendency originates in the generally tight balance of payments situation of industrializing countries; at the level of the individual company, the direct motive for seeking foreign credit often lies in the greater ease with which import licenses can be obtained if deferred payment has been agreed upon (18). Companies have learned from experience that the payment terms often count, in the eyes of exchange control authorities, as much as the priority of the proposed investment.

This phenomenon has gradually been moving up from the status of unwritten rules of the technique of import control to the realm of official regulations. Brazil, Argentina and India have offered the most remarkable examples of regulations aimed at influencing payments terms; in the first two countries the measures adopted were equivalent to the use of a special exchange rate for imports with deferred payment; in the third they amounted to an

(17) *Ibid.*

(18) This explains requests for credit even in cases when a comparison of the interest rates prevailing for domestic credit with the rates charged on the credit from abroad would seem to militate against the latter method of finance. An additional reason sometimes is the desire to limit the more conspicuous forms of internal indebtedness for the sake of the balance sheet's appearance. Only thus can one explain certain apparently perverse movements of medium term capital within Europe.

outright prohibition of capital goods imports to be paid for on terms other than those prescribed by the authorities (19).

Much as one may doubt the ability of importers to impose their own credit terms in the face of a coordinated effort by the major exporting countries to keep these terms within reasonable limits, the fact remains that policies of this sort present a formidable challenge to capital goods exporters in Western Europe. By making the prospects clear in advance, the importing countries' foreign exchange budgets and rules concerning payment terms should spare exporters the disastrous unexpected involvements of the past. Yet the financial effort which is required of the Western European countries is a matter for serious consideration and careful planning. At present their export credit facilities do not appear up to the task, in view of the willingness of both Russia and the United States to engage for political reasons in long term financing at very moderate rates.

5. Export Credit as a Trade Custom

The argument developed thus far may now be briefly summarized: in the postwar years, with the decline of extraordinary sources of finance such as economic aid, bilateral credits and accumulated foreign exchange resources, the need for new credit facil-

(19) *Brazil*: Act No. 1807 of 7 January 1953 established favorable exchange conditions for imports of capital equipment into Brazil for certain basic industries, provided that such imports were paid for on specified deferred payment terms. The import licenses granted under this Act have increased rapidly in recent years, rising from \$29 million in the first half of 1955 to \$118 million in the first half of 1956, and to \$266 million in the first half of 1957. As a result of delays in the delivery of goods in certain cases, only part of the imports for which these permits were granted have actually entered the country so far.

Argentina: after earlier regulations of similar content had been discarded, Circular 2881 of May 24, 1957 decreed that machinery of over \$15,000 fob value could be imported with "free" exchange if payment terms could be obtained requiring no more than 20% initial payment and granting four years' credit for the rest (for non-dollar countries; eight years for dollar countries).

India: in January 1957 the Government issued directives intended to limit the import of capital goods to what could be obtained on terms of 20% cash payment and seven years' credit for the remainder, except for cases where it could be proved that the foreign exchange earnings (or savings) of the new plant would permit a quicker amortization. Under these regulations — in a somewhat more moderate form, however — agreements have been concluded with East Germany and with Japan (for the latter the terms for textile machinery were five years credit and 6% interest). Subsequent revisions of the regulations have introduced greater flexibility but maintained the principle.

ities to sustain the expansion of international trade in capital goods has come to be acutely felt in exporting countries. The expansion of the demand for capital goods imports has not been matched by a revival of international long term capital movements on a sufficient scale: hence the clamor for improved export credit facilities. It is this gap in international finance and not the sharpness of competition among the exporting countries that accounts for the enhanced importance of suppliers' credit. The advent of the buyers' market has of course made a difference. However this has generally consisted not so much in the exporters making credit offers in order to "push" their sales, as in their having to yield to the importers' requests for credit prompted by the latter's rising import needs. The problem of export credit is therefore truly a problem in the finance of international trade, not in the economics of monopolistic competition.

Seen in this perspective, the problem appears to have long run implications. The years since the end of the Korean boom have seen the emergence of payments habits in the capital goods trade that are by now firmly established and have achieved the status of a trade custom. The consequences are, first, that the credit problem has now become for exporters an integral part of their marketing problem, and secondly, that countries must budget for the expansion of the revolving funds for the finance of exports at a rate equal to, or more likely higher than that of the expansion in the value of trade in capital goods.

No fully satisfactory estimates exist of the aggregate volume of medium term credit now outstanding. The United Nations put medium- and short-term export credits granted by European countries at no less than \$2.5 billion for 1953 (20), while the periodical survey conducted by the International Bank and referring to medium term credit only (but including also the United States and Canada among the creditors) revealed a global figure of some \$3.3 billion for the end of 1956. This estimate is probably on the low side for the reasons mentioned above. If we add the annual increase in total credit outstanding to the amount lent from the funds received as amortization of the maturing credits, we arrive at an estimate for the volume of medium term credit granted annually

(20) United Nations, *International Flow of Capital*, *op. cit.*, p. 42, f. 6.

in the last two years of between \$1.5 and \$2 billion. These are not trifling amounts; and we must recognize that for European countries, even half this burden implies a considerable effort in terms of resources, the assumption of wide-ranging risks, and the need for careful management of the monetary and balance of payments problems of export finance. These topics will be discussed in the following chapters which include a survey of the problems just mentioned and of the solutions adopted for risk-bearing, special studies devoted to the European countries that have been most active in the field of export credit and account for the bulk of its volume and finally some considerations on the possibility of introducing improvements in the present state of affairs.

CHAPTER II

THE ECONOMICS OF MEDIUM TERM EXPORT CREDIT

1. Characteristics of Export Credit Contracts

As a trade custom, deferred payment terms in the capital goods trade have, for obvious reasons, not been able to attain the degree of standardization typical of payment terms applying to staple goods. Nonetheless medium term export credit contracts have by now acquired certain well-defined features that are worth discussing.

A typical contract might be drawn up in the following terms: 20% of invoice value to be paid at the moment the order is booked, 20% on shipment, and the remaining 60% in ten equal semi-annual instalments, the first falling due six months after shipment. This is a purely arbitrary example: in practice the prepayment and the cash payment on shipment, or on delivery, may be higher or lower, or even missing altogether, and the credit period may vary from one to eight, or even ten years, and still be considered "medium-term". Four to five year credits tend, however, to predominate. The explanation is not far to seek. Five years is the maximum length of financing which the money market can, following tradition, be asked to bear. Often, also, it is the minimum period of foreign exchange financing on the basis of which a country will feel justified in undertaking additional large investment projects (21). These again are generalizations needing careful qualification; but I believe they form a good enough foundation for an understanding of the characteristic features of medium term export credit.

Considering first the supply of funds, we must remember that medium term financing in general, although by no means an innovation — suffice it to mention the importance attained by "term loans" in the United States before the war — developed with particular vigor in postwar Europe, owing to the much greater

(21) It is hardly necessary to add that, inasmuch as maximum credit periods have been informally agreed upon by the members of the Berne Union, the restraint on credit giving may also have a legal origin, not only an economic one.

case with which finance could be obtained from the banks and the money market than from the capital market. Admittedly, the former were called upon to perform operations that were outside their usual sphere of action. Hence, although they were assisted by special arrangements (guarantees and rediscount facilities) their intervention was subject to definite limits, dictated by the customary liquidity and safety criteria and the needs of credit control. These considerations affected the development of medium term export credit techniques as vitally as — or possibly, given the additional risks, more vitally than — they affected that of domestic medium term credit. And they were reinforced by the pressing need for shortening credit terms in order to satisfy more borrowers, given the excess of demand for credit over supply during most of the postwar years. Thus the norm for export credits became four to five years. The question may be asked whether this solution bears any relation to the economic conditions underlying the credit transaction, or whether it is rather a "second best" which must be accepted temporarily, because of the unavailability of other finance. This is a question to which there is no unique answer, and I shall have to deal with it at some length.

Looked at from the standpoint of traditional finance (22), medium term operations appear, at first, as short term production credits extended over an unusually long period. This view is correct so long as we limit ourselves to the so-called "pre-financing stage" during which the goods destined for export are being manufactured. After delivery of the goods, however, the credit takes on the character of investment finance compressed into a span of time which is shorter than usual.

No generally valid criteria for judging the appropriateness of such credits can be established by looking at the nature of the contracts currently being financed; these differ greatly among themselves. For the moment, the business deals in which deferred payment seems to appear most frequently are contracts for the construction of whole industrial plants, transportation systems and rolling stock, and for ships and power stations. But quite commonly large orders for the supply of tractors, motor buses and trucks also qualify for extended payment terms. The study of British, French

(22) A good discussion of the nature of medium term credit can be found in: SIMON et PAVES, *Le Crédit à Moyen Terme*, Paris, 1957, Ch. 1.

and German experience in this field has convinced me that the decisive factor was often the size of the order, not the nature of the goods exported. Medium-term finance for small orders was either not available or not worth arranging, given the complexity and the cost of the process. Two other complementary explanations besides that of cost can be advanced: only large orders carried the guarantee, from the importing country's government, that is often necessary to secure finance; and the importers' bargaining powers were sufficient to extract deferred payment terms from the suppliers only when they were offering attractively large orders.

2. The Problem of Repayment

We have now to approach more directly the question that is of greatest interest to the lending country: the possibility of regular amortization of the credits.

Amortization out of the increased production permitted by the new investment should of course be the rule, so long as it is remembered that this financial amortization must be additional to the "technical" amortization of the investment so as to avoid the need for refinancing or the inability to replace the asset at the end of its economic life. Traditionally, a credit period as short as five years has been considered inappropriate for investment in any but the lightest types of equipment, but this judgment has to be revised in the light of a more realistic analysis. In the first place, a company may have a substantial cash flow from depreciation allowances on pre-existing investments, a flow which, added to that from the new investments, permits comfortable amortization of the credit in the short contractual period. Secondly, additions to plant — especially for technical modernization — often have an extremely high marginal productivity which allows the cost of the new equipment to be paid off within a very few years. Thirdly, semi-monopolistic market situations may make it possible to treat investment expenditure practically as current expenditure from the standpoint of pricing (23); this amounts to a form of "taxation" of the public

(23) Industries where technical obsolescence is high also have to behave in a similar way, and there is no reason why these should not finance their investments on medium rather than long term, if they will not in any case embark on new investments unless the pay-off period is within some very low pre-determined limit.

in order to finance investment, and even if it is of doubtful benefit to the economy of the borrowing country, it is to a certain extent reassuring for the creditor.

Subsequent funding of the debt (24), may be contemplated as an alternative to repayment out of current production and if funding occurs the nature of the investment is immaterial.

The above considerations relate to medium term credit transactions concluded directly with private firms in the borrowing country. If instead a government (or a government-controlled body) is a party to the transaction (as borrower, guarantor, or financial sponsor of the initiative), the corporate finances aspect must be clearly separated from (and generally subordinated to) the foreign exchange aspect of the credit operations. The perspective is then rather different. In order for the investment to be self-liquidating in foreign currency, a pay-off period in national currency within the contractual period is neither a necessary nor a sufficient condition. The export-increasing and import-saving effects of the new investment and, more generally, the probable evolution of the borrowing country's balance of payments are the factors determining the appropriateness of additional investment financed by medium term suppliers' credit. At the level of company finance there may actually be very different arrangements from those made by the external credit contract. For example, it would be perfectly orthodox for a government that expects a new plant to yield quick results in terms of foreign exchange — but not a quick turnover of the capital invested — to use suppliers' credit for a comparatively short period, to finance the company on longer term, and to take care of the difference by some non-inflationary form of domestic finance.

This is a logical procedure: for if the additional production leads to increased earnings, or savings, in foreign exchange, these will be determined by the *total* of the domestic inputs (gross production minus import content), which is of course larger than the part which could be applied to "writing off" the capital investment. In the case of international medium term credits, a comparison of the contractual repayment period with the presumable rate of turnover of the investment, according to accounting criteria, is

(24) This is a rather unlikely occurrence in the international field nowadays as credit tends to be granted only for well-defined new investment projects, except of course for the case of consolidation by mutual agreement of debts already in default.

thus of doubtful usefulness. The foreign exchange budget of the borrowing country is the instrument through which the utilization of the resources accruing from suppliers' credit and the settlement of the claims to which it gives rise are programmed. Given the availability of credit and exchange from current receipts, it is indifferent then whether power stations or light machinery are financed on five-year credit, provided the program as a whole is manageable.

The insistence by the lenders on financing only exports of productive capital goods, likely to improve the foreign exchange earnings of the borrower, can be useful insofar as it impresses upon the latter the need for an effort on his part in that direction. Unless, however, this is the only investment taking place in the country, strict lending criteria can still be circumvented by the use, for the investment projects which the lender refuses to approve, of resources otherwise available to the country. There is then no substitute for a thorough appraisal of the borrowing country's balance of payments prospects, as a means of determining the soundness of a given credit operation (25).

3. Export Credit and the Lending Country's Balance of Payments

It is not sufficient for the lending country to be assured of regular amortization and interest payments. It must also be satisfied that the granting of credit abroad will not endanger its own monetary stability and cause balance of payments difficulties. I propose to give in this section a theoretical outline of the way in which the problem presents itself in various situations.

I. *Extension of medium term credit abroad unaccompanied by an increase in exports.*

Let us assume that a weakening of the purchasing power of some of the country's foreign customers requires an extension of

(25) This problem actually merges into the broader one of the determination of investment criteria in foreign-financed development programs, which obviously cannot be brought into this study. See: J. J. POLAK, "Balance of payments problems of countries reconstructing with the help of foreign loans", *Quarterly Journal of Economics*, February 1951; H. B. CHENERY, "The application of investment criteria", *Quarterly Journal of Economics*, February 1953; R. NURSE, *Problems of Capital Formation in Underdeveloped Countries*, New York, 1953, pp. 136-139.

five year credit for exports previously sold for cash or on short credit terms (26). Credit may be granted to old customers, or the country may have to turn now to new ones who cannot pay cash: either case is equivalent to a change in payments habits. The effect, as presented in the accompanying table, consists substantially in a deterioration in the *quality* of the lending country's foreign assets: the fall in foreign exchange receipts — equivalent in the first year to the full amount of the credit granted and then gradually lessening as amortization and interest payments begin to accrue — means a decrease in the international monetary reserves and a parallel increase in less liquid claims. These claims (which in our example, with the granting of 100 per year in five-year credits and with regular amortization reach the stable level of 300 after five years) would become available in case of need to cover the country's import needs at the rate of 100 in the first year following the decision to stop granting credit, 80 in the second, 60 in the third, 40 in the fourth, and 20 in the fifth. This is still a reasonable degree of liquidity. Also, the claims accumulated at all times exceed the decrease in the foreign exchange reserves; the difference is due to the interest receipts, which will actually restore the reserves to their original level after a certain number of years.

It seems most unlikely that there could be inflationary effects in this case, unless an insufficiency of reserves at the outset compelled the authorities to restrict imports. Even then, appropriate fiscal and monetary measures could prevent inflationary pressures from developing. Such measures would, however, entail additional saving which the above-discussed change in the composition of the reserves makes unnecessary. Given sufficient reserves, therefore, medium term credit may make possible a "painless" adaptation to changed market conditions; it is definitely preferable to a shift to bilateral trading under payments agreements stipulating mutual swing credits that may easily become frozen claims, recoverable only on unfavorable terms.

(26) This was for instance the case in Latin America in 1953 when only countries ready to grant longer term credit could prevent a slump in their exports. See: United Nations, Economic Commission for Latin America, *Economic Survey of Latin America*, 1953, Ch. III.

II. *Expansion of exports by means of additional medium term credit in countries with idle productive capacity.*

Here the granting of credit abroad is intended as a means of expanding the country's sales abroad. At the same time the increase in exports will clearly have income effects of an anti-depressive nature. The existence of idle resources makes it appropriate to finance the additional exports with money creation, but this is necessary only up to the moment the desired revolving fund has been set up. From that point on, reimbursements on capital account are supposed exactly to match the new credits granted (27). Two points should be noted. The fact that exports are financed by medium term credit has nothing to do with their expansionary effects. Also, the fact that money creation can be used for such financing without creating inflationary pressures is dependent upon the existence of unused productive capacity not only in the industry receiving the order from abroad (a capital goods industry) but also in the consumer goods industries, which are confronted with an increased demand due to the multiplier mechanism.

Under the conditions postulated, the effects of the expansion of exports will follow the pattern outlined in the table. I have assumed that on an export order of 110, 10 would be paid in cash and the remaining 100 would be financed by a five year credit, repayable in equal annual instalments. The export flow is supposed to remain constant at the new higher level, thanks to the finance provided by the revolving fund constituted in the first five years.

The items in the table are self-explanatory, except perhaps for the column labelled "Disbursements". This represents the impact on imports of the additional exports. It is composed of two parts: the import content of exports (imported materials and semi-finished goods) and the imports induced through the multiplier mechanism. I have assumed the impact on imports to take full effect during the year in which the additional goods are exported. This is only a simplifying assumption, and reality may be a good deal more

(27) Net additions to the money supply will of course still take place to the extent that the increased foreign exchange receipts accruing to the country are not matched by equivalent disbursements. Such money creation does not stem from the medium term credit, but from the surplus itself.

CASE I

EXTENSION OF MEDIUM TERM CREDIT ABROAD UNACCOMPANIED
BY AN INCREASE IN EXPORTS (a)

Year	Exports	Addition to credit outstanding	Revolving Fund	Disbursements (b)	Cash receipts (c)	Amortization	Interest (d)	Net change in res. (5+6+7-4)	Cumulative change
	1	2	3	4	5	6	7	8	9
1	—	100	100	—	-100	—	—	-100	-100
2	—	80	180	—	-100	20	5	-75	-175
3	—	60	240	—	-100	40	9	-51	-226
4	—	40	280	—	-100	60	12	-28	-254
5	—	20	300	—	-100	80	14	-6	-260
6	—	—	300	—	-100	100	15	+15	-245

CASE II

EXPANSION OF EXPORTS BY MEANS OF ADDITIONAL MEDIUM TERM CREDIT
IN COUNTRIES WITH IDLE PRODUCTIVE CAPACITY

1	110	100	100	55	10	—	—	-45	-45
2	110	80	180	55	10	20	5	-20	-65
3	110	60	240	55	10	40	9	+4	-61
4	110	40	280	55	10	60	12	+27	-34
5	110	20	300	55	10	80	14	+49	+15
6	110	—	300	55	10	100	15	+70	+85

CASE III

EXPANSION OF EXPORTS BY MEANS OF MEDIUM TERM CREDIT, STARTING
FROM A SITUATION OF FULL EMPLOYMENT

1	110	100	100	5	10	—	—	5	5
2	110	80	180	15	10	20	5	20	25
3	110	60	240	25	10	40	9	34	59
4	110	40	280	35	10	60	12	47	106
5	110	20	300	45	10	80	14	59	165
6	110	—	300	55	10	100	15	70	235

(a) All figures represent absolute changes from the base year. All are annual flows, except columns 3 and 9, which are the cumulated series corresponding to columns 2 and 8 respectively. All flows stabilize at the level reached in the 6th year.

(b) Import impact of additional exports resulting from the import content of exports and the imports induced through the multiplier mechanism.

(c) Changes in cash payments for goods, exclusive therefore of interest and amortization payments.

(d) Calculated at 5% on the credit outstanding, i.e. the revolving fund, in the previous year.

complex. A lag of imports of materials behind the increase in production will occur if stocks are drawn on; the reverse will be true if stocks are increased so as to preserve the customary ratio to production, or if there is a spurt of speculative imports. As to the appropriate concept of import content of exports, there is no doubt that we must here use a marginal ratio, which may be perceptibly higher than the average if imports are needed to increase production which, at a lower level, could be carried out with domestic materials (28).

The results of the analysis also require comment. We see that initially foreign exchange reserves decrease; only later do they recover; and this is a fact which has often been considered the stumbling block by countries desiring to combat a depression by increasing export sales on credit terms. If the country's reserves are near exhaustion, this problem is no doubt a real one; in other cases, however, we must remember that only the quality, not the quantity, of the foreign assets changes. The obstacle would also be less serious were the cash payment higher (10% must be considered unusually low) and were the import content of exports, and the marginal propensity to import, lower. Inflationary pressure, on the other hand, is unlikely to develop so long as there are unused resources (unless, of course, there are bottlenecks in production). The following example deals more fully with this particular problem.

III. Expansion of exports by means of medium term credit, starting from a situation of full employment.

The problem centers on the avoidance of inflationary pressure as exports expand. Starting from full employment, this aim can be achieved by combining two series of measures, i.e. by restricting domestic investment (or consumption) and, when in due course a foreign exchange surplus tends to appear, diverting demand so as

(28) See on these points: W. Z. BILLEWICZ, "The import content of British exports", *Economica*, May 1953, pp. 162-70 and W. HASSELBLATT, "Industrie-produktion und Rohstoff-einfuhr", *Weltwirtschaftliches Archiv*, v. 73, 1954, pp. 244-269. In the example I have assumed a total import impact of 50% of the additional exports, which would be obtained with a marginal import content of exports of 10%, a marginal propensity to import of 20% and a marginal propensity to save of 25%. The import content is lower than the marginal propensity to import because of the generally higher value added/gross output ratio in the

to take full advantage of the increased availability of purchasing power that can be used for additional imports.

We suppose therefore that the granting of additional credit abroad is matched by an equivalent restriction of domestic credit, or by appropriate fiscal policy measures; the investment in the revolving fund is thus financed by real savings. As mentioned above, it does not matter if medium term credit replaces short term credit, for instance; what matters is the size of the revolving fund that is transferred from the domestic to the foreign sector. For simplicity's sake I have assumed the import impact of the additional exports to be identical, percentagewise, with that of the domestic demand that is being suppressed, so that no monetary or balance of payments effects are to be expected from this side.

At the very start, however, and increasingly in successive years, a part of the additional exports adds to domestic purchasing power without any offset from a corresponding credit restriction or fiscal policy measure. The size of this potential inflationary gap is given by the theoretical accumulation of foreign exchange (29), which could actually be retained by the economy only if forced saving occurred as a result of a rise in prices. But the avoidance of inflationary pressures is possible if part of domestic demand is diverted to the foreign sector so as to match the increased receipts from abroad. There would then be no need for forced saving as a means of absorbing the additional foreign exchange reserves: the addition to purchasing power implied by the increased exports would be dissipated through the import "leakage".

This point serves to explain also what might be the justification of a policy aimed at increasing exports, in a situation of full employment, and at the cost of granting credit abroad. If it were foreseen that the future growth of production would raise the country's import needs, an expansion of exports would also appear

capital goods industries than in the consumer goods industries: this varies, however, from country to country, and the example is, in this, perfectly arbitrary. Calling X the increase in exports, F the marginal import content of exports, M the marginal propensity to import, and S the marginal propensity to save, we obtain the following formula for the import impact:

$$(X - FX) \frac{M}{M+S} + FX = X \frac{M(1-F)}{M+S} + FX = X \left(\frac{M(1-F)}{M+S} + F \right)$$

The use of such a simple multiplier is justified by the nature of the example.

(29) This is of course net of the effects of the import impact of the additional exports not matched by a restriction of domestic demand.

necessary in the long run. If such an expansion were obtained in the way indicated earlier, the country could increase its capacity to import, while the rising demand for imports would avert the danger of inflationary pressure coming from a foreign surplus.

The case of a continuous rise in exports at a constant annual rhythm, would differ from cases II and III only to the extent that export credit outstanding would also increase continuously, instead of stabilizing at a given level. However the additions to the revolving fund would increase only at the beginning and would stabilize subsequently. The effects on the balance of payments and the foreign exchange reserves would not differ from the previous cases but would have a different distribution through time.

In principle therefore there is nothing in medium term export credit itself that makes it dangerous from the viewpoint of monetary and balance of payments stability, provided it is properly managed. It is true, however, that the necessary selective credit controls may be difficult to apply, as will be shown in the case of France (see Chapter V). It is also true that easy availability of export credit may divert sales from hard currency markets to other markets where selling is easier — and perhaps more remunerative — so long as it is accompanied by deferred payment terms (30). But the danger of misuse calls only for the improvement of the system, not for its abandonment.

In the rest of this chapter I shall examine the problems connected with the organization of medium term export credit, beginning with its appraisal from the viewpoint of the exporters.

4. Prefinancing of Export Contracts: the Exporters' Position

In export contracts with deferred payment terms, special financing is needed to cover the interval between the beginning of the production cycle and the final payment by the foreign purchaser. The first stage of this interval ends with the delivery of the goods and the transition from "prefinancing" to the "credit period"

(30) The article by G. SÖDERLUND, "Export credits as means of competition", *Skandinaviska Banken Quart. Review*, July 1954, pp. 62-65 is typical of the supporters of this viewpoint. A similar concern was also at the heart of the early British hesitations about export credits: in that particular case they were justified by the inelastic supply conditions of many British industries at that time.

proper. Superficially this first stage appears to involve nothing more than normal working capital finance, which is ordinarily obtainable through the customary forms of short term accommodation. The length of the production cycle in the manufacture of heavy goods and the reluctance of foreign customers to make more than a token payment before delivery, would, however, often compel the exporter to strain his financial position were he to attempt to cover his credit needs in the customary ways. Moreover the cost of credit must in certain cases be kept below the very high rates asked for ordinary overdrafts if the exporter's competitiveness is not to be impaired.

As we shall see in the following chapters, special facilities have been arranged in France and Germany to meet this problem, and enterprises producing primarily for export were entitled to preferential treatment whenever selective credit controls were applied in Great Britain. Insurance coverage against events preventing the regular fulfilment of the export contract has also been generally available: the additional security it provides naturally enables the manufacturer to secure finance on more favorable terms.

On the whole, business opinion does not seem to have been overconcerned with this problem: the reason may be twofold, that credit, though often expensive, has been amply available for this particular purpose, and that the finance of work in progress cannot reasonably be refused as being outside the suppliers' responsibilities.

5. The Credit Period and the Exporting Firm's Finances

Wholly different has been, and continues to be, the exporting manufacturer's attitude towards the provision of finance for the credit period *after* delivery. It is argued that once the contractual obligations have been fulfilled with the delivery of goods acceptable to the purchaser, credit granted to the latter becomes a pure finance credit which industry should not be asked to provide. The fact that the credit transaction begins with the normal features of working capital finance (purchase of raw materials, payment of wages, etc.) should not obscure the fact that by far the longest phase of it actually finances investment in the foreign country.

The consequences for industrial firms of running into debt (or using up their liquid reserves) in order to finance such credit trans-

actions can be serious, and must be fully realized before a judgment is passed on the methods of export finance which lead to this result (31):

- a) the balance sheet of the firm is artificially inflated and presents a worsened debt/equity ratio;
- b) the lower liquidity of the firm raises the cost to it of credit and of equity capital;
- c) the borrowing powers of the firm — whether specified in its articles of association or determined by banking criteria — become unavailable for other purposes and the firm's ability to adapt its policies to changing circumstances is thus reduced;
- d) the financial structure of the firm is weakened by the risk of sudden sizable liquidity drains in case the foreign borrower defaults and the financing institution exercises its right of recourse to the exporter; this is so even though the firm will eventually be able to collect from the insuring institution;
- e) potential losses, and not merely liquidity problems, threaten the firm on account of the incomplete coverage (both as to amount and as to risks) offered by the insurance schemes.

Another disadvantage is that, whenever the exporter appears as the primary obligor in the credit transaction, the financing institution will scrutinize the application looking more closely at the creditworthiness of the exporting firm than at the soundness of the project and the importer's ability to pay. In consequence, the actual selection of the export contracts to be financed is practically left to the manufacturer, who is certainly less well equipped for the job than is the banking institution.

Last but not least, fast-growing firms whose financial resources are heavily committed to expansion plans, find it inconvenient to have to seek credit for export just at the time when they need it most to support their increased turnover.

It is true that if the manufacturer were allowed to withdraw from the transaction altogether after the delivery of the goods, he

(31) Business opinion on this point is well represented by a Memorandum of the Bundesverband der Deutschen Industrie, "Möglichkeiten der langfristigen Exportfinanzierung", Köln, 2-15-1956, and by an article by J. P. Ford, "The case for an export finance corporation", *The Director*, London, July 1953, pp. 499-500.

might be inclined to relax his criteria of creditworthiness and to sponsor dubious contracts. It has always been the rule, however, that the exporter should retain a stake in the success of the credit transaction by financing a part of it (generally 15-20%) at his own risk, a requirement which should be sufficient to ward off any such danger.

On balance, therefore, indirect finance through the exporter to the foreign customer has weighty disadvantages; and an analysis of the problem from the viewpoint of financing techniques shows that other solutions are possible and preferable.

6. Alternative Forms of Medium Term Export Finance

The drawbacks I have been discussing appear when the manufacturer finances the credit transaction out of his own resources, or extends credit to the foreign customer and then refinances himself by borrowing from a domestic institution on the security of his own name, of the documents evidencing his credit on the buyer, of the credit insurance policy, and possibly of additional collateral which he may be required to provide.

An intermediate solution is that where the credit institution purchases or discounts the promissory notes issued by the foreign customer (or the bills drawn on and accepted by him) with the endorsement of the exporter. The right of recourse is maintained here, as in the former case, but the balance sheet of the exporter will carry only a footnote mentioning the contingent liability thus contracted, so that the financial structure of the firm will be less seriously affected.

Finally, funds can be advanced directly to the foreign buyer, or his promissory notes can be bought from the exporter, by the financing institution without right of recourse to the exporter in case of non-payment. This solution is possible only when the buyer's creditworthiness is absolutely beyond doubt or when the credit is backed by a direct guarantee from the export credit insurance institution.

The direct guarantee has a clear superiority over the indirect security provided by endorsement of the insurance policy in favor of the supplier of finance. This point will be discussed in detail in the chapter on Great Britain, where the system has been widely

used; and a few words of comment will suffice at this juncture. The coverage afforded to the bank by a direct guarantee is far more complete than is that given by ordinary credit insurance, and for all practical purposes the guarantee is unconditional. Paper covered by it thus comes close to government securities from the point of view of safety, and the creditworthiness of the first obligor loses greatly in importance.

In cases where this or equivalent features have been introduced in export financing, the manufacturer has greatly benefitted. For the financing institution, however, there has remained the problem of securing suitable and sufficient resources for employing in the medium term credit field.

7. Sources of Funds for Medium Term Export Finance

The raising of funds on the capital market has, on the whole, played only a minor role in export finance in European countries. It would have been possible for a specialized institution to obtain funds by issuing long term bonds that might have interested insurance companies and social security systems. But, even apart from the limited size of the market and the lack of a marked advantage in cost over money market and bank facilities, the problem of ensuring full utilization of the funds still presented a serious obstacle. Fluctuations in the demand for export credit may be such as to endanger the regular servicing of the debts contracted by the institution, unless the latter keep lending rates well above borrowing rates. Thus, although some use has been made of long term capital — raised on the capital market in Belgium and in the Netherlands and set aside from ERP counterpart funds in Germany and in Italy — medium term export finance has remained predominantly the concern of banking institutions.

This does not mean that the ordinary banking mechanism has been found ready to extend its ordinary field of activity to medium term export credits without further adaptations: it must be realized that these were quite unorthodox operations, confronting the banks with peculiar liquidity and risk problems. In countries with a relatively plentiful supply of floating capital seeking investment, such as Great Britain, the problem was to allay the fears of the established banking institutions; it was solved by providing insur-

ance and guarantees which considerably strengthened the status of medium term export paper. An effort was made also to protect both prefinancing and financing credits from the impact of credit restrictions: an element of qualitative control helped to avoid a deterioration of availability and cost of credit for exports. The banks' own resources were not supplemented by special facilities, and the funds devoted to export credits, therefore, were limited to what the banks considered a safe proportion of their assets, given the structure of their liabilities.

In countries where credit facilities were strained by industry's investment effort and where the money market was narrow, the primary need was instead for means of tapping additional sources of funds. Such means were found by setting up specialized institutions which would enable the banks to "mobilize" their medium term paper. Rediscount facilities were provided in a variety of ways, all aimed at making use of money market funds whenever possible, but allowing recourse to the central bank as a last resort. The actual sources of finance were therefore a combination of bank credit, monetary savings and money creation, on the basis of methods widely applied in the finance of internal investment and partly justified by sound monetary considerations, partly by sheer expediency.

The rationale of specialized institutions to take care of the need for medium term export credit consists not only in the problems connected with raising the funds, but also in the desire to make good use of the scarce trained personnel available for processing the often very intricate credit contracts.

The broad sketch just given is intended as an introduction to some of the problems that will be discussed in the case studies of Great Britain, France and Germany. The emphasis has been on structural problems; but such an approach might prove sterile were it not accompanied by an analysis of how the institutional framework actually stood up to the stresses and strains of changing economic conditions and general policy directives and of how it was itself affected by these. An obvious example is the situation created in Germany by the succession of surpluses in the finances of governmental bodies, surpluses that helped the banks by contributing a stable and substantial mass of "Geldkapital" that could be used to finance medium term credit for investment and export. Conversely,

the disequilibrium of government finances in France accounts for the near failure of a mechanism designed to finance export credit by money creation only in exceptional circumstances.

The case studies, however, will be concerned with the financial aspects only. The vitally important problem of risk-bearing, the solutions of which are much less dissimilar among the three countries, will be dealt with as a whole in the next chapter.

CHAPTER III

THE PROBLEM OF RISK BEARING IN EXPORT FINANCE

1. The Place of Credit Insurance in Export Finance

The difficulties created by the risks peculiar to export credit have been tackled in most countries — the United States being the chief exception — separately from those concerning the supply of finance proper. The latter activity has been entrusted to the traditional lenders with the help of newly devised arrangements, while export credit insurance has, from the organizational viewpoint, developed autonomously (32). This institutional separation can be misleading: credit insurance is in fact an integral part of the mechanism of medium term export finance because of its importance in determining both the availability and the cost of credit. Indeed it is at the insurance stage that the decision whether to grant or refuse credit for a given export transaction is often taken. Once insurance cover has been obtained, financing presents much less of a problem than it would otherwise. The charges for insurance premiums in medium term business are, moreover, generally not negligible as a cost item.

The role of export credit insurance is still often misunderstood, even if its history goes back as far as the early 'twenties (33). One reason for this is the varying emphasis in the use of this instrument. It was originally used to overcome the special difficulties encountered in trading with the Soviet Union, then turned into a tool for foreign trade policies to combat depression, and only recently integrated into the general mechanism of export finance.

(32) In order not to burden the argument with too much institutional material, the description of the structure and operations of the insurance systems that concern us directly, the Export Credits Guarantee Department (ECGD) in Great Britain, the Compagnie Française d'Assurance pour le Commerce Extérieur (COFACE) in France, and the Hermes A.G. in Germany, has been presented in a separate appendix (Appendix I).

(33) For the early history see: E. M. SHENEMAN, *Insurance against credit risks in international trade*, London, 1935, pp. 11-63. Important source material for Britain can be found in the various parliamentary reports that touch upon this topic: Hill Report Cmd. 2619, 1927; Balfour Report, Cmd 3282, 1929; Niemeyer Report, Cmd. 3450, 1929; Macmillan Report, Cmd. 3897, 1931.

It may be useful therefore to recall some of the principal developments which have made the risk problem in international finance so important. With the introduction of new commercial and exchange policy instruments, the relative predictability of the equilibrating mechanisms of the gold standard era has been replaced by uncertain patterns of behavior. But the financial collapses of the '30s and several incidents of the postwar years have left no doubt as to the probable lot of foreign creditors in the event of payments difficulties. As a result, the traditional categories of investors in foreign securities have become painfully aware of their implicit function as risk-bearers, and have generally rejected it by withdrawing from the market. The finance of international transactions was thus left to the traders and to the banking system, just at a time when credit terms were lengthening with the change in the commodity structure of trade. And, in the case of medium term credit, the difficulty of resorting to the forms of security characteristic of documentary credits was an added reason for calling specialized risk-bearers into existence.

In general terms, the purpose of credit insurance today is to allow exporters to expand their business turnover without jeopardizing their financial position by assuming excessive risks. An insurance coverage of 80% will, for instance, make possible a quintuplication of export sales on deferred payment terms, without any increase in the absolute risk the trader has to bear. At the same time, the assumption by the state (or by a state-supported institution) of the risks implicit in the export transaction increases the ability and willingness of outside lenders to participate in the supply of finance. The signatures of the parties to the export sale are strengthened by the intervention of the insurer, and the financing institutions' portfolios of export paper can therefore be expanded. From this it is clear that credit insurance performs a task not unlike the traditional work of "acceptance houses" in London, by adding an even better signature to those of the buyer and of the seller (34).

At this point we need to be more precise about the nature of the risks that come within the scope of the insurance of export

(34) This was actually the object of some concern in the Macmillan Report, where the fear was expressed that the acceptance houses' functions might be usurped by the state insurance institution. Such fears have been dispelled by experience. See: Committee on Finance and Industry, *Report*, Cmd. 3897, 1931.

earnings. Not all such risks can be defined as credit risks; in practice, too, cover against them is not always possible and is not uniform in all the countries.

2. Nature of the Risks

Export risks can be classified according to three criteria: the sphere in which the risk arises, the quality of the buyer, and the period covered. I shall use a combination of these criteria.

a) *Commercial risks:*

1) Before acceptance of the goods:

a. Refusal of a private buyer to accept delivery and/or to pay under cash-against-document (CAD) payment terms, without responsibility for non-performance on the part of the seller.

2) After acceptance of the goods:

- a. Insolvency of a private buyer.
- b. Protracted default on payments due by a private buyer.

b) *Political and transfer risks:*

1) Before acceptance of the goods:

- a. In contracts with private buyers.
 - i. Imposition of fresh import restrictions, or of regulations entailing additional costs, or cancellation of a valid license.
 - ii. Imposition of general embargoes or specific export prohibitions.

b. In contracts with foreign governments or public law corporations:

- i. Imposition of embargoes or specific export prohibitions.
- ii. Arbitrary cancellation of the contract by the buyer.

2) After acceptance of the goods:

- a. In contracts with private buyers:
 - i. Inability to transfer the export proceeds, due to government action.

- ii. Forced conversion of the export proceeds into a currency other than the stipulated one, or at an arbitrary exchange rate, resulting in exchange losses.

b. In contracts with foreign governments or public law corporations:

- i. Default on payments due under a valid contract.
- ii. Blocking of the export proceeds or forced conversion, as above.

c) *Catastrophe risks:* war, strikes, flood, earthquake, revolution, civil war. etc.

d) *Economic risks:* cost increases (in wages, materials) under contracts in which price adjustments are not possible; exchange losses that cannot be covered by forward sales because of the remoteness of the settlement date.

It may seem strange that insurance against the risks listed as "economic" and "commercial" should be found necessary at all: for most short term credit they clearly come within the scope of risk-bearing in the ordinary course of business, except in the case of particularly unstable economies for which previous experience is of no help. Extended payment terms, however, change the picture completely for both these types of risks.

The failure of the exchange rate to respond to changes in the internal purchasing power of the currency may subject the exporter to serious losses in the case of sharp increases in costs, when the contract stipulates a firm price in a stable currency (e.g. U.S. dollars) and the transaction is not completed within a short period (35). It is no mere accident that the French Government should have found it necessary to introduce cover against this kind of risk (*garantie de prix*). The exchange risk is, in a sense, the converse problem: the importer may not wish to assume a foreign exchange obligation, fearing that his own currency may be devalued and repayment thus become more burdensome. For the exporter, in such cases, a credit in a currency less stable than his own

(35) The rule for long term contracts is of course to insert an escalator clause linking the price of the goods to the cost of materials or to wages, but sometimes a firm price must be quoted.

involves the danger of a loss at the time of settlement: forward sales and "swapping" do not offer a practical solution for credits extending over several years, and they are quite costly. The insurance institution, by guaranteeing a fixed conversion rate for the proceeds (as is done in France with the "garantie de change") takes an open position in the foreign currency, a position which is compensated by the premiums and by possible gains from an upward revaluation of the national currency.

Let us now turn to the credit risks proper: in the case of private buyers, the problem is one of precisely defining the event against which insurance may reasonably be granted. Default before acceptance is a marginal case, only recently introduced in the British system on an experimental basis and strictly circumscribed so as to avoid insuring the exporter against the consequences of his own acts (36). The real problem is whether protracted default should be deemed sufficient for an insurance claim, or whether the ascertainment of insolvency should be required. The latter solution implies that the exporter must institute legal proceedings to obtain a declaration of insolvency, unless the debtor is already known for other reasons (bankruptcy action by other creditors, etc.) to be unable to meet his obligations. This is unsatisfactory for the insured exporter because it may involve him in expense and in legal problems with which he is ill-equipped to cope, and moreover may cause him harm simply by retarding an inflow of cash that is important for his financial equilibrium. A credit insured on such terms does not therefore gain in liquidity as much as it should. The Compagnie Française d'Assurance pour le Commerce Extérieur thus seems justified in offering to pay claims simply on the basis of protracted default; it implicitly takes upon itself the task of collecting these "slow" credits, a task which it is better organized to perform than is the individual exporting firm. Similarly, the Export Credits Guarantee Department in Britain is evidently satisfied that the six months' delay (formerly twelve months) which must elapse before any overdue payment can become an insurance claim, is a sufficient inconvenience to prevent the exporter from knowingly taking on dubious credit risks; here, however the task of collection

(36) The exporter must bear alone any losses not exceeding 20% of the contract value. The Export Credits Guarantee Department will bear 85% of the residual losses, provided these do not exceed 40% of the contract value.

remains up to the exporter, although the Department can give him valuable assistance. The stricter rule might be a serious shortcoming were it not that much of the medium term business is transacted with governments or public corporate entities; all risks on these purchasers are considered "political risks" and simple default or refusal to pay is sufficient to give rise to a claim.

An actuarial basis for the insurance of *commercial risks* in export business is conceivable. It is currently applied by private credit insurance companies (37), and relies on a combination of past experience and current credit ratings of the individual firms (38). Nothing of the sort is possible for insurance against political and transfer losses. The events giving rise to them — such as crop failures, unrealistic exchange policies or unchecked inflation — are characterized by very high uncertainty (in the Knightian sense) and abruptness. Risks of this sort are typically "linked risks" that threaten whole countries or export sectors, rather than individual transactions. A prolonged weakness in the prices of major primary commodities would no doubt bring out this characteristic convincingly. A satisfactory spread of the risks is not possible, except perhaps by means which are more within the realm of taxation than in that of insurance, as I shall try to show further on. As Shenkman points out, such risks "cannot be estimated with the help of the law of averages... Their economic effects are crushing for the individual exporter and not commensurable with the financial resources of the insurance market" (39).

Two points are worth elaborating, if we want to understand why export credit insurance has become such an important element in the finance of international trade. The first point is that the consequences for the exporter of failure to receive payment at the due date can be out of all proportion to the magnitude of the event, particularly when we consider that it is often a case of illiquidity rather than of loss. But illiquidity can spoil the credit rating of the firm, and may force upon it distress borrowing at unfavorable rates. It may also interfere with the firm's investment programs and the regular turnover of its inventories. Even if the

(37) The leading example is the Trade Indemnity Co. Ltd., in the UK.

(38) On the technique of credit insurance in general, see: H. KARRER, *Credit Insurance*, London, 1957.

(39) SHENKMAN, *op. cit.*, p. 49.

credit is recovered at a later date, the financial embarrassment suffered may already have wrought heavy damage. Large export concerns, with a diversified range of business and customers, are not very differently placed, since the special nature of the risks minimizes the benefits obtainable from spreading them. Should self-insurance be technically possible, it would certainly be uneconomic, for it would require a very costly accumulation of liquidity reserves.

3. The Rationale of State Insurance

The second question that should be considered is whether insurance against political and transfer risks is within the possibilities of private insurance systems. The answer must be substantially in the negative, for the reason that export credit insurance institutions have to be able to face without difficulty very sizable drains on their liquidity. Export credit insurers may have to meet claims greatly in excess of the ultimate losses realized after the gradual liquidation of frozen credits has been permitted. This phenomenon has been characteristic of the postwar years: instead of the bankruptcies, rejections of orders, and cancellations of shipments that reflected distress in individual customers' situations during the raw material crises of prewar days, "the exporting community has been beset by difficulties arising out of exchange shortages, which have caused payment delays even though individual customers were able to make prompt payment in local currency" (40).

Of course the credit insurance systems of the postwar period have not yet been put to the severe test of a world economic crisis, so that we cannot rule out the possibility of serious losses occurring in the future. But the distinctive feature today is that much of the medium term debt outstanding is owed by governments or government-sponsored bodies and that these, having experienced in the past the consequences of spoiling their credit rating, may be expected to make earnest efforts to give first priority to their foreign obligations, even though the possibility of default may never be ruled out.

(40) "Latin American export credit information", *Federal Reserve Bank of New York, Monthly Review*, February 1949.

In the case of two export credit insurance institutions, we have data confirming the purely temporary nature of the major part of their "losses". The accounts of the Export Credits Guarantee Department in Great Britain (see Appendix III for greater detail) present for the years between 1930 and 1952 (March 31) gross payments on claims amounting to approximately 9.6 million pounds, and recoveries of 6 millions (63%); only 1.5 millions (16% of the total) had been written off as irrecoverable, and 2.1 millions were still in process of collection. In 1952-53, as a consequence of the Brazilian payments crisis, the Department had to ask for a supplementary appropriation of 14.8 million pounds to help cover payments to exporters and with this the Department was not yet in the red, because its notional reserve barely managed to cover the sum. The year 1953-54 was not much better, as claims of 11.4 million pounds had to be paid. Starting in the same year, however, recoveries shot up to quite substantial figures: 4.8 millions in 1953-54, 5.4 in 1954-55, 4.5 in 1955-56 and 5.3 in 1956-57. The annual estimates of the probable percentage recoveries on claims paid in recent years have never fallen below 75% and have gone as high as 94%.

The *Compagnie Française d'Assurance pour le Commerce Extérieur* also shows a high proportion of recoveries to payments for claims on account of medium term credit insurance contracts against political and transfer risks. Between 1929 and the end of 1956 payments amounted to Frs. 7.663 billion, of which only 821 billion (11%) had had to be written off as irrecoverable; 3.888 billion (51%) had actually been recovered, while 2.953 billion (38%) remained in course of collection. In the German case we do not have data on recoveries, but we know that losses considered final amounted to only 4% of total claim payments.

Since the problem of export insurance is mainly one of liquidity to bridge delays in the collection of credits, there would seem to be many advantages in having a state-sponsored scheme. If recourse to the practically unlimited borrowing and lending capacity of the state is allowed for, the level of premiums needed to break even over a reasonable period can be kept much below the figure that would otherwise be required to build up and maintain reserves.

It should, however, be added that even state insurance schemes may incur losses in the case that substantial export credits become illiquid. Such losses may arise from the low rates of interest usually

paid by debtors on their frozen balances or from a fall in the value of the currency in which the exporters' credits were expressed. When we consider that consolidation agreements following default on commercial debts often stipulate gradual repayment over several years, it is obvious that the losses just mentioned may severely strain the finances of the credit insurance institution. It is important therefore that provision be made, in the form of a charge against premium income, for covering the cost to the government of borrowing to meet insurance claims in excess of accumulated reserves, and to amortize exchange losses. No justification would then remain for the claim that state insurance, because it can count on the financial support of the state is « ipso facto » subsidized (41). There is a further very practical argument for a state insurance scheme: namely that private companies would simply not agree to insure, on their own, political and transfer risks (which are by far the most important ones). This does not necessarily mean that the state is ready to insure risks which, from a business point of view, it would be unreasonable to insure; it is the fact that the state is not in danger of becoming illiquid that introduces a real difference in the cost of risk bearing for public and for private insurance schemes respectively.

It may be said that the state, operating here as a temporary « lender of last resort », performs a function similar to one known and accepted in central banking for decades. In the case of export credits, this function has in fact often been performed by the central banks themselves, in taking over from exporters illiquid claims accumulated under payments agreements: A recent example is that of the 1957 debt settlement between Argentina and Germany, in which the Bundesbank agreed to advance to exporters 25% of the sums due to them over a period of years under the agreed amortization schedule (42). It is more appropriate that such operations, when necessary, should be performed by export credit insurance institutions without involving central banks, which have always shown a strong reluctance to become committed in this way.

(41) Another claim seems to me even more weakly founded: namely that the export credit insurance institutions are granted a form of subsidy also in that they are given access for obtaining credit information to the consular and trade services which the state maintains abroad for its own purposes.

(42) *Frankfurter Allgemeine Zeitung*, August 5, 1957.

Summing up, we may say that an essential feature of export credit insurance systems to-day must be the ability to fall back, in case of need, upon much larger resources than could be provided even by a pool of private companies or by private reinsurance arrangements. Nevertheless an effort to make use of the experience and connections of private insurance would seem desirable: as, for example, by offering state re-insurance facilities instead of setting up wholly state-operated institutions. It is hard to say just how far private companies would be prepared to go in undertaking the insurance of export credit risks, but there is little doubt that the greater part of the risks would have to be borne eventually by the state. It is quite possible, however, that by a patient work of trial and error in setting premiums and apportioning risks, present arrangements, in which private insurance companies have so far played only a very minor role, could be significantly improved upon.

In practice, export credit insurance systems have followed one or the other of the following patterns:

- a) Insurance of all risks directly by the state through a government department or agency (Great Britain, Sweden);
- b) Insurance by the state of political and transfer risks, with commercial risks being left to a private company with state participation. The company will usually act as agent for the state in regard to insurance against the first group of risks (France, the Netherlands);
- c) Insurance of all risks on behalf, and for account of the state by a private company acting as commission agent for these transactions, but also carrying on other business (Germany, Austria);
- d) Re-insurance by the state (or by a government-controlled company) of part of the risks underwritten by private companies (Belgium and Norway, sometimes).

4. The Concentration of Risks and the Volume of Insurance

The specialization of the function of risk bearing has resulted in a substantial reduction in the cost of financing exports with extended payment terms. For instance, the rates charged by the European credit insurance institutions have been considerably lower than the risk premiums implicit in the interest rates charged by

commercial suppliers of credit to finance United States exports to many Latin American countries. It has often been claimed that the reduction has been made possible by a virtual subsidy system. It will be impossible to refute altogether this charge until we have the record of premium income and losses of the institutions over a longer period (the prewar years cannot be included, since credit insurance operations at that time followed different principles). What evidence we have seems however to indicate that so far, equilibrium between premium income and losses has generally been maintained, as will be shown more clearly in Appendix III. This conclusion is confirmed by the results of the Berne Union's conferences at which members submit trading accounts for mutual scrutiny: almost without exception it has been shown to everybody's satisfaction "that members' operations were free from subsidy" (43).

Financial equilibrium would have been difficult to achieve for the export credit insurance institutions had they not been able to obtain a sizable volume of business at moderate rates. A policy of low rates was necessary to counteract the tendency of traders to insure only that portion of their export credit business that goes to markets they consider relatively unstable. On the other hand, low rates could be applied without degenerating into a form of subsidy, only if a vigorous effort was made to extend the scope of insurance and to improve the quality of the risks. This could be done by calling the attention of exporters to the hazards of particular markets or operations and, more directly, by the use of selective controls. An effort in this direction was in fact made by the insurance institutions in the three countries with which this study is mainly concerned — Great Britain, France and Germany. I have thought it necessary to deal at some length with the methods adopted to expand turnover and to effect a selection among the insured risks.

Compulsory insurance of all export credits would of course be a straightforward but rather unpopular way of securing a good risk spread. The Export Credits Guarantee Department in the United Kingdom, without going to this extreme, requires all exporters wishing to insure short term and "extended term" credits (i.e. credits with terms of up to the six months and three years respect-

(43) See: *The Economist*, May 21, 1955, p. 689.

ively) to insure their whole short term turnover with all countries, or at least with an agreed group of markets. The premiums quoted for "whole turnover insurance" are of course more favorable. Medium term credits are not subject to the same requirement, although the Department looks with greater favor upon exporters who regularly insure their transactions, and it can occasionally render valuable services to them, such as giving them preference in the allocation of insurance on certain markets for which credit ceilings have been imposed. Separate cover for political and transfer risk is not provided, and commercial risks are always included in the insurance. Exporters whose business is largely with stable markets or who deal with firms whose solvency is not in doubt, and would like therefore to obtain cover against transfer risks only, have objected strongly to this requirement; they feel they could save on insurance charges by limiting cover in accordance with their own judgment. The Government on the other hand has defended its position by pointing out that for credit insurance "the appropriate principle is... a combination of the wide spread of risks with a high turnover" (44) and that this policy would benefit the trading community as a whole. In fact, one cannot help feeling that what this amounts to is a form of redistribution, by means of a tax device, of the burden of maintaining trade relations with the riskier markets. It should be added, however, that very often the exporters who feel they are being taxed when they export to stable markets, forget that it is this "tax" which makes possible the low insurance rates they are charged when they export to less stable markets. Moreover this type of tax can easily be shifted forward, so that its incidence is more likely to be on importers in good markets like Belgium or Switzerland, than on the exporter himself.

Hermes, in Germany, has not imposed "whole turnover insurance" even for short term business. Instead it has adopted an incentive system under which global policies are provided at cheaper rates. The choice of the risks and markets to be insured, however,

(44) Hansard, April 8, 1957. This controversy has found an echo in many studies on export credit insurance (e.g. *Fourth Report from the Select Committee on Estimates*, House of Commons paper n. 149, Session 1952-53; A. ZECCHI, "Il sistema statale britannico dell'assicurazione del credito all'esportazione", *Moneta e Credito*, December 1957), and has been debated often in the British Parliament.

has been left pretty much to the exporter, who can choose single transaction policies if he so desires.

In France, COFACE's position on "whole turnover insurance" has also been a good deal more flexible than ECGD's; cover limited to political and transfer risks can be authorized if the importer can persuade his own bank to guarantee his solvency, an operation which is often less expensive than the cover against commercial risks offered by COFACE.

The type of policy offered is but one of the elements influencing the export credit insurance institutions' risks; together with the commodity composition of exports and the credit facilities available, it determines the structure of the risks. Their volume remains instead mainly subject to the political and economic outlook of the moment. Between 1949 and 1951, for instance, the volume of business declared to ECGD for cover rose by about 70%, while exports rose by 50%; the increase in the desire to insure reflected certainly the anxiety induced by the Korean crisis. A lull followed in 1952-54, largely on account of the decline in business with Brazil; but the subsequent deterioration of the international situation raised the demand for insurance sharply. In the first nine months of 1957 insured shipments were 23% above the figure for the corresponding period of the preceding year, as against an increase in exports of only 6%.

The data we possess on the structure and volume of insured risks are fragmentary and of uncertain interpretation. Nevertheless an attempt is made at presenting them in an orderly fashion in Appendix IV. We know among other things, that until relatively recently ECGD had been covering short and medium term credits respectively in the proportions of about four to one (45) (although half of the premium income came from medium term policies), while COFACE and Hermes had apparently been committed more heavily on medium than on short term.

This latter fact — resulting in a definite prevalence of single-transaction over whole-turnover business — accounts for the greater

(45) A distinction on the basis of the policy issued would lead now to the proportion being overestimated as far as the actual length of credits granted is concerned, because short term policies can cover, with the "extended term endorsement" shipments sold on credit of up to three years and therefore definable as medium rather than short term.

concentration of the risks insured by COFACE and Hermes, as compared with those insured by ECGD (46).

The concentration of an institution's risks on a few countries is certainly not desirable, but it is not necessarily a sign of weakness in the institution's policies. It is the debtor country's ability to service regularly its obligations abroad that matters, and this can be gauged by keeping informed on that country's total indebtedness. If the country is creditworthy, its high relative share in total risks insured need not be a cause for concern. A "freezing" of the credits, as revealed by an unchanging composition of the insured risks over the years, rather than by their concentration at any given moment, is the danger one should guard against.

5. Discretionary Controls on Export Credit Insurance

Credit insurance institutions, although bound by their public service character to give access to their facilities to all that may require it, try of course to control the risks they insure by establishing selective conditions (premiums, percentage coverage) and by submitting the risks to the prior scrutiny of a commission before accepting them. Some have contended that the nature of the risks is such as to make it desirable to grant insurance on standard terms, leaving the selection of risks entirely to administrative discretion (47). The reason given is that the odds are incalculable and that a fixed fee, covering administrative costs and a margin for contingencies, would be just as equitable as any complicated rate structure. This view neglects the point that a differentiated rate structure has other functions besides that of adjusting premiums to presumptive costs.

Before discussing this argument in further detail, I should like to consider the controls involving the use of administrative discre-

(46) At no time in recent years did any debtor country account for more than 10% of the Department's risks, even when the liability on its Brazilian business reached the abnormally large figure of 32 million pounds. Logically, a lower percentage of exports to the more stable markets is covered by ECGD, partly also because exporters may desire in these cases to insure shipments against commercial risks only, through the Trade Indemnity Company Ltd. In Germany, instead, eight countries accounted at the end of 1954 for two thirds of the credit of over six months duration insured by Hermes.

(47) See for instance the letters to the editor of *The Economist*, Jan. 4 and 25, 1958, written by A. N. Patrick of the Trade Indemnity Co. Ltd. and the reply by Sir Frank Nixon, head of ECGD in prewar days.

tion. The screening of the guarantee is a responsibility which organs outside the credit insurance institutions share in all three countries, although in varying degree depending upon the administrative traditions of the country and the structure of the insurance institution. In Germany guarantees are authorized by a committee whose members come from the several ministries concerned; business representatives and the representatives of Hermes have only an advisory function. Transactions exceeding DM 1 million require a special approval by higher officials. Policies are quite standardized and therefore, except for credits below certain limits (Selbstprüfungsgrenze) within short term global policies for which the exporter is left free to choose, the selection of risks is entirely up to the committee. Rates do not differ as between countries of destination of the exports.

COFACE, given its double function of insurer on its own account in the case of commercial risks, and of agent for the Government in the case of all other risks, except for a few guaranteed through other channels, decides independently, subject to governmental veto, about the former risks, and depends on an interministerial committee for decisions about the latter risks. Judging from the variety of premiums, the reliance on "rules" appears on the surface quite important: in practice, the application of the rules is quite flexible and is based upon decision from above whenever large contracts are involved.

The case of ECGD is perhaps the most interesting one: in principle the Department's decision to underwrite a given risk (48) is subject to approval by the Export Guarantees Advisory Council, a consultative body which scrutinizes the insurability of the transaction as a "commercial risk".

In practice the Advisory Council has delegated authority to the Department to underwrite most of the day-to-day business. Only for business involving large amounts does the Department need the specific approval of the Council; this is usually given by one or the other of the "City members". In exceptional circumstances, however, when the Department considers a guarantee to be expedient in the national interest but judges the risk not to be com-

(48) With global short term policies the Department's approval is not needed for each individual transaction, provided a credit limit (non-vetting limit) imposed in advance is not exceeded.

mercially insurable — or if the Advisory Council withholds its approval — the transaction can be covered all the same by a Special Guarantee under Section 2 of the Export Guarantees Act, 1949 (49). Such guarantees have been used particularly for exports to countries in Eastern Europe and in South East Asia, which presented abnormal political hazards; there is always the possibility, however, that a country may be shifted from the Commercial to the Special Guarantees Section, and vice versa. The finances of the two sections are kept separate, but so far there has been no need for particular subsidies for the latter section.

The Special Guarantees system may be viewed as an attempt to help export trade which could not be insured without jeopardizing the principle of "commercial operation" of credit insurance. It is therefore an important alternative to measures aimed at restricting the assumption of credit risks towards countries whose economic or political situation is seriously deteriorating. Such measures have usually turned out to be either ineffective or unduly drastic.

The first type of measure is the downgrading of the country in the scale determining the premium rates to be applied; as can be seen from Appendix II, however, even the higher ranges of the rate schedule are not so high as to be likely to choke off trade in any substantial measure on cost grounds.

Rate increases can be passed on by the exporters with comparative ease if the importing country is in balance of payments difficulties and therefore anxious to secure credit. The effects that are to be expected from changes in credit rating are thus only the psychological effects on the exporters' willingness to commit themselves for the limited share of the transaction carried at their own risk (50).

(49) The ceiling on ECGD guarantees is divided into 750 million pounds for Commercial Guarantees and 250 million for Special Guarantees. According to what emerged in the parliamentary debates, the latter was raised from 150 millions in 1957 to permit new operations, especially with the Middle East. See HANSARD, March 20, 1957.

(50) The only case, the Brazilian crisis of 1951-52, on which we have a detailed report on the sequence of events (See: *Fourth Report* etc., *op. cit.*, pp. 44-45) shows clearly that even a doubling of rates may have only a moderate effect; the case was complicated by the indecision shown by the Department in dealing with the situation, the premiums being first sharply increased, then reduced again, before the eventual suspension of cover. See the severe criticisms of *The Economist*, Feb. 7, 1953, p. 378.

The second type of measure is outright refusal to insure transactions with a given country, and can be used not only as a protection, but also as a means of bringing pressure to bear on the debtor country. In fact, apart from cases of unexpected political risks, such as those of Iran in 1951 (after the Abadan nationalization) and of some Middle Eastern countries at the time of the Suez crisis, suspension of cover seems to have come only "in extremis" when substantial claims-payments appeared imminent or had already occurred. This was true, for instance in the case (for ECGD) of Brazil, and (for all three institutions) of Turkey, and more recently of Colombia.

6. Built-in Selective Features of Insurance Contracts

Having looked at the discretionary controls we must now turn to the pre-established "rules", that is to the terms of the insurance contract concerning premium rates and share of risk left to the exporter. These rules have three main purposes:

- a) to ensure that the charges are equitably adjusted in accordance with the presumptive cost of the facilities provided;
- b) to encourage restraint on the part of the exporter with regard to the safety and length of the credit he grants abroad;
- c) to make it financially more attractive to secure cover for all risks and several countries of destination, than to make only sporadic use of the facilities offered.

The third point has already come up in the previous discussion, when it was indicated that Hermes grants lower rates for global policies than for single-transaction policies. I should only add that this principle is also applied by granting more favorable conditions for joint insurance of risks arising before and after delivery. For ECGD the problem is solved in a more radical way, since separate cover is not granted. COFACE, which covers a greater variety of risks than either of the other two institutions, simply adds up the premium rates established for the single risks.

Rate discrimination according to borrowing country is primarily directed towards fostering a sense of responsibility in the exporters, although it is also supposed to help distribute equitably the cost of running the guarantee scheme. The validity of the second point

is questionable, particularly in the field of medium term operations, where several years are likely to elapse between the assumption of the risk and the final repayment by the importer. It is all but impossible to charge premiums that reflect the absolute (or even relative) probability of losses on the individual contracts considered. In fact it is doubtful whether one can form definite expectations about them at all. On the other hand, the exporter's willingness to engage at all in credit transactions with a given country is likely to be significantly affected by that country's grading in the schedule of premiums. As was observed earlier, what matters is not so much the cost aspect (51) as the confidence of the exporter in the better-informed judgment of the guaranteeing institution.

There is however no better stimulant for the exporter's sense of responsibility than the knowledge that he will have to share in any losses to which the transaction may lead. This is the reason for imposing limitations on the percentage of risk covered by the insurance and for the selective use of such limitations (52).

I should like here to indicate the general principles underlying the determination of the risk share. The first principle is that since the exporter is much better able, by the use of foresight,

(51) The rate spread can, however, be quite considerable; for short term credit, rates more than double from the best to the worst countries in the grading adopted by ECGD (six classes are distinguished, in agreement with the Treasury) and increase more than threefold from the first to the fourth of COFACE's four classes. We do not possess data on the spread of premiums according to country of destination for medium term credit, but the differences are known to be even greater. See Appendix II.

(52) The treatment granted by ECGD is the most liberal one: political and transfer losses are now generally covered after shipment to the extent of 95%, while losses due to insolvency or default are borne by the Department up to 85%. This percentage at times has been lowered to emphasize the dangers of a special situation: when cover was resumed on exports to Brazil after two years' interruption, it was limited to 80% for transfer risks, instead of the then current 90%.

In the summer of 1956 Hermes reduced its participation to 70% for commercial risks and to 80% for political and transfer risks, from 75% and 85-90% respectively. The reason given was the "rising balance of payments surplus"; in fact, it was one of the conditions imposed by the Government for authorizing an increase in the ceiling for guarantees from DM 7.5 million to DM 9.5 million. As of October 1, 1957, cover against conversion and transfer risks has been lowered further to 75%. The committee that controls the issue of guarantees by Hermes has made use all along rather freely of its discretionary powers to vary the exporters' risk quotas.

Finally, COFACE and its supervisory commission vary commonly the cover on political risks between 80% and 90%, and that of commercial risks between 65% and 80%, according to country of destination and other characteristics of the risks they insure.

to guard against bad commercial risks than against political risks, the latter should be covered up to a higher percentage. A distinction is also often made, presumably on the same grounds, between sales to governments and sales to private firms, the risk share carried by the exporter being higher for the latter than for the former. Finally, the quality of the market is often also used as a criterion in determining the cover to be granted to the exporter.

It is clear that the variation of the risk share is conceptually equivalent to a differentiation of premiums; and it is in fact applied in similar circumstances. The relationship is, however, not a simple one; for example a premium reduction of 10% cannot be considered an adequate compensation for a reduction in cover also of 10%. In fact there are certain limits below which the guarantee appears to fail in its purpose of permitting the expansion of export turnover without worsening the financial structure of the firm; it does fail when the insured share of the credit contract falls much below the share of costs (52). Indeed, the determination of the appropriate risk share is one of the most difficult problems in credit insurance and would require a case by case solution, which is evidently not feasible. While it is clear that often the standard coverage is too high to impose any significant restraint on the exporter, even the general principle that the exporter should stand to lose his profit and also to suffer a slight net loss is not clear cut. There is a conceptual problem particularly in deciding whether failing to recover part of the overheads can be considered a net loss. This depends on whether capacity is fully utilized or not, for in the latter case a net loss can arise only if marginal costs are not recovered. As between different industries or firms, one should also take into account the degree of vertical integration; where subcontracting and specialization characterize the structure of production for the exporting firm, the share of marginal costs on the contract value will of course be larger.

The remaining criteria again concern rate setting, and merely establish differentials corresponding to the actual or expected cost of the facilities granted. By far the most important of these criteria is the length of time for which the guaranteeing institution will be

(52) For example in Switzerland, a guarantee limited to 80% of cost (not of invoice value minus prepayments, as is true elsewhere) proved unsatisfactory, and in Italy, a 70% cover had to be raised to 85% after three years of unsuccessful operation of the scheme.

on risk; the length on the period of manufacture and on the length of credit granted. So far as the former is concerned, the risk of loss due to inability to deliver goods manufactured to specifications, on account of political or monetary obstacles, can be covered in all three countries. The special guarantee issued by Hermes (*Garantie zur Deckung von Fabrikationsrisiken*) costs a flat rate of 1% (.75% if taken together with insurance of the credit risk proper), irrespective of the period covered. ECGD, instead, takes the length of the period of manufacture into consideration in setting the premium for this risk which cannot, however, be covered separately (53).

In the British system for medium term credit insurance, the average period (taking into account prepayments and repayments) for which credit to the foreign buyer is outstanding, determines the rate to be applied to the face value of the contract. COFACE uses instead a "basic rate" applied to the face value of the policy, combined with a premium "pro rata temporis" on credit actually outstanding: this is identical, per year, with the basic rate. In both cases, of course, the basic rate itself is determined by other criteria: country of destination, nature of goods, etc. A basic rate plus a monthly rate are used by Hermes, both rates being determined, however, solely by the quality of the purchaser (private firm or government body). This distinction, stipulating a lower premium for sales to governments and public bodies, is justified by the lack of ordinary insolvency risks on such transactions.

The nature of the goods shipped is an important auxiliary criterion for rate setting, and it is applied both by ECGD and COFACE. Its relevance is much greater, however, for short term than for medium term credits, since the latter cover almost exclusively capital goods which rank as "essential goods" enjoying the best rates.

Hermes also applies a system of rate differentiation (for sales to public bodies) based upon the face value of the policy and aimed at passing on to exporters the savings on administrative costs realized on the larger transactions: the basic rate is 1% for the first 3 mil-

(53) Medium term credit transactions can be covered from the date of shipment of the goods (instead of from the date of contract) as is usual for standardized goods sold on short term. Insuring only the credit risk from the date of shipment permits a saving of some 25% on the premium, but it is quite rare for capital goods, less than 10% of total medium term guarantees.

lion DM, .75% for the next 2 million DM, and only .50% for the amount in excess of 5 million DM. The monthly premium "pro rata temporis" is $.4^{0}/_{00}$ or $.5^{0}/_{00}$, on the credit outstanding, according to length of credit.

Finally, COFACE has recourse also to an appraisal of the exporter's past record as a whole, and takes into account his insured turnover, the prevailing terms of payments on his exports, and his experience with losses on export credits.

7. An Appraisal

Export credit insurance is by now an institutional factor of major importance in the domain of international trade. Indeed the systems of finance based on the bill of exchange, and still more largely on open-account credits, have been significantly modified by the emergence of risk-bearers with practically unlimited financial backing, and with greater possibilities of obtaining credit information and analyzing balance of payments developments than acceptance houses and banking institutions ever had. The latter have assumed in the new systems different, but not less important, roles which will be discussed in the following chapters. The accusation that the free use of Government facilities has meant unfair competition against the established institutions, appears therefore unwarranted and it would be denied, I think, by the private credit institutions themselves; indeed these have found the cooperation with credit insurers most profitable.

The progress of export credit insurance in the last few years has been such as to allay the fears of those who suspected it of being a device for waging credit wars with government support. It has served instead, to prevent the disruption of trade in cases where exporters would have been unable to maintain their business in the face of increasing uncertainty.

Complacency would not, however, be justified at this point. For one thing, business opinion still appears somewhat baffled by certain features of the administration of the insurance schemes. One of the most serious flaws consists in the delays involved in the settlement of claims. COGD has recently (54) made an effort to

solve this problem by reducing the waiting period for payments on transfer and political losses from six months to four, and on losses through the buyer's default from twelve months to six. This is not yet enough: there is much to be said in favor of further improvements in the same direction, even if they should imply a deeper involvement of insurance institutions in the collection of "slow credits". Such operations can be performed centrally at substantial savings. Improvements of this kind render claims on foreign buyers more liquid and easier to finance. One should not underestimate the hardship for an exporting firm of having promptly to repay bank advances obtained to finance exports on credit terms, while it has to wait up to twelve months for the sums due from the insurance institution in case of non-payment. The bank itself is likely to take a dim view of this prospect. In fact, some of the difficulties which exporters have had in obtaining finance can be traced to deficiencies of this sort, which could be easily eliminated. The next chapter will deal more fully with this problem, as part of an analysis of medium term export finance in Great Britain.

(54) In March, 1957; see *The Economist*, March 16, 1957.

CHAPTER IV

MEDIUM TERM EXPORT CREDIT IN GREAT BRITAIN

1. The Prewar Background

The City of London has never officially possessed machinery for financing the export of goods sold on long payment terms. The idea itself is foreign to the traditions of orthodox banking. Under the pressure, however, of business demands, and the threat that competing institutions might be set up by the Government to perform the task, the City made efforts to fill this gap in its facilities by adapting existing techniques to new needs.

The basic factors were, of course, the growing importance of machinery and other capital goods in British exports, and the failure of long term capital exports from London to satisfy the demand for finance coming from Britain's traditional customers. Progress has not been continuous nor always satisfactory; but the fits and starts in the development of new facilities are partly explainable by the instability of the economic background against which the City has had to operate.

Soon after 1914 warnings began to appear that new facilities were required, and two separate committees were appointed within a few years of each other to consider the matter. Both recommended the establishment of appropriate institutions for export finance (55). Their proposals were finally implemented by the establishment soon after the war of the British Trade Corporation, but this experiment proved unsatisfactory (56). Meantime commercial banks had gone into the acceptance field (up to then the exclusive province of merchant banks), and in the unsettled conditions of the early 'twenties, that instrument of finance took on new and unorthodox functions. The business that grew up in non-documentary acceptances, which often were periodically renewed

(55) Cmd. 8346, 1916; Cmd. 9227, 1918.

(56) See, on the history of this period, BALOGH, *Studies in Financial Organization*, London, 1947, pp. 243 ff.

and had the character of "finance bills" rather than "real bills", probably helped meet the demand for longer term accommodation from abroad, though exchange and commodity speculation were doubtless the main factors fostering this development.

Several years later the hearings before the Macmillan Committee brought out additional evidence on this problem, including the frank admission that in such an important industry as ship-building, export finance had to be secured by means of 180-days bills that were repaid by discounting new bills, a method contrary to orthodox banking and dangerously exposed to the cold winds of monetary policy. Specific complaints of inadequate facilities were also heard with respect to credit for agricultural machinery exports (57). It was the impression that credit for anything over the usual 90, or at most 180 days, was hard to get that prompted the Committee's pessimistic statement: "At present... we do not believe that the facilities available here in the case of foreign trade are so complete as those provided in some other countries", and the recommendation that "British institutions... should be developed for the purpose of assisting British industry and trade abroad" (58). Unfortunately, the world financial crisis was just around the corner and the problem of export finance was soon shifted to a wholly different context, where the old solutions would have been inappropriate.

2. The Postwar Years: Britain's Trade Position and Exchange Control

Metal and engineering products contributed about four-fifths of the increment in the volume of British exports between pre-World War II days and the early 'fifties; sales of these products increased by 2½ times approximately. The world markets could easily absorb what Britain had to offer in this line up to the end of the Korean boom in 1951; in fact, during most of this period, productive facilities in the capital goods sector were badly strained and delivery periods were unusually long.

From the end of 1951 onwards, however, British machinery exports stopped growing at the spectacular rate to which the country

(57) Committee on Finance and Industry, *Minutes of Evidence*, V, II, p. 40.

(58) Committee on Finance and Industry, *Report*, Cmd. 3897, 1931, p. 170.

had become accustomed. Divergent interpretations have been offered for this turn in the situation, some stressing the impact of rearmament and increased domestic investment as factors diverting goods from the export to the home market (59), others pointing to the reappearance of powerful competitors on the world market and to the failure of the import capacity of industrializing countries to match the increased output offered for sale.

A thorough analysis of this particular problem is outside the scope of this study. For our purposes it is sufficient to mention that, while exporters generally held the latter of the two views and unremittably insisted on the need for export credits to ease their task, the British Government initially took the stand that equipment could be sold for cash in the United States, Canada and other desirable markets, and refused to agree to easier sales terms. Except for the sterling area markets, sales abroad on more than 180 days' credit were subject to the approval of the Foreign Exchange Control Commission — that is to Bank of England consent — so that the Government could enforce this directive without difficulty.

The balance of payments crisis that beset Britain in 1951-52 found the Government committed to correcting the external disequilibrium by tightening credit at home in the hope of diverting resources and efforts to the export field. Cash sales abroad were more than ever considered imperative. As a short run policy, these directives were probably appropriate; but the attempt to impose on foreign customers the terms of payment that happened to be agreeable to the British Government might have done great harm in the long run to many of Britain's traditional markets.

Admittedly there was a dilemma here: on the one hand the Government felt that "no satisfactory solution could be found for the balance of payments problem without a further substantial increase in the exports of the metal-using industries" (60). On the other hand, easier credit for exports might have resulted in an accumulation of relatively illiquid credits to the detriment of hard currency reserves.

(59) This thesis is ably presented by R. NURSE, "The relation between home investment and external balance in the light of the British experience, 1945-55", *The Review of Economics and Statistics*, May 1956, pp. 121-154.

(60) *Economic Survey for 1952*, Cmd. 8509, p. 32.

A compromise solution was found, partly as a result of the downturn in activity in early 1952. The Chancellor of the Exchequer promised to modify the exchange control rules regarding credit terms, rules which at that time required payment of half the contract price within six months and the rest within two years. The concessions granted consisted essentially of the extension of the maximum credit period to three years or, in the case of exports of exceptional national interest, to four or five years (61). A few months later the President of the Board of Trade, speaking in the House of Commons, elaborated further the Government's position:

"Some people suggest that we should ease our general export position by a more generous credit policy. We are to a larger extent than almost any country dependent upon imports of essentials, for which we have to pay in cash and generally upon the nail... Therefore the extension of credit is clearly limited... We examine each case upon its merits and look sympathetically upon requests for the extension of credit, particularly when important capital goods exports might be lost" (62).

This was still unsatisfactory to business circles that had seen markets, particularly in Latin America, shrink further and feared they might be hard to recover, once lost. At the same time the balance of payments situation had eased and industrial activity had declined further. In April 1953 the Government announced that credit for exports would receive still more liberal treatment, but did not commit itself to definite terms. In practice, from then on, the exchange control authorities seem to have taken account of the payments habits that had become established for capital goods in the relevant markets, so as not to hamper British industry's competitiveness in this field.

3. The City's Attitude to Medium Term Export Finance

By early 1953, with exchange control difficulties practically out of the way, the problem of securing suitable credit facilities in the City began to be keenly felt by exporters. It was clear that

(61) HANSARD, July 29, 1952.

(62) *Ibid.*, November 5, 1952. This statement emphasized the selective character of the concessions: the Treasury had its own ideas as to "which markets were worth cultivating".

commercial banks were reluctant to tie up for relatively long periods (and with substantial risks in spite of the security afforded by ECGD insurance) funds which had been derived from sight or short term deposits. Also, by this time, specialized institutions had already been set up in both France and Germany. (British exporters appear either to have been badly misinformed about the activities of these, or to have deliberately inflated their role). There were demands that Britain should follow suit.

The Chancellor of the Exchequer, in his 1953 Budget statement, implicitly referred to these demands and tried to ward them off, at the same time giving a hint to the City that further progress was expected from it: "I have asked those who speak for industry and commerce whether our banking and financial system provides adequate finance for our exporters. On the whole I believe that it does. If there is a problem here it is rather one of making more widely known the financial facilities that already exist".

The City was not slow to take the hint but, while showing greater readiness to grant medium term credit, pointed out that some adjustments in the facilities provided by ECGD would help the joint stock banks better to meet the exporters' demands. What was actually being asked was an undertaking by ECGD to take over the transaction on demand, the closest thing to a rediscount facility the City could conceivably obtain (63). Alternatively, the City would have liked a Government guarantee on the export paper so that this could be sold without difficulty on the money market and possibly to insurance companies.

The attitude of the various banks was by no means identical. A Vice-Chairman of Barclays' Bank suggested that as long as the finance requested did not exceed certain limits, the existing facilities would be sufficient, though special arrangements might become necessary later on (64). The same bank's Review carried a statement to the effect that "events and the obvious needs of the country may force a further reshuffling of prejudices", concluding however,

(63) What they had in mind were evidently the "take-out agreements" that the Export Import Bank concluded with US banks in order to induce them to participate in its own financing.

(64) See: Sir CECIL ELLERTON, "Conséquences pour les banques de l'évolution du commerce extérieur après la guerre", in *L'évolution récente du rôle des banques dans l'économie*, Proceedings of the 6th International Banking Summer School, Knokke (Belgium), September 1953.

"there is no need of a government sponsored institution to lead the way" (65). Another of the "Big Five", whose name I am not free to mention, was already willing at that time to give finance up to five years *without* recourse to the exporter for the part covered by ECGD insurance and *with* recourse for the remaining part. The other three held aloof and so far as I know are only now, after several years' experience among the other banks, beginning to take an interest in this type of transaction (66).

The 1954 Budget speech showed the intention of the Government to meet the exporters and banks even more than halfway: a new form of direct guarantee by the ECGD to banks was to be introduced, a form that came very near some of the proposals mentioned above. Apparently this was a last minute initiative of the Government, taken without extensive consultations with the Export Credits Guarantee Department. The latter did not at first react favorably and did not manage to get started until several months later for lack of agreement on the scope of the new facilities and on the minimum size of transactions that should qualify for the special treatment (67).

The direct guarantees were not meant to replace the Department's existing forms of insurance and were not a sharp departure from established practice, as banks had in exceptional cases been able to obtain similar treatment. Once put on a routine basis, however, direct guarantees became a highly coveted form of insurance cover (because of the advantages I shall discuss below) and banks requested them almost as a matter of course, whenever the credit contract could qualify. In the eyes of the banks, this development was a real turning point, even though their hopes of securing the participation of institutional investors in the financing appear to have been frustrated. The increased activity that has been noticeable in the field since 1954 must therefore be taken partly as an index of the great importance attributed by commercial

(65) *Barclay's Bank Review*, November 1953, p. 79.

(66) For an expression of the feelings of banking circles in 1953, see: "The City and export finance", *The Banker*, July 1953, pp. 13-17. See also the annual speech of the Chairman of the National Provincial Bank, *Financial Times*, January 22, 1958.

(67) Eventually this was set at 250,000 pounds, even though the ECGD had asked initially for a much higher figure. During the debate on the Budget in April 1958 the limit was lowered to 100,000 pounds.

banks to the risk element. Up to April 1958, direct guarantees to a total of 84.7 million pounds had been issued, of which 29.1 million in the last financial year alone.

4. The Impact of Credit Control

The availability of credit for export was a function not only of the banks' willingness to engage in such transactions, but also of their ability to do so. This was limited by specific controls and directives concerning advances, by the banks' own liquidity, and by their commitments in other credit fields.

The Capital Issues Committee was supposed to pass judgment on all lending for capital purposes in excess of 50,000 pounds (10,000 since March 1956) unless the operation was in the "ordinary course of business", that is, merely financed the processing and sale of goods. Credit to exporters, apparently (though not much is known about c/c activities) often qualified for exemption even when it was obviously equivalent to indirect finance abroad. Credit direct to buyers was instead subject at the outset to the rule that lending was allowed only on condition that funding would take place within six months. This restriction proved particularly inconvenient to the shipbuilding industry which lodged vigorous complaints and finally, in December 1953, obtained the ruling that the repayment schedule should be left to the discretion of the banks. The decisive relaxation, however, came in March 1958, when it was announced that bank loans to finance exports on which the banks had already received a guarantee from ECGD would automatically be approved by the Capital Issues Committee.

The relatively easy — although belated — start of medium term lending for exports, after the relaxation of exchange control rules, was very much helped by the improved liquidity of the banking system. After the credit squeeze of the preceding months, bank rate came down to $3\frac{1}{2}\%$ in September 1953 and was lowered to 3% in April 1954, after a massive inflow of short term capital due to renewed confidence in the pound. With falling activity and a balance of payments surplus, bank holdings of treasury bills increased sharply and there was thus scope for partly restoring the proportion of higher yielding assets by engaging in medium term export credit.

By mid 1955 the situation had again changed radically: the emphasis of monetary policy was now on the reduction of advances through voluntary compliance by the banks with an informal request from the Chancellor of the Exchequer. With bank rate at $4\frac{1}{2}\%$ and falling liquidity, conditions were becoming clearly unfavorable: commenting upon the growth of export credits in 1955-56, some could say that it had "obviously been affected by a year of general credit restriction. All forms of export credits are more expensive... and medium term credit for capital goods is now becoming much harder to find" (68). In fact, the credit squeeze had no destructive effects on the progress achieved up to then, as export credits were specifically exempted from the Chancellor's request and the increase in cost could be easily passed on to customers abroad. Also, by that time the mechanism for financing on the basis of direct guarantees was better understood and was exerting its full effect.

Renewed doubts have arisen recently with the new directives of the Chancellor of the Exchequer and the even higher bank rate of 7% . On September 19, 1957 a new brake was imposed on advances: "Although special considerations may arise in relation to certain export credits... the situation requires that the average level of bank advances for the next 12 months be held at the average level for the last 12 months" (69). We shall not know for a long time whether finance for capital goods exports has been seriously affected: negotiations of such contracts often take several months, sometimes years, so that even the indications obtainable indirectly from ECGD returns will not be significant in the near future. On balance it is doubtful whatever the monetary authorities will want to clamp down on this sector, considering the much greater importance that attaches to movements of short term funds from the standpoint of monetary policy. Provided these are under control, medium term export credits linked to a long run expansion of foreign markets can be left undisturbed.

(68) "Banking and Insurance Supplement", *The Financial Times*, April 30, 1956, p. 27.

(69) Chancellor's statement reported in *The Times*, September 20, 1957. Later the Chancellor announced that "the banks had been told that, in calculating the total of bank advances, medium term advances guaranteed by ECGD could be excluded".

5. The Technique of Medium Term Export Finance

The distinctive feature of medium term export finance for British banks consists in the fact that they do not here have the opportunity of calling in the loan before the agreed period has expired or of disposing of the paper on the money market. Normal advances are nominally repayable on demand or after appropriate notice: this condition is evidently not applicable to export contracts of the type under discussion, for which the manufacturer must be assured of finance for the entire period.

For the prefinancing period, however, the contract is generally financed as part of the manufacturer's overdraft facilities. The cover which the manufacturer obtains from ECGD from the date the contract is signed indirectly provides security for the bank as well, and may enable it to agree informally to longer finance than is usual.

After delivery the transaction requires a firm commitment from the bank, whatever form the credit takes. I should like to stress that this varies considerably from case to case and from bank to bank, and the presentation that follows simply reflects the results of my interviews with ECGD and some of the more significant financial institutions in the City of London, but by no means purports to give a complete picture.

The manufacturer can secure evidence of his credit either by drawing a bill (or rather a series of bills conforming to a maturity schedule) on the buyer and having it (or them) accepted by him, or by obtaining promissory notes from the buyer. The bank in turn can either purchase (or discount) the bills or promissory notes, or alternative advance funds to the manufacturer on the security of the latter (70). If the bank has also assisted the manufacturer during prefinancing and subsequently buys the foreign customer's bills or notes from him, it will reduce his overdraft accordingly.

In the British banking tradition, advances usually carry a rate linked to the Bank of England discount rate. Investments carry of course a fixed rate but are negotiable so that medium term paper, even though backed by Government insurance, cannot be put in

(70) In the case of at least one bank the manufacturer did not always receive the advance in the normal overdraft form, but often had to sign promissory notes in favor of the bank: however this is more usual where direct guarantees are involved (see below).

this category. When tendering for orders, the manufacturer would like to obtain a firm rate allowing him to quote a firm price without risk of having to shoulder possible increases in interest rates. The fixing of a firm rate would require the banks to take a view of the market for many months or even years ahead, which ordinarily they refuse to do. The longer and more important contracts are financed, therefore, on the basis of bank rate plus $\frac{1}{2}$ to $1\frac{1}{2}$ percentage points. The effective rate may thus fluctuate, but is subject to a floor — recently about $5\frac{1}{2}\%$ — which limits the possible benefits that the buyer (or manufacturer) can derive even from drastic falls in the bank rate. This account of the rates chargeable for medium term finance serves to emphasize the difference between the latter and ordinary short term credit facilities available to exporters in the acceptance and discount market, where total cost, inclusive of stamp fee and commission, is generally well below that indicated above. The difference is still more marked if credit insurance costs are included in both cases: not only are premiums for medium term contracts generally higher, but also insurance is an absolute necessity in transactions with extended payment terms, which is not true in the other case. With short term finance, the security afforded by documentary bills and the use of acceptance facilities very often make recourse to ECGD insurance unnecessary.

This brings us to an examination of the security demanded for medium term transactions. The importer may be asked to provide a guarantee from a leading bank in his own country that payments will be forthcoming on the due dates; although the commercial risk is thus considerably reduced, the transfer risk remains to be covered by credit insurance in any case. The exporter can proceed to assign his right under the policy to the financing institution, which will agree to finance the part of the credit contract covered by ECGD. In practice this means that the bank will finance up to 85-90% of the transaction on this security, but will ask for additional collateral for the remaining 10-15%, if it will take it at all. It would also seem that banks are willing to undertake the latter financing only for regular customers, whereas they might accommodate even a non-customer for the insured part of a transaction.

An ECGD policy is normally considered satisfactory collateral, even if it does not make the paper it covers a gilt-edged investment. There are two main cases — namely rejection of the goods by the

foreign customer and insolvency or bankruptcy of the British exporter — in which the bank would get no redress from the Department. Also, the delay involved in obtaining settlement of claims is a further and important cause for the bank to consider such transactions more risky than one might at first suspect.

6. Financing with the Assistance of Direct Guarantees

From the viewpoint of banks, the loopholes in insurance contracts just mentioned are serious enough to justify demands for guarantees that might be considered iron-clad. With the introduction in 1954 of the direct guarantee system, the banks were given access to a more satisfactory commitment from ECGD. The Department would take over from a bank any bills of exchange or promissory notes which had been acquired in the way to be described, and which, after being duly presented for payment, had remained unpaid three months after the due date.

The direct guarantee thus gave the bank an unconditional right of recourse to the Department and one that it could exercise with a minimum delay and without obtaining a formal declaration of insolvency or bankruptcy of the debtor. The bank was thus enabled to provide finance without recourse to the exporter, who could in consequence accept orders involving long and substantial credits without impairing his normal borrowing powers. As the direct guarantee takes effect only after acceptance of the goods, the manufacturer must still cover his pre-acceptance risks with an ordinary credit insurance policy.

In fact the direct guarantee is nothing more than an extra clause in a normal credit insurance contract: the Department guarantees payment to the bank but retains recourse to the exporter in case the amount paid under the guarantee exceeds what is due to the exporter himself under his policy (71). For this service the Department charges an additional fee of $\frac{1}{2}\%$ to $\frac{3}{4}\%$, and reduces the maximum cover obtainable to 90% (85% until April 1958)

(71) That is, in practice, if it had to pay a claim from the bank arising from a cause of loss the Department does not cover in its normal policies. Also, after cover under direct guarantees has been raised to 90%, the Department might pay out 90% of the loss to the bank in a case in which the exporter is entitled to only 85% cover and the Department would have therefore right of recourse for the marginal 5%.

of the part of the contract payable on credit terms. Yet to the exporter this is well worth while in view of the easier and generally cheaper finance he can obtain, and above all of the possibility he has to avoid burdening his balance sheet with additional bank indebtedness.

The bank may advance the funds in one of several ways: the first consists of the purchase from the exporter, without recourse, of the buyer's accepted bills or promissory notes. To be more precise, the bills or notes are usually drawn in two separate sets referring to 85% and 15% respectively of the total credit and only the former set is purchased without recourse. The money will only be advanced after the goods have been accepted.

Alternatively, the bank may make an advance to the exporter and obtain the direct guarantee of ECGD on the promissory notes issued by him to the order of the bank. The reason why promissory notes are used in this case is the obvious one that it would be impossible to use the guarantee system on an overdraft.

The third method is the most interesting one, under it the exporter does not enter into the financing transaction at all. The advance is made directly to the foreign customer, who will issue promissory notes directly to the bank. There will thus be two contracts running side by side. On the one hand, the buyer will stipulate with the exporter to pay him on terms of, say, 10% with order, 80% Cash against Delivery in the United Kingdom, 5% 12 months after delivery and 5% 18 months after the same date. On the other hand, the bank will open a letter of credit in favor of the importer, providing for him to repay the bank in, say, 15 equal half-yearly instalments, the first one due six months from date of order. The letter of credit would also provide for payment by the bank to the exporter, according to the terms set out in the contract between the latter and the buyer. It is not hard to see that this procedure represents an extension to the field of medium term credit of the time-honored technique of refinance credit, under which the British exporter is paid at once by the British bank, while the foreign importer or bank draws on London to obtain a delay of 90 to 120 days before payment is due. The technique is particularly appropriate when the importer is dealing with several exporters at the same time, as it would be cumbersome to arrange separate financing and guarantees for each contract of sale. The condition remains, however, that the contracts should all

refer to a given project and should not be put together merely in order to reach the minimum sum eligible for a direct bank guarantee.

A number of important projects have recently been approved for finance according to this third formula, which has proved flexible and welcome both to banks and exporters (72). Since June 1957, however, the ECGD seems to have had second thoughts about it, largely for technical reasons connected with the right of the Department to modify the terms of the guarantee or suspend it altogether. There is thus still some uncertainty as to whether it will be continued in the same form or not.

On the whole one may say that the introduction of direct guarantees has been a very significant step forward for the finance of capital goods exports; also, the progress has been obtained without imposing significant new burdens on the ECGD, but by exploiting further the advantages of its more elastic liquidity position.

7. The Role of the Merchant Banks and Specialized Institutions

Merchant bankers, by lending their name to ensure the discountability of bills on the market, used to act as screeners of commercial risks and perform insurance functions which today they share with ECGD. We have it on good authority that in the postwar period, besides attending as usual to short term export financing, they sometimes tried to apply the same techniques to transactions involving longer credit, with the assistance of ECGD insurance of course (73). Their limited resources and capital do not permit them, however, to contribute much to the actual financing and risk taking. Their role has been of quite a different nature in recent years.

A few of the merchant banks — among which some of the best known names in international finance: Lazards, Barings, Morgan Grenfell & Co. — have taken to acting regularly as managers for syndicates of commercial banks formed to finance large medium term export contracts. The need for such syndicates

(72) An eloquent testimonial is the size of some of the contracts, among which a credit line of up to 25 million pounds for a power plant and other projects in Argentina, bearing interest at $\frac{3}{4}\%$ above bank rate, and one of over 7 million pounds for a battery of coke ovens in Italy.

(73) See: Credit Insurance Association, *Finance for Exports*, London, 1953, p. 10.

is clear, considering the size of some transactions, which no bank would be able or willing to finance alone. But bringing together the number of banks and of sellers, as well as ECGD, that are often involved in one operation is the type of task for which merchant banks are ideally suited. Thus once they have been approached by exporters asking them to sponsor a given contract, they take on the task of examining the transaction from the technical viewpoint, of conducting negotiations with the Department and with the borrower, of convincing other banks to put up the funds (their own participation if any can only be modest) and finally of doing the burdensome paper work and interest accounting that complicated transactions such as these inevitably require.

It should be remembered, also, that close connections exist between certain firms and certain merchant banks on account of financial sponsorship, particularly in the case of rapidly growing firms. These connections afford the bank an opportunity of participating in the negotiation of the export contract from the very start, with a view to the possibility of subsequent financing. A typical example was the plan to finance an important hydro-electric project in Turkey, to be built by George Wimpey & Co. and English Electric: the latter is sponsored by Lazards who, even in a difficult case like this — Turkey already had commercial arrears to the United Kingdom — could still manage to prepare a plan providing credit up to nine years and for very substantial amounts (74). In other cases, apparently, it is the bank itself that takes the initiative in forming the syndicate on the basis of mere prospects for contracts. The Barings credit for Argentina — up to 25 million pounds have been put at the disposal of the Argentine Government by a consortium of London banks managed by Barings to finance orders placed with British industries (75) — is not an exceptional case. It is of course impossible to say what part political pressures play in stimulating the banks to engage in transactions of this type. (In the case of the $11\frac{1}{2}$ million pounds credit arranged by a bank consortium for the Durgapur steel mills in India and announced in 1956 (76), they are known to have been an important

(74) *The Economist*, April 10, 1954, p. 141.

(75) *The Economist*, July 28, 1956, p. 341, and *The Manchester Guardian*, October 29, 1957.

(76) *The Economist*, March 3, 1956, p. 563.

factor). The interesting thing, nevertheless, is that British banks seem to have found the way, with the cooperation of the ECGD, to fill a part of the gap left by the decline of international long term lending through the City.

Merchant banks have also contributed a great deal to one of the most interesting initiatives of the past few years: the formation in September 1953 of a special finance company, Air Finance Ltd., designed to enable British aircraft manufacturers to compete in a market where American exporters are supported by substantial Export-Import Bank credits. It is not a pure coincidence that Lazards, with their very close ties to Rolls Royce, a major aircraft engine manufacturer, should figure prominently among the promoters of the new company. Associated with Lazards were Erlangers, Morgan Grenfell & Co., the Finance Corporation for Industry (which was also supposed to provide a 10 million pounds credit line) and leading firms in the aircraft industry. The idea was that Air Finance, with its 1 million pounds capital, the FCI loan and additional credit lines from banks would be able to hold in its portfolio the bills it agreed to discount for the aircraft manufacturers. To limit the financial effort of the company, quite stringent conditions were to be imposed on credit granting: 60% of the order had to be paid before delivery, and the remaining 40%, guaranteed by the ECGD, over a maximum of 3 years.

In fact, circumstances seem to have required significant deviations from original plans. On the one hand, American exporters have tried to maintain their supremacy by offering even better credit terms and the British have had to follow suit. On the other hand, the idea that Air Finance should take credit from banks to build up its own portfolio of export bills has revealed itself as expensive and unnecessary in view of the increased willingness of banks to hold such bills themselves. In consequence, Air Finance has taken to acting substantially like a merchant bank, doing the preparatory work and the management of the transaction for a fee of $\frac{1}{4}\%$ to $\frac{1}{2}\%$, but little, if any, of the actual financing; it has been eminently successful, however, in the first of these tasks.

A somewhat similar story is that of the Ship Mortgage Finance Company, Ltd., formed in 1951 to facilitate the purchase of British-built ships by both domestic and foreign shipowners. We need not dwell on this case, since the company's activities in general,

and particularly those in support of exports, have been quite limited, apart from special deals connected with take-over and re-charter of tanker fleets, in which it too, acted on the lines of a merchant bank (77). The relatively high cost of refinancing facilities for the company and the availability of cheaper alternatives, such as ship mortgage credits from insurance companies, have probably been the main factors limiting the company's success.

In a few cases in which the need to grant unusually long credits coincided with the special interest of the transaction from the political viewpoint, ECGD itself has been able to intervene more directly. The Department was empowered to do so by Section II of the Export Credits Guarantee Act, 1949, which included "economic assistance" among the objects of the guarantees in the national interest. Once the operation had been approved, the promissory notes issued by the foreign government, in a mutually agreed tenor, as the payments to the British exporters fell due, were supposed to be guaranteed by ECGD and then purchased by the Department itself with funds provided by the Exchequer (Section 3 of the same Act). The main operations were an early 10 million pounds credit to Pakistan in July 1953, another 10 million credit to Iran extended in November 1954, a 17 million credit to Yugoslavia, and a 15 million credit to India for the already-mentioned Durgapur steel mills. As of March 31, 1957 the Economic Assistance Scheme showed loans outstanding of 32,433,331, pounds and a notional credit balance resulting from the excess of interest receipts over payments, of 248,963 pounds (78). The cost of the facilities provided by the Exchequer is of course linked to the rates which the government has to pay in the bond market and it has fluctuated widely between little over $2\frac{1}{2}\%$ in 1954 and $4\frac{3}{4}\%$ in 1956, not to mention the recent effects of the 7% bank rate. The Department has therefore been exposed at times to losses, as its own lending rate was about 4%; but an overall surplus has been achieved. Recent amendments have corrected some imperfections in the

(77) Advances and investments outstanding totalled only 2.9 million pounds, and commitments 3.2 million at the close of the financial year 1956-57; these figures include both domestic and foreign business. See: Report of the Directors and Statement of Accounts, June 30, 1957.

(78) ECGD, Trading Accounts of the Economic Assistance Scheme for the year ended March 31, 1956, in *Trading Accounts and Balance Sheets*, House of Commons Paper No. 18, Session 1956-57.

mechanism of the system and remedied past errors (79): thus the British Government now has at its disposal a tool of international finance not very different in structure from the Export-Import Bank. Should the need be felt for more liberal credits, in case of a widespread recession or of an "economic drive" for political purposes, the Economic Assistance Scheme could be rapidly adapted to the task, a possibility to which the Chancellor of the Exchequer hinted explicitly in his 1958 budget speech.

8. The British Experience, Record and Prospects

We must now try to appraise briefly the attempt of the City of London to solve the problem of medium term credit for export by adapting its existing institutions to the changed conditions. On the whole this has been a remarkably successful experience, even if we cannot yet consider the system fully mature and complete. The relative slowness of the start has been compensated by acquisition of the joint stock banks' support, which at first seemed doubtful and which was of tremendous importance in view of the large resources they could contribute. For all this, the efforts of the merchant banks and the cooperation of the ECGD deserve great credit. One should not underestimate, however, the effort — psychological perhaps more than real — that entrance into the medium term field has implied for the joint stock banks.

Export credits, together with some recent credits for tanker construction, are the only cases in which commercial banks have willingly accepted in their portfolios relatively long term non-negotiable paper. This is not only a break with tradition but also opens up the possibility of truly novel developments, should it be extended to domestic equipment credits. There are other reasons (competition from the so-called "industrial banks" why such an extension is likely; but what should be stressed here is that the experience made with export credits may be the thin edge of a

(79) Sections 2 and 3 of the Export Credits Guarantee Act, 1957. In the debate that preceded approval of the amendments, the Board of Trade came under heavy fire for the form in which operations had been conducted, but not for their substance. The amendments have substantially enhanced the Department's freedom by establishing a procedure whereby losses on interest account can be covered by the Treasury. See: HANSARD, March 20, 1957

wedge opening up the resources of the joint stock banks to wider and new uses.

Once the safety of export credit operations is ensured by an ECGD direct guarantee or regular insurance policy, the banks should not consider medium term credits as very different from their normal advance business. With an average maturity of 5 years, and regular amortization payments, the cash inflow per year would amount to 20% of the total credit outstanding. This represents the leeway that banks would have for reducing their commitments on this account in case of need, and it is doubtful whether domestic advances, nominally repayable on demand, do in fact possess a much greater flexibility.

The record in recent years has shown a rapid growth of medium term export credits: medium term policies issued in 1956-57 more than doubled from the previous year, and the third quarter of 1957 showed a spectacular jump, with 108.5 million pounds worth of new business. The data are subject to great difficulties of interpretation, and an analysis of them is given in a special appendix (Appendix IV). It confirms the impression of an expansion of this form of credit at a satisfactory pace.

We do not yet know whether the resources which commercial banks will consider themselves able to devote to this type of financing will be sufficient in the near future, or whether new ways will have to be sought. It is unlikely that the ECGD "economic assistance" facilities will be expanded except in an emergency or in cases of special political interest; support for a Government-sponsored institution in any other form is also unlikely to be forthcoming. There seems to be some prospect of an attempt on the part of banks to secure larger fixed term deposits, which would allow them to give a greater weight to medium term credits — both domestic and foreign — among their risk assets. Another likely development is the fuller exploitation of the considerable resources accruing to instalment sales finance companies; in Britain these are significantly engaged in the industrial field (hence the name they often take of industrial banks) and some have Commonwealth subsidiaries. For the lighter types of equipment these subsidiaries could provide finance directly to importers and thus obviate the need for export credits; the funds would, however, come largely from Britain in the form of intercompany loans between the parent house and the subsidiaries. Finally, should credit terms be extended beyond the

now customary five years, the banks might succeed in convincing institutional investors to take up the longer maturities. This would be one way of tapping the resources of the capital market without losing the flexibility that is necessary to operations of this sort; the great increase in personal savings in the last few years makes this development all the more desirable and likely.

The cost of export credit facilities has not been a major cause for complaint, and although it is difficult on account of the wide variations to indicate an average, it appears to have been competitive all along, if not with the rates obtaining in France, certainly with those of the German institutions. A fuller commentary can be found in Appendix II.

Finally we have to look at those elements of the picture which most often give cause for criticism on the part of exporters, and which are in urgent need of improvement. The main complaint is the inability of small and medium-sized exporters to obtain the financial facilities they need. When the banker says he will consider the customer's commitments in relation to the latter's capital resources, as under the usual credit systems, he is not particularly mindful of the fact that the objective is the expansion of export trade. He is concerned with the danger that the exporter may be "overtrading", that is, burdening his balance sheet with liabilities falling due for payment in excess of debts becoming due for collection. This danger is almost inevitable when the exporter has to grant deferred payments terms and cannot rely upon a substantial uncommitted equity capital (80). The only solution is an extension of those methods that permit the seller to part altogether with the buyer's notes or bills in exchange for cash (without recourse): the direct guarantee mechanism must be made more accessible and the recent reduction in the minimum size of con-

(80) I owe to the courtesy of Dr. R. F. Henderson of Corpus Christi College, Cambridge, the possibility of examining some of the results of a study he has carried out for the National Institute for Economic and Social Research, on sources and uses of industrial finance in Britain for the 1948-53 period. In a particularly interesting case, that of the electrical engineering industry, we see that net trade credit given (much of which abroad) was 13% of total uses of funds, almost as much as net investment in fixed assets (14%). Net trade credit given accounted for 30% of the growth in net assets of the companies studied. All this gives an idea of the magnitude of the strain which trade credit has put upon the finances of companies engaged significantly in export business. It must also be remembered that this happened in a period when the credit that could be granted abroad was strictly limited by exchange control.

tracts entitled to this facility, from 250,000 to 100,000 pounds, is certainly a step in the right direction.

A similar problem faces contracting engineers, who are often lightly capitalized in relation to the value of contracts they have undertaken and must finance. They must rely to a very large extent on bank credit: when making tenders, they usually require conditional commitments from their banks that, if they are successful, the necessary finance will be forthcoming. These, however, are precisely the type of commitments which banks hesitate to grant, not unreasonably, in view of the fits and starts of monetary policy in recent times (81).

In fact, the future of export credit in Great Britain depends largely on factors of this nature, namely on whether a more satisfactory equilibrium in the balance of payments and a normalization of the credit market can be achieved. Given these preconditions, most of the other difficulties would probably find a solution in the flexible framework of the London market, and would in time disappear.

(81) On this problem see: "New facilities for export finance?", *The Banker*, May 1956, p. 278.

CHAPTER V

MEDIUM TERM EXPORT CREDIT IN FRANCE

1. The Problem and Its Setting

The French system of export financing requires a somewhat different approach from that followed in the previous chapter. What we have here is not a continuous adaptation of existing institutions, but the organization of a coordinated system with some radically new and unorthodox features. Our attention will therefore be focussed first on the economics of medium term credit as practiced in France, and then on the specific organization of such credit for the financing of export contracts. Finally we shall try to indicate how general monetary policy measures and special provisions for export credit have affected the functioning of the mechanism.

The idea that underlies the whole system, that of allowing the banks to "mobilize" their medium term risk assets by means of an organized system of rediscount, has a fairly long history in France. Already in 1931 the Caisse des Dépôts et Consignations (82) could provide rediscount facilities for such paper, and from 1937 onwards the Caisse itself was permitted to rediscount it further, in case of need, at the Bank of France. The insertion of the Crédit National (83) in this framework in 1943 provided further facilities for vetting medium term credits and indirectly widened the circle of business enterprises entitled to use them (84). The postwar years

(82) The Caisse des Dépôts et Consignations is a state institution established in 1816, that manages the surplus funds of savings banks and social security and insurance funds, and acts as a public trustee. Such funds are invested mainly in government- or government-guaranteed securities, in loans to public bodies, and in money market assets.

(83) The Crédit National is a semi-public body established in 1919 whose field of activity is at present mainly long and medium term lending to industry.

(84) I am omitting any mention of direct loans granted by specialized medium term institutions such as the Crédit National, and of medium term loans that were in fact being granted by the banks by means of short term paper renewed periodically; here, however, although the Bank of France did not refuse until 1926 to take such "finance paper", it

saw a further rapid growth of the volume of medium term credit granted for reconstruction and for re-equipment purposes by means of rediscountable paper, to the point where these credits came to account for a very high percentage of all bank credit outstanding (See Table 7). The reasons for this rapid growth lay both in the magnitude of the demand for such facilities, and in the inadequacy of alternative methods of finance. Medium term credits assisted by rediscount facilities were convenient for banks and comparatively cheap for business firms, while individuals were not inclined to make their savings available through the capital market.

The organization of medium term facilities for export finance was first undertaken in March 1950 and has remained substantially unchanged ever since. Shorter term facilities (up to two years) for export financing and for prefinancing were set up earlier and have had a less regular development throughout. Although prefinancing will receive some attention, this chapter is primarily concerned with medium term facilities.

The impulse came, as in other countries, from the realization that payment habits were changing on the international markets under the pressure of the forces we have already discussed. But in the case of France there were two distinctive features. First, the price competitiveness of the mechanical industries was weak, both because of low productivity and because of unrealistic exchange rates, with the consequence that France could not afford to remain behind her competitors in the credit field. Secondly, in prewar days the Paris money market had been largely dependent on the London market as far as international credits were concerned; export paper discounted in the former had often been rediscounted in the latter. And this facility was no longer available in the post-war years.

Following very closely the pattern of domestic medium term credit facilities, export finance for terms exceeding two years came to be organized, schematically, as follows: the exporter could obtain, on the security of his own credit on the buyer, duly insured, an equivalent credit (or rather a slightly smaller one corresponding to the percentage covered by insurance) from his own bank. The

ignored it officially and was not committed to accept it. See P. CAUBOUX, "Medium term lending by the French banks", *Banca Nazionale del Lavoro Quarterly Review*, July 1954, pp. 129-46.

paper thus created and strengthened by the unconditional guarantee of a special institution would be rediscountable by the bank outside ceiling (without that is to say impairing its limited rediscount rights) with the *Crédit National*. This, in turn, could pass it on to the Bank of France.

The objects of this procedure are clear. It is intended to provide the banks with guarantees that ensure both the liquidity and the safety of the paper; to guard against unsound or simply unnecessary operations by having specialized institutions scrutinize various aspects of the transaction before the credit is approved; and to limit recourse to the central bank by interposing a dampening mechanism through the action of the *Crédit National*. We must now look more closely at the system in order to see what is unorthodox about it, and which of its features are most open to criticism.

2. The Implications of the System

The banks that grant the credit to the exporter in the first instance must be given an incentive, if they are to participate in the actual financing of export contracts with long payment terms and not act merely as intermediaries. The incentive might consist in high lending rates or in special privileges for the export paper. In the first case we should have a high cost of credit, which would be in contrast with the ends in view; and the funds made available by the banks would still be limited for liquidity reasons. Under the alternative solution of providing guarantees and rediscount privileges, the paper is made riskless and perfectly liquid, while at the same time the bank is not denied a reasonable consideration for its services. At the time of writing, the rate of return is 1.10% if the paper is rediscounted, and 4.10% if it is "nursed" in the bank's portfolio (see Appendix II for further details).

This type of transaction has one unusual feature from the viewpoint of traditional commercial banking. To the bank, although medium term export paper belongs to the category of risk assets and not to that of investments, the nature of the transaction underlying the credit is more or less indifferent. The bank does not look to the "intrinsic liquidity" (self-liquidating character) of the loan in order to avoid tying up its funds; it looks instead to the "shiftability" of the paper. In fact, as we shall see, medium term

bills are the best of the secondary liquid assets of the bank, since they are not subject to the rediscount ceilings imposed on each bank for most other commercial paper.

The system has another anomalous consequence: although it is nominally the exporter's bank that opens the credit, that bank plays in practice a very limited role in deciding whether the credit should be granted or not, except to the extent that it can always refuse to participate in the transaction. It could hardly be otherwise, considering that the bank is not even compelled to finance a given percentage of the transaction at its own risk and with its own resources (as is often the case in Germany). The scrutiny of the credit application is entrusted therefore to the other actual or potential parties to the transaction, who must concur in its approval. This point will become clearer when we examine the institutional aspects in greater detail.

The really unorthodox feature, however, consists in the monetary implications of this credit technique. In this connection we shall have to consider, together with export credits, the other medium term loans for domestic purposes. We shall group these under the name of "investment credits" (85). The similarities of the two types, and the far greater weight of investment credits, makes it necessary to deal with them together: the effects of export credits cannot be considered in isolation.

Given the perfect liquidity of medium term paper, it must have been clear from the outset that banks would adjust their holdings to their liquidity needs and would be deterred only by controls (and by the risk they must usually bear in the case of investment credits) from creating more paper than they intended to hold. This meant in practice that rediscount facilities would be used in the normal course of medium term business, and also in any other case in which the banks desired to improve their liquidity or make room in their portfolios for other, more profitable loans and investments.

The "screen" that was inserted between the commercial banks and the Bank of France consisted of the requirement that the *Crédit National* in all cases, and the *Caisse des Dépôts* in most cases, should act respectively as first and second rediscounter (before the Bank

(85) They include in fact important credits for construction.

of France) and should "nurse" the paper in their portfolios for as long as possible. It was supposed that in this way direct recourse to creation of central bank money would be reduced and that medium term credits would be financed by a combination of bank credit and savings. The *Crédit National's* own resources came from long term loans and hence were capital market funds, while the *Caisse des Dépôts* could rely on quite substantial savings resources also appropriate for long term financing.

In itself the system was unobjectionable and ingenious, for available resources would have been utilized where they were most needed, with a minimum of inflationary money creation. In practice, however, the system did not make sense unless it was supported by monetary and fiscal policies that would ward off the dangers presented by the huge potential rediscount commitments thus contracted by the Bank of France, commitments which were not subject to ceilings and could not decently be repudiated. The last section of this chapter will deal with the consequences, for the functioning of the system, of the financial policy actually followed by the Government, and will indicate how — contrary to what had been hoped — medium term credit came to be financed largely by central bank money creation.

An analysis of the logic of the system appears to be needed now: although it will be conducted mainly at the theoretical level, I believe it can be of help for appraising the wisdom (or folly) of this particular brand of unorthodoxy. The busy reader, however, would be well advised to skip the next section altogether and proceed to the institutional discussion.

3. Medium Term Credits and Money Creation

The Bank of France undoubtedly knew that part of the paper would eventually be rediscounted: it did not simply take a calculated risk but was confident that the French economy would react favorably to a "shock treatment" like that of pushing investment and exports, even if they had to be financed through money creation.

The orthodox views are no help in judging the wisdom of this philosophy, as the situation was clearly an exceptional one; moreover one cannot even be sure that there is today an orthodox view concerning the relations between inflation and money creation.

Nonetheless a simple concept of inflationary financing might define it as the creation of additional means of payment in excess of what would be absorbed by the growth in real terms of the Gross National Product, by the possible reconstitution of cash balances from what was previously an abnormally low level, by the foreign deficits that the country can afford in view of its exchange reserves and of the international credit it enjoys and, finally, in excess of what can be used to "activate" the private hoards that are being built up in the form of gold or foreign currencies.

Seen from another angle, such financing can be identified as the money creation that will be eventually absorbed by an increase in GNP in money terms only, by balance of payments deficits larger than had been expected, and possibly by an increase in liquidity enforced through rationing and controls. I think this simple concept can be used here, as we have to judge the appropriateness of a policy that happens to be the typical example of inflationary policy, an increase in investment financed by money creation. Unfortunately we cannot hope for a precise answer, but the question whether there was any scope for such a policy must be answered in the affirmative. The leeway the Bank of France could count on, before its monetary financing assumed an inflationary character, was offered by the following factors:

(a) the liquidity of enterprises, which had been drastically reduced in the immediate postwar years, had to be built up, and thus provided a form of savings that could be tapped;

(b) disinvestment vis-à-vis the rest of the world was still possible and current account deficits in the balance of payments would absorb part of the new money;

(c) the public was increasing its gold hoards and, to that extent, the injection of additional money could take place without creating excess demand;

(d) finally, for investment credits, there was the fundamental argument that production would increase rapidly under the stimulus of new investment and that this increase would reabsorb the newly-created money as "transaction balances" (86). For export credits,

(86) This thesis was argued with particular vigor by Jean Monnet, then Commissaire au Plan.

the argument had to be slightly modified so as to allow for the fact that the anti-inflationary effect would come from increased foreign currency earnings and not from increased production. But the substance of the matter was identical if one considered that the expenditure of such earnings abroad would reabsorb the possible excess demand initially created by the new money.

This fourth argument was the only one that related to opportunities offered by more than merely transitory conditions. There is, however, one serious objection to it; namely that the process to which it refers has a time dimension which cannot be ignored. During the gestation period of the new investment or the period preceding reimbursement of the medium term credit granted abroad, the expenditure financed by money creation may have inflationary effects. If the yield of the investment in terms of new production is more than sufficient to pay off the debt, such inflationary effects may be neutralized. There is no such possibility, however, in the case of export credits; here the return in foreign exchange will, for obvious reasons, be identical with the original loan (except for interest). On the basis of these rather schematic lines of reasoning, it must be admitted that exports financed by new money creation will be "per se" an inflationary factor, provided of course there do not exist considerable idle resources.

If we are properly to appreciate the significance of the inflationary effects, we must qualify this conclusion carefully. First of all, the ratio of currency to total money in circulation is much higher in France than, for instance, in the United States (48% instead of 21%) (87), which means that creation of a given amount of central bank money can give rise to multiple expansion of credit by the commercial banks only to a much more limited extent. Secondly, given the fact that a certain rate of money creation by the Bank of France is possible in any case without inflationary effects, there is nothing wrong in using it to finance medium term operations, provided it is kept within well-defined limits. It would be wrong to distinguish between medium term and short term operations from this angle, for credits that are self-liquidating for the single firm may be a permanent fund for the economy as a

(87) Data for February 1957, from *International Financial Statistics*.

whole. The trouble starts when there is no check on the monetization of such credits (88); because the central bank must then be ready to take offsetting measures in case the limits are overstepped, measures that may cause distortions in the credit structure.

There is one final point that deserves attention, namely the effects of this institutional set-up on the ordinary control of credit. Measures directed towards raising interest rates and curtailing bank liquidity are those most seriously affected: high interest rates make it convenient for the banks to reduce their holdings of low yielding medium term paper in order to engage in more profitable business; a liquidity squeeze has very similar effects and may lead to large scale rediscounting. It is also clear that when the average rate of turnover of commercial paper outstanding is decreased by the presence of a large mass of medium term paper, the possibility of reducing credit promptly in case of need is impaired (89).

All this may be dismissed in the case of export credits on the grounds that they have never given rise to a large enough mass of bills to be a serious threat by themselves to the stability of the currency. This is clearly an irrelevant criticism when directed against the *analysis* of the system. Even as a factual statement, however, it is not altogether correct. As a first indication (to be further developed in Appendix IV), we may say that export credits rediscountable outside ceilings amounted to some Frs. 36 billion in short term bills and Frs. 51 billion in medium term bills at the end of 1956. If we now suppose the banks to be holding such bills in their portfolios and to turn them in at the Bank of France at a moment when there is a liquidity squeeze, for instance, the result is a significant volume of money creation. Apart from visualizing such extreme cases, we must keep in mind that export credits have been growing rapidly and that the present amounts may not be a good indication of what can be expected in the future.

(88) Of course there is a check in the French case in the prior authorization to be obtained from the Crédit National and the Bank of France itself. However there is the possibility of sudden "monetization" of paper previously held by the commercial banks in their portfolio, without any limit: now it cannot be expected that the Bank of France will act from the outset as if such credits were all to be monetized at any moment, otherwise it would needlessly limit its own freedom of action in normal times. Hence the problem discussed in the text.

(89) This point is elaborated by J. RUBFF in his introduction to SIMON and PAVÈS, *op. cit.*

4. Prefinancing of Export Orders

Let us now turn to the actual institutional arrangements, beginning with prefinancing. The system dates back to 1944, but has undergone changes from time to time, according to the needs of credit control. It has, however, generally offered, advantages, with respect both to cost (90) and to availability (91), over the alternative form of financing, i.e. an ordinary overdraft. An exporter who has a firm order on his books will ordinarily ask his banker to arrange a "crédit mobilisable", which allows the banker to refinance himself by borrowing against it "en pension" at the "service du marché monétaire" of the Bank of France. In all cases such refinance must at present come under the pre-established ceilings allotted to each bank. The exporter will make out 90 days promissory notes, renewable up to a maximum of two years, to the order of his banker, in accordance with a financing plan which has to be submitted to the Bank of France for prior authorization. The prospectus of expenses and receipts from advance payments has to be examined and possibly revised by the central bank, to prevent the manufacturer from using this cheaper form of financing to satisfy his other credit needs as well (92). This is understandable in view of the fact that prefinancing credits have in general been "easier" and at times cheaper than regular domestic credits, especially when these cannot be obtained in the form of "crédit mobilisable" but only in the form of overdrafts.

The Bank of France also requires a third signature, besides that of the exporter and the endorsement of the bank. This signature is provided by the "aval" of the Banque Française pour le Commerce Extérieur (93). The "aval" is a special form of endor-

(90) The structure of rates is analyzed in Appendix II.

(91) Quite recently, for instance, on the occasion of the imposition of an over all limit on bank credit (Decision of the Conseil National du Crédit of February 7, 1958) banks were permitted to exceed the stated limit to the extent of 3% of the total in the case of credits for prefinancing of export orders and for financing deferred payments.

(92) Recently, however (February 10, 1958), the Bank of France has declared itself willing to grant its authorization on a global basis for each exporter, instead of scrutinizing the single transactions.

(93) The BFCE is a specialized institution set up in 1946 as successor to the Banque Nationale Française du Commerce Extérieur. Its capital is held by the Bank of France, other specialized credit institutions and by the nationalized banks. It can carry out most credit operations in support of foreign trade, but far the most important of its activities is the

sement whereby the repayment of the debt evidenced by the promissory note bearing the aval is guaranteed by the signature of a third party. The signature of the BFCE may be given in the form of a conditional or of an unconditional aval; the latter frees the exporter's bank from all risks. A conditional aval, instead, engages the BFCE towards the Bank of France, and entitles the exporter's bank to rediscount facilities (or access to the "marché monétaire") but leaves with it the risk. Sometimes the aval is conditional for a part of the transaction and unconditional for the rest, and the bank shares the risks with the BFCE in agreed proportions (94). These risks are mostly of a commercial nature, since most other risks can be covered by the various forms of insurance described above (assurance crédit, garantie de prix, garantie "risque de fabrication", garantie de change). They concern the exporter's inability to complete the manufacture and particularly the customer's refusal to accept the goods (the latter is the problem of the "vice caché") (95).

There is a second method whereby the three signatures required by the Bank of France can be secured. The banker may accept a draft drawn on him by the exporter and then discount it with another banker, usually sharing the risk with the latter. This method however — the so-called "acceptations croisées" or cross-acceptances — is today less profitable for the bank (although of identical cost for the exporter) and therefore less widely used. Supposing that the bank takes a 50% share of the risk, the profit on a transaction effected by cross-acceptance is 0.90%, and the profit on one backed by a BFCE aval 1.25%. The banker can in any case protect himself by having his customer assign to him any

guarantee of export and pre-financing paper by means of "avals", as explained in the text. For a full description see: J. BELIN, "Le Financement du commerce extérieur", in *Le Financement des Investissements*, 3rd International Banking Summer School, Paris, 1951, pp. 102-135; and G. GARAGUSO, "Credito speciale ed altre agevolazioni all'esportazione in Francia", *Moneta e Credito*, No. 23, 1953.

(94) For instance, in the case of the largest transaction effected under the system — the prefinancing of the Paz de Rio steel mills in Colombia — the BFCE took a 25% risk share, leaving the rest to the bank consortium that was sponsoring the credit.

(95) Cf. J. CHAINE, *Le crédit à l'exportation et l'assurance crédit*, Paris, Centre d'Etudes Supérieures de Banque, 1950, p. 211 ff. This risk is accepted only to guarantee the liquidity of the paper, and is not a real form of insurance for the exporter, against whom the BFCE retains recourse. This is only natural, as the exporter should not be insured against the consequences of his own acts (in this case failure to comply exactly with the terms of the contract). It is true, however, that the BFCE runs a real risk of loss, in case the exporter is found insolvent when recourse is exercised against him.

payments forthcoming in the future from the foreign buyer, as well as any benefits accruing under one of the possible credit insurance policies that the customer may take out on his own.

Exports to countries within the French Union can be pre-financed by similar techniques but enjoy less favorable rates and are subject to rediscount restrictions similar to those obtaining for domestic credits.

In cases where there are not yet firm orders, but prefinancing is required to begin manufacture or build up stocks for prompt delivery, it is still possible to obtain special credits. These, however, are unsecured credits and carry a higher rate (the difference is now 0.60%); the BFCB does not grant avals in these cases and a cross-endorsement technique is used. They also come under the ordinary credit ceilings and do not in fact differ very much from domestic commercial credits. For us they are not of particular interest as they rarely concern capital goods.

In 1951, when credit control was tightened and rediscount ceilings were imposed on prefinancing credits that had previously been exempt, the Bank of France opened a special rediscount line for financing large contracts from abroad. This line is available to the BFCB for transactions amounting to at least Frs. 300 million (96); in January 1958 it was announced that the previous ceiling of Frs. 15 billion would be raised to 25 billion. The "ligne grands ensembles" thus permitted a continuation of the preferential regime for the most important cases.

5. The Mechanism of Medium Term Export Credit

Short term export credits as usually defined are outside the scope of this study. In France, however, credits of up to two years qualify as short term, although very few cases of export credits for a period between one and two years have in fact occurred. The technique is the same as that used in prefinancing credits: "avals" or cross-acceptances can be used, the latter being the more expensive by 0.10%. The paper created to "mobilize" such credits can be sold outside ceilings to the "service du marché monétaire" of the

(96) Frs. 1 billion until August 29, 1957.

Bank of France; and, at present, the rate applied is a preferential one two full points below the 5% bank rate (97). The total cost of the credit is quite moderate, amounting to 4.50%, inclusive of all commissions.

Medium term credits proper are available for periods of from two to five years; the limit is the general one for the Crédit National's rediscount commitments, and is quite rigidly observed. Where part shipments are foreseen, the five year periods can be staggered so that a longer interval may elapse between the first shipment and the final payment. There is a delicate problem here of deciding when the primary credit can be said to have come into existence. Only from that moment on can the exporter's bank ask for the intervention of the Crédit National, which has to abide strictly by the conditions set out in the credit insurance policy that serves as the main security for the "crédit mobilisable". These conditions ask for the unequivocal acceptance of the goods by the buyer, which may come quite some time after shipment. In certain cases, therefore, special "crédits de relais" have been authorized by the Bank of France to fill the period between the end of the prefinancing credit and the beginning of the medium term credit. The total length of the transaction may thus exceed seven years in certain circumstances.

Before concluding the contract with the foreign buyer, the manufacturer will try to secure the help of his bank in financing the transaction and to obtain from the Compagnie Française d'Assurance pour le Commerce Extérieur (COFACE) comprehensive insurance cover for the credit to be granted abroad. The banker may proceed on his own, or organize a consortium. Should bank assistance be difficult to secure, the exporter can try to obtain direct credit facilities from the BFCB; this is, however, generally unnecessary. The BFCB is instead asked by the banker to provide the third signature in the form of aval. As the commercial credit risks cannot be covered by COFACE for medium term credits, they are apportioned by mutual agreement between the BFCB and the banker (or the consortium). In general, the guarantee of a first-class bank, or even of the Government or the central bank, must be provided in these

(97) In other words, the 3% bank rate that obtained before April 1957 has continued to apply.

cases by the importer. I may add, however, that so far four-fifths or more of the credit outstanding has been granted to foreign governmental bodies, so that the problem of the guarantee against commercial risks has not arisen very frequently. If the BFCE agrees to provide the aval, the banker may then turn to the Crédit National and ask for a commitment to rediscount the paper on demand. The commitment will become effective after acceptance of the goods and may be preceded by a "waiting period" during which the Crédit National, the BFCE and the banker are entitled to small commissions which now total 0.45%.

The actual "mobilization" of the credit on the foreign buyer then follows this course: the exporter makes out to the order of the banker a series of 90 days promissory notes (renewable according to the amortization schedule fixed in the contract) for an amount not exceeding the percentage covered by credit insurance (80-90% of the invoice value of the contract). These "billets de mobilization" are discounted by the banker and provided with the aval of the BFCE which has in the meantime received the following items as security: (a) the credit insurance policy, duly assigned in its favor; (b) documentary evidence that the goods have been accepted in the agreed form; (c) the drafts drawn on and accepted by the foreign buyer, and any bank guarantees by which they may be backed. Should the buyer not have the authority to sign notes or accept drafts, as is the case with many public administrations, the seller will write out "pro-forma" drafts which are sufficient to give the endorsee a prior claim in case of insolvency of the exporter. The drafts or notes are immediately turned over by the BFCE to the Crédit National "in deposit". Thus the banker is guaranteed unconditionally by the BFCE aval; the BFCE can rely on the insurance policy issued by COFACE, if asked to honor its aval; the Crédit National can have recourse to the BFCE; and finally, the Bank of France (in whose portfolio most medium term credit paper is at present held) is abundantly covered by the four signatures which it requires for rediscounting such paper.

The cost to the exporter of a medium term "crédit mobilisable" amounts now to 4.675% for sales to public bodies, and to 5.275% for sales to private buyers; the 0.60% difference is accounted for by the risk quota of the aval commission, generally shared between the BFCE and the banker.

The facilities just described — like those connected with pre-financing — are not available for exports to countries within the French Union.

6. The Role of the Banques d'Affaires

The "mobilisation" mechanism for prefinancing and financing contracts with deferred payment appears so rigidly organized as to give the impression that the functions performed by the banker are merely of a routine nature. Although this may be so in certain simple cases, the truth is in general quite different. French banks, especially the "banques d'affaires" (98) have taken quite an active interest in export credits and have been willing to cooperate very closely with industrial enterprises in developing their foreign business. This activity has of course been facilitated by the fact that financial ties between banques d'affaires and industries are very close, and extend also to stock holding. In some cases, notably that of the Union Européenne Industrielle et Financière, which belongs to the Schneider steel group, the bank may be controlled by industrial interests and act as their financial branch. Besides furthering the business of concerns in which the bank is interested, export credits are quite lucrative by reason of the foreign exchange transactions that are involved and of the commissions which the bank earns on such transactions.

The "Department of Commercial Affairs" of the Banque de Paris et des Pays-Bas has, for instance, been set up specifically to assist in the expansion of exports. It has the task of exploring possible opportunities for large contracts abroad, of conducting the preliminary negotiations, and of assisting the exporter in his contacts with the foreign customer in all details of the transaction, which,

(98) With the reform of the French banking system in 1945 the distinction between deposit banks and banques d'affaires became a matter of law, and limitations on the activities of both categories of establishments were imposed. At present banques d'affaires may engage also in investment banking and industrial finance; they may not accept deposits from the general public but only from enterprises or from private persons whose investment portfolio they manage or for whom they have opened a credit. The deposit banks are dominated by the four nationalized establishments and by two other large banks, and transact a business of the more orthodox short term type. For an enlightening analysis of the structure and functioning of the banking system, see: J.S.G. Wilson, *French Banking Structure and Credit Policy*, London, 1957, particularly Ch. IV. This is the most thorough and up to date work on the subject and should be referred to for a better understanding of the necessarily concise hints given in this text.

when ready for actual financing, is taken over by the Banking Department (99).

A banque d'affaires very often acts as "chef de file" (manager) for the banking syndicate formed to finance the transaction and conducts all the preliminary negotiations with the BFCE and the Crédit National. The organization of a syndicate is desirable in the case of most large contracts since, besides shouldering the residual risks indicated above, the financial sponsors of the transaction often undertake to finance at their own risk the 10-20% which cannot be "mobilized". Sometimes credit is also made available to permit the concession of better payment terms than are allowed by Crédit National rules (100). The syndicate may include both banques d'affaires and deposit banks, although the latter obviously must abstain from the riskier and longer term operations and keep their activities within the system of "crédits mobilisables".

7. An Appraisal of the System's Structure and Performance

The institutional organization of medium term export credit, although it reflects an ingenious attempt to meet a difficult situation, is open to criticism for being excessively cumbersome. However much we appreciate the reasons for desiring thorough scrutiny of the transaction, it is hard to see why, for instance, the guarantee granted by the BFCE in the form of "aval inconditionnel" should not be replaced by a direct guarantee which the COFACE could establish along the lines of the successful British experience in this field and issue as a special endorsement to the standard credit insurance policy. The fourth signature required by the Bank of

(99) Reading through the annual reports of the Banque de Paris, the achievements of this program appear quite impressive, and include the following projects: in 1951 the Paz de Rio steel mills in Colombia, a \$29 million contract, subsequently increased by further extensions; in 1953 the development of harbor facilities and the supply of rolling stock to Chile, ammonia works in Brazil, a sugar refinery in Bolivia, one in Turkey, and cement works also in Turkey. In 1954 the Chimbote steel works (in cooperation with the Corporación Peruana del Santo) and rolling mills in Spain; in 1955 a \$12.5 million contract for special steels in Brazil, an oil refinery in Finland (together with the BFCE) and a sugar refinery in Thailand.

(100) A third related problem is that of financing the local expenditure which the borrowing country may not be able or willing to finance herself: sometimes banks have been willing to help, without official assistance. In all such cases, however, industrial firms with sufficient liquid resources may prefer to contribute part of the finance and earn on their own money the high rates that would otherwise be charged by the banks.

France could instead be provided by having the Crédit National rediscount with the Caisse des Dépôts, as is currently done with domestic investment credits. The COFACE would remain sole judge of the risk aspect, and the Crédit National of the credit aspect. A further important point concerning the monetary aspects of the system may be better presented later on. A simplification of the mechanism might also give broader access to medium term credit facilities, which are at present hardly available for contracts below Frs. 50 million or so.

From the cost angle the system has been satisfactory for the French exporter; foreign competitors, however, consider the rates to be subsidized. This claim is impossible to prove, of course, in a system like the French one where interest rates are agreed upon by the authorities and banks, rather than determined by market forces. It is a fact that the banks' remuneration in this field is lower than in that of investment credit, for instance, and that the commissions charged by the Crédit National are also lower. It is also true, however, that the risks incurred by the credit institutions are significantly lower, thanks to COFACE insurance; if the premiums charged for this were included in the cost of credit, the difference might well disappear. Only recently (September 1957) on the occasion of a bank rate increase, was a preferential discount rate granted by the Bank of France for medium term export finance. Otherwise the central bank's help has been limited to granting the banks access to rediscount facilities outside their ordinary ceilings.

We ought therefore to speak of a system of qualitative controls granting high priority to export credit, rather than of subsidies. In this France has not been alone; but she has gone further than other countries towards making the system practically open-ended. Still, export finance has not been altogether sheltered from the impact of restrictive monetary policies. In particular, prefinancing credits and export credits up to two years have been, since 1944, subjected at times to ceilings and prior authorization, while the rates charged have with few exceptions (101), followed the changes in the Bank of France rediscount rate.

(101) For a precise account of the monetary policy measures that have directly affected export credits, see: "Les avantages spéciaux accordés aux exportateurs, etc.", *Bulletin d'Information et de Documentation de la Banque de Belgique*, June 1953, pp. 374-397, and GARAGUSO, *op. cit.*

An estimate of the quantitative progress of this form of credit is presented in Appendix IV. Here I shall say only that the use of the facilities has been increasing at a rapid rate in the past four years, with the natural development of French export trade in capital goods, brought about by greater competitiveness, and by the expansion of investment in capital-poor countries. Both these factors are likely still to be at work in the future, and they will be reinforced by the effects of the devaluation of the franc on the foreign price of French goods.

If we ask, however, whether the system has worked out according to intentions, the answer must be largely in the negative. The idea was to finance medium term credits (102) mainly out of savings. What actually happened was quite different (see Table 8). The responsibility rests with the government's financial policy and investment programs, often working at cross purposes with monetary policy and neglectful of the balance of payments consequences. On the other hand it has to be added that there is in the system itself a flaw not very different from the conceptual error that marred the Federal Reserve System's early "eligibility approach" for commercial paper. Once the banks are allowed to ease the strain on their resources by rediscounting paper of which they are always likely to have a plentiful supply, rediscount ceilings become much less meaningful as an instrument of quantitative credit control. Also, the selective effects of the system are overshadowed by the fact that it provides the banks with secondary liquid assets expendable for any purpose. The combination of the two factors just indicated has created an unsatisfactory situation in which medium term credits — for investment, construction, export, etc. — are in very large part (83% at the end of 1956) held in the portfolio of the Bank of France.

They actually accounted for 55.7% of the portfolio at the end of 1956 and for 67% in April 1958.

The "monetization" of medium term credits is the result of two successive developments: the early and crucial one was the decision of the Government to have large scale recourse to the Caisse des Dépôts to finance its own deficits. As a consequence

(102) We must again deal with export and investment credits together, as from the point of view of liquidity, they are equivalent for the banks, who do not probably care which they rediscount.

this institution was prevented from "nursing" the medium term paper which came to it through the banks and the Crédit National (103) and had to rediscount most of it at the Bank of France, retaining only a proportion which was already very small in 1954 and 1955 (8.5% and 7.9% respectively of total medium term bills outstanding), and had been reduced to a trifling amount by 1957. The Caisse's resources had in the postwar years risen by some thousand billion francs, so that the obstacle was not on that side. The Crédit National likewise was unable to build up a substantial portfolio of "mobilizable" medium term bills; its holdings never exceeded Frs. 15 billion, or some 2% of the total.

The second decisive development, linked with the first, was the behavior of the banks. They held substantial portfolios of medium term bills but these never exceeded 30% of the total (1953) and never rose above an absolute level of Frs. 226 billion (1955). This meant that they usually rediscounted without delay most of the bills they had discounted for their customers, and kept only what suited their liquidity position. This was a dangerously unstable situation, as the events of 1956 convincingly showed. The banks' cash resources were severely reduced by subscriptions to the National Loan, by tax increases affecting private incomes, and particularly by heavy losses of foreign exchange. The compulsory secondary reserves of Treasury bills were also increased, thus immobilizing further liquid resources. Under these circumstances the banks found it expedient to unload at the Bank of France no less than Frs. 138 billion of medium term paper previously held in their portfolios, while all new credit naturally found its way immediately to the Crédit National and indirectly to the central bank (see Table 9).

Although no details are published on medium term export paper held by the Bank of France, I was able to ascertain that its holdings increased by Frs. 16 billion in 1956. At the time of writing no data for 1957 are available, but evidence I was able to collect confirms the impression that the reduction of the portfolios of "mobilizable" paper held outside the Bank of France continued. Of Frs. 36 billion recorded as outstanding on account of short term

(103) Export paper does not need to go through the Caisse, as it bears the four signatures already at the Crédit National stage, but would be rediscounted at the Caisse if this had sufficient resources.

export credits in the first Census conducted by the "Centrale des Risques" on March 31, 1957, 10 billion were already at the Bank of France at that same date. When rediscount ceilings were lowered by 10% on July 10, an additional 17 billion worth of bills — rediscountable outside ceilings — were turned in for cash; the further reduction of ceilings by 10% on August 10 brought the total in the Bank of France's portfolio to 35 billion, or that is practically the whole of the bills outstanding.

All this points to the conclusion that, while it is very desirable to use short term resources to finance medium term transactions that could not be financed otherwise, it is not desirable to put into the hands of the banks an instrument that may lead to the frustration of quantitative credit controls. The basic condition for improving the system would be for the Government to stop preempting the resources of the Caisse des Dépôts for its own financing. The Government should borrow in the market, if it must borrow at all, or agree with the Bank of France on suitable short term financing for temporary needs. If the resources of the Caisse could thus be released, they should bear the greater part of medium term financing; the banks should do the preparatory work, rediscount immediately a given percentage of the credits, and keep in their portfolios part of the paper, which should not be granted better rediscount conditions than other commercial bills. The present system of ceilings is flexible enough to guarantee that no liquidity embarrassments would come to the banks on account of their medium term portfolios (104). The monetary authorities would thus know at all times what the claims on central bank credits are likely to be and could keep the situation under better control.

(104) See on this point: WILSON, *op. cit.*, Ch. XIII.

CHAPTER VI

MEDIUM TERM EXPORT CREDIT IN GERMANY

1. The Trade Background

Germany's commercial expansion abroad in the postwar years still remains today a controversial subject in spite of the balanced appraisals (105) that have by now appeared. It has often been said that the slow growth of internal demand forced industries to seek abroad outlets for their productive capacity, but the crucial question — whether the German authorities kept down demand by restrictive fiscal and monetary policies precisely with this end in view — has not been answered satisfactorily yet. Similarly, export financing facilities are known to have been somewhat more generous during the years 1949-53 in Germany than in some countries, notably Britain, that are her competitors. Whether these facilities had a strategic role in the expansion of German exports is, however, questionable in view of the continuation of the expansion in the subsequent years, when export credit was no easier in Germany than elsewhere. My aim here is not to debate these questions further, but to evaluate the situation in the field of medium term export credit today: retrospective analysis will be limited to what is strictly necessary for an understanding of the present situation.

Germany's early export credit organization served two purposes: that of giving German goods a competitive edge, and that of developing new markets. The latter function is often forgotten by observers in competing countries, yet it was vitally important in view of Germany's peculiar market situation after many years of absence from the mainstream of international trade. In fact, it has to be recognized that Germany took courageous action in making credit facilities available to countries which her competitors

(105) See particularly: H. C. WALLICH, *Mainsprings of the German Revival*, New Haven, 1955, Chs. 7 and 8, and: Credit Insurance Association, *German Competition*, 2nd ed., London, 1954.

were considering very dubious risks. The difficulty of gaining access to Commonwealth markets pushed Germany to try to develop Latin American and Middle Eastern connections which appeared interesting from the long range viewpoint (106). The success of the German export drive in the direction of Latin America, for instance, was spectacular up until about 1953 when the exchange difficulties of the non-dollar countries slowed down the growth of their imports. By 1953 the trade with the bilateral account countries had become severely unbalanced in Germany's favor, under all but two of the seventeen payments agreements. Swing margins were generally exhausted, and often largely exceeded, so that Germany's position was reversed from a debtor one of DM 111 million at the end of 1951 to a creditor one of DM 895 million at the end of 1953 (the peak was DM 966 million in September 1953).

It was widely realized in Germany that the credits thus granted were in large part being used for long term investment and that this trade technique involved the immobilization of considerable resources. For a country suffering from a severe capital shortage, this was hardly justifiable. A successful effort, therefore, was made to recover the credits and liquidate the agreements as soon as practicable. The case of credits granted through EPU was rather different, as these could be considered a good deal more liquid, in fact they could be regarded as equivalent to foreign exchange reserves, given the prevalence of EPU countries in Germany's foreign trade.

All these credits had been financed by the Bank deutscher Länder through money creation (see Table 10), but as soon as the real nature of such lending became apparent, the Bank made it quite clear that long-term financing was not part of its task and that it expected to be freed from this obligation as soon as other means became available. Its concern for the monetary effects of large scale financing of balance of payments surpluses was at that time allayed by the offsetting budget surpluses, but this concern

(106) A very interesting study by H. MENDERSHAUSEN, "Anglo-German Export Competition", *Review of Economics and Statistics*, August 1952, pp. 262-69, shows that relative substitution has been far more frequent than absolute substitution between the two countries' exports; this lends support to the contention that the German action did not merely result in better payment terms for the importers, but in an actually increased import volume. Data published by the British Engineers' Association for Middle and Far Eastern trade and for European trade also point in the same direction. See: Credit Insurance Association, *op. cit.*

still remained in the background. Yet the BdL could not refuse to bear the burden of export credits for the first few years in view of the precarious state of the balance sheets of the banks. The latter's resources had been cancelled to the extent of 90% or more by the currency reform of June 1948; their rather limited liquidity in the following two years barely allowed them to take care of the most urgent domestic demand for credit, and even this could be done only at the cost of considerable recourse to rediscount facilities. There was no question of their being able to finance foreign trade on any significant scale until much later, except for particular projects which the central bank favored by giving the banks permission to rediscount "Ausgleichsforderungen" (compensation claims received at the time of the currency reform and otherwise illiquid).

2. The Export Financing Facilities of the Bank deutscher Länder

Credits granted under trade and payments agreements are of interest mainly from the commercial policy viewpoint. For us, they are less relevant than the export financing facilities proper which the BdL set up as early as 1948 and developed gradually in the following years. These facilities were of a short term character but are worth mentioning because of the peculiar techniques used for pre-financing credits.

Export drafts (Exporttratten) could be drawn on the foreign customer on the basis of a firm order, then be presented for discount at the exporter's bank before acceptance by the drawee, and be rediscounted subsequently at the central bank (107), regardless of any ceilings imposed for other commercial paper. The Exporttratten could be used for prefinancing for periods up to 90 days (180 for exports to non-European countries); the interesting feature was that they could be rediscounted (from November 1950 until May 1956) at rates identical with those obtaining in the importing country, if these were more favorable than domestic rates, plus a rediscount commission of 0.10%, and an endorsement commission

(107) I shall speak of the "central bank" and the "BdL" to indicate the whole central bank system; in fact, rediscount took place at the single Landeszentralbanken. Since August 1957 the system has been unified into the Deutsche Bundesbank.

for the discounting bank (108). Also, the exporter was covered against exchange risks as the draft was taken for discount at the exchange rate of the day. These three features — rediscount outside ceilings, at a preferential rate, and with cover for exchange risks — account for the popularity of the system, which was used for very substantial amounts up to the time of its discontinuation (see Appendix IV).

Foreign acceptances, which were instead used to finance the post-shipment period, were discountable at the same rates, whether labelled in Deutsche Mark or in a foreign currency. The dovetailing of Exporttratten and acceptances allowed a somewhat longer credit period to be granted than is customary with ordinary short term credit. Above all, they provided a cheap, convenient form of credit favored by what amounted to an open subsidy. The progressive dismantling of export incentives, in response to the growing balance of payments surpluses, led in August 1957 to the discontinuation of the system of Exporttratten, so that prefinancing now receives no better treatment than ordinary commercial credit. Foreign acceptances, on the other hand, lost the advantage of preferential rates in May 1956, and no longer enjoy protection from exchange risks, which must therefore be covered in the forward market: rediscount at the central bank is, however, still possible and is in itself a significant advantage.

The progressive lowering of the BdL rediscount rate since May 1956 has helped to moderate the impact of the end of the preferential rates, but German exporters have protested vigorously against the measures which, in times of high bank rate, say $5\frac{1}{2}\%$, may mean a difference of some 2 to 4% in the cost of credit for exports to countries with traditionally low bank rates. On the other hand, the system had lent itself to abuses, speculative movements of funds, undue exchange losses for the BdL, and discrimination in favor of exporters who could obtain a foreign acceptance as compared with those that were shipping "open account" and had to bear the very high premiums sometimes required for hedg-

(108) The precise provisions, that included a certain differentiation among currency groups and the possibility of obtaining finance at the London rates even for exports to certain other countries, can be found in the booklet: *Möglichkeiten der Exportfinanzierung*, published by the Sddeutsche Bank AG, Frankfurt, 1952. Between May 1956 and their suppression, Exporttratten could be rediscounted at a rate 2% above the ordinary rediscount rate.

ing in the forward exchange market. The latter problem is perhaps less serious now than it once was, since a larger part of trade (now about 50%) is being invoiced in Deutsche Mark without exchange risks.

3. Early Provisions for Medium Term Export Credit

The reasons that weighed with the central bank in favor of granting short term export credit facilities were reinforced in the case of medium term credits (109) by the large and growing share of capital goods in German exports. As early as 1951 machinery, ships and vehicles accounted for 29.6% of total exports from Germany, and by the end of 1956 their share had reached 40.6%. On the other hand, the possibility that banks might help in this field appeared even more limited than in the case of short term credits, in view of the very high cost and limited availability of medium term credit, for which demand was particularly keen. Hence the BdL decided to establish special facilities on a temporary basis.

Specialized institutions for export financing were no novelty in Germany: in the 'twenties the Industriefinanzierungs AG-Ost (Ifago) had been set up to finance trade with the Soviet Union with funds obtained on the money market. At the same time, the Deutsche Golddiskontbank had come into existence, to transact general export credit business, with the assistance of refinancing facilities at the Reichsbank in case money market funds were not available. The Golddiskontbank was particularly important in the 'thirties, when rearmament and public works expenditures had resulted in a very liquid money market (110); after the war there were demands that the institution should be revived, but the basic conditions no longer existed and other ways had to be tried.

At the beginning of 1950 a rediscount line of DM 400 million, based on ERP counterpart funds, was put at the disposal of the Kreditanstalt für Wiederaufbau (Reconstruction Loan Corporation) by the BdL for medium term export financing up to four years.

(109) It is common practice in Germany to consider "langfristig" (long term) any credits above two years; I shall, however, keep to the terminology used thus far and maintain ten years as the upper limit for medium term credit.

(110) For the history of the two institutions just mentioned, see: SHENKMAN, *op. cit.*, pp. 293 ff.

The ceiling was raised to 600 million in May 1951, while a special rediscount line of DM 126 million for export credits to Yugoslavia was added later on in the year and increased to 157 million in the third quarter of 1952. The exporters issued 90-days promissory notes (Sola-Wechsel) renewable for the agreed period, notes which, with the endorsement of the exporter's bank and of the KfW, were taken for rediscount at the central bank. The rate was first fixed at 4% (the ordinary BdL rediscount rate), with a cost to the exporter of 5½%, including endorsement commissions; the 4% rate was maintained for a year after bank rate had been raised to 6% (October 1950), and was then brought in line with the other rates as it became apparent that no bank would hold the bills in its portfolio at the lower rate (111) when more profitable opportunities were at hand.

The task of the KfW in these operations was evidently not very different from that of the Crédit National in France: it consisted mainly in the scrutiny of the soundness of the credit, and the enforcement of the conditions set out jointly with the BdL for the utilization of the same. By the end of 1951 the KfW had entered into commitments for DM 823 million, a sum which was far in excess of the rediscount lines granted originally by the central bank. Hence the latter's decision to make continuation of the system conditional upon an effort on the part of the banks to join in the task of financing with whatever resources they could muster. Evidently the BdL felt that, by that time, the banks' position had consolidated sufficiently to permit them to offer a significant contribution: this was evident from, among other things, the growth in savings deposits that had taken place. Several months of negotiations finally led to the founding of the Ausfuhrkredit A.G. (Export Credit Corporation) on March 28, 1952.

4. The Consortial System of the Ausfuhrkredit A. G.

The Ausfuhrkredit A.G. (AKA) is a non-profit corporation whose capital of DM 20 million (half of it paid up) is held by a bank consortium consisting originally of 28 members, among which are now the three "Grossbanken", some large Regional, State and

(111) See: BdL, *Report for 1952* (English ed.), p. 82.

Local Banks, and the leading private bankers. The funds at the disposal of AKA come from two credit lines of different origin, the so-called "A line" and "B line".

The A line is made up of a credit line of DM 270 million extended by the members of the consortium and equivalent to 3% of the savings deposits held by them on September 31, 1951 plus the quotas financed by the exporters' banks (112). These funds represent AKA's additional contribution to the previously existing facilities and may, in case of need, be supplemented by "Lombard loans" at the central bank on the security of the export paper discounted by AKA, at a rate 1% above bank rate.

The B line is simply the rediscount line at the BdL formerly at the disposal of the Kreditanstalt für Wiederaufbau; it was taken over by AKA to ensure the consistency of export credit policy and now has a ceiling of DM 500 million, having been reduced from the original 600 million in early 1957.

In addition, AKA managed between 1953 and 1957 a special credit line, the "PJ line", put at its disposal by a consortium of Girozentralen (central institutions of the savings banks) to finance export contracts concluded with Yugoslavia in 1952, and payment for which had had to be postponed until 1956-57. The PJ line, originally of DM 58 million, was a purely temporary facility and was scheduled to be reimbursed completely by January 10, 1958.

The credit period may now vary for both lines between 12 and 48 months (113): for the A line, however, the credit period dates from the first utilization of the funds (provided there is no more than a year's lag between the credit agreement and the utilization of the funds), so that it can in fact attain a maximum of five years. The possibility of obtaining an advance commitment from AKA that credit will be forthcoming after the conclusion of a contract under negotiation enables the exporter, by careful planning, to make the most of the limited credit that is allowed to him. These commitments (Finanzierungszusagen) may be obtained in a binding form, involving reservation of the necessary funds on the A- or B-line, for a quarterly fee of ½⁰/₁₀₀ for each of the first two 3-months

(112) These quotas (Vorwegquoten) were fixed in 1954 by agreement among the consortial banks at 25% for credits up to two years and at 40% for longer credits.

(113) Decision of Zentralbankrat, February 6, 1957. Two-thirds of the B line were originally reserved for credits of between 6 and 24 months.

periods, of $1^0/00$ for the third 3-months period, $2^0/00$ for the fourth one, and $2\frac{1}{2}^0/00$ for each period thereafter. As it has been the experience of AKA that many of the commitments never become effective, owing to the exporter's failure to conclude the contract, the consortial banks have authorized AKA to engage the A-line up to a maximum of DM 400 million ($1\frac{1}{2}$ times the funds actually available) so that merely potential engagements should not prevent the financing of contracts already concluded.

The quota financed by AKA may not exceed 80% of invoice value (A line) or 60% for credits financed on the B line. The funds are advanced according to the rhythm of expenditures and of incoming payments, at a rate designed to prevent the self-financing quota of the exporter from falling below 20% and 40% respectively.

Credits of over two years' duration must be generally covered by Hermes insurance (114) and the exporter is asked to assign his rights under the policy, his claims on the buyer, and any other security he may have obtained from the latter or from a third guarantor.

Further security may be asked by AKA at its discretion, and the authorization of the Bundesbank is needed for B line credits if the invoice value is in excess of DM 1 million (formerly 5 million).

The cost of the facilities available on the two credit lines generally differs by 2%: the rate fixed for the B line is $1\frac{1}{2}\%$ above the Bundesbank rediscount rate, and the bank consortium, although not tied to a particular directive, has lately maintained the cost of its own credits at $3\frac{1}{2}\%$ above the same rate. The actual rates applied so far and an analysis of their structure appear in Appendix II: for the A line the rate has varied between $6\frac{3}{4}\%$ and 9% for the B line between $4\frac{1}{2}\%$ and 7%, including all commissions.

The difference in cost would seem to mean that it is a matter of some importance for the borrower on which credit line the transaction is financed. This is decided by the Credit Committee of AKA, which scrutinizes the application presented by the exporter through his bank: the latter may only suggest that A or B facilities should be used. AKA must remain the final judge, not only in order to ensure the proper utilization of the two lines, but also

(114) The insurance against commercial risks may exceptionally be waived.

because the exporters' banks, that must finance at their own risk any credit granted on the B line, might tend to suggest the A line for the less attractive propositions. It is, however, not necessarily true that B line credits result in lower interest costs: in fact, the obligation on the exporter to finance out of his own funds (or with ordinary bank credit) 40% of the invoice value, instead of 20% as required for the A line, makes today the preferability of B line credits questionable.

AKA credits serve in principle both for prefinancing and for granting deferred payment terms to the foreign buyer: the exporter must prepare a plan showing the funds he will gradually need to finance production, the schedule of amortization agreed upon with the buyer, and the credit needs resulting, during the development of the transaction, from the difference between advance payments and total costs (overheads are imputed "pro rata") (115).

The plan is presented for approval through the exporter's bank to AKA: once the credit has been assigned to one of the two lines, the bank is notified and the "mobilization" can take place. The form used for "mobilization" is one peculiar to German banking practice, the "eigentrassierter Wechsel", a bill of exchange drawn by the exporter on himself and provided with his own acceptance; the bill has a usance of 90 days, but is renewable for the whole of the agreed period.

If the credit has been granted on the A line, the exporter may himself present the bill (drawn to the order of AKA) to AKA for discounting: the first endorser — and therefore the risk bearer — is AKA, to which the bank that happens to rediscount the paper

(115) The following prospectus presents the development of a credit operation carried out by AKA out of A line funds. The example assumes an order of DM 100,000 with the following payment conditions: 20% with order, 30% cash against documents, 25% six months after delivery, and the remaining 25% six months later. The manufacturing period is assumed to last six months.

(thousands of DM)

Months after conclusion of the contract	1	2	3	4	5	6	12	18	
Direct costs plus overheads and profit apportioned pro quota	30	20	20	20	10				= 100
Self-financing quota: 20%	6	4	4	4	2				= 20
Part payments by foreign buyer	20						30	25	25 = 100
Disbursement of AKA credit (Costs-20% quota-part payments)	4	16	16	16	8				= 60
AKA credit outstanding at end of period	4	20	36	52	60	30	5	—	

according to the terms of the consortial agreement has full right of recourse. Credits assigned to the B line must instead be assisted by a guarantee of the exporter's bank which strengthens the endorsement of AKA in case the paper is presented by the bank for rediscount. AKA itself does not keep in its portfolio the rediscounted B line bills but tries to place them in the money market if possible, or else turns them over to the Bundesbank for rediscount.

For the banks, therefore, the paper created in the two cases has profoundly different characteristics. When the paper "mobilizes" credits on the A line, it is practically riskless, because of AKA's previous endorsement, but illiquid, except for the possibility of Lombard loans at the central bank; it is taken from AKA and kept in the banks' portfolios only to the extent of the consortial commitments and earns for them a higher rate. Paper originating from B line credits is by contrast perfectly liquid — it can be rediscounted at the Bundesbank, through AKA, at any moment — but is only assisted by Hermes insurance, if insurance is required at all, the bank remaining exposed to recourse by the holder of the paper (if it has been rediscounted) or to outright loss in case of default by the exporter. In spite of the lower rate that this paper earns, it is a coveted asset because of its perfect liquidity. The Bundesbank is, for this same reason, exposed to sudden large scale calls on its rediscount facilities, should the conditions of the money market drastically alter, but the limits imposed on its potential commitments permit it to look to this eventuality without concern for monetary stability.

To conclude this brief survey of the mechanics of the system (116), we may consider the character of the AKA credits from the exporter's viewpoint. For him they are not different from ordinary commercial credits except for the somewhat lower cost and for the protection afforded by Hermes insurance. The financing institution has full recourse to him — insofar as the loss is not covered by insurance — in the particularly direct form allowed by the bill of exchange law of most European countries: the credit is a direct obligation of the exporter and not a contingent liability,

(116) A full account of the formalities necessary for the processing of the applications, the renewal of the bills, the payment of commissions, etc. can be found in the booklet published by AKA itself, *Kreditrichtlinien für die Finanzierung mittel- und langfristiger Exportgeschäfte*, Frankfurt, March 1, 1957.

and thus worsens the structure of his balance sheet. This has been a major cause for complaint among exporters, as they would much rather be able to discount the drafts drawn on the buyer than appear themselves as credit-takers. In the particular conditions of postwar Germany, where industry had had to run into debt to the banks for the finance of investment, this additional balance sheet burden is justly resented. Finally, the exporter is fully exposed to the exchange risk, unless he can invoice in Deutsche Mark.

5. The Record of the Ausfuhrkredit A. G.

AKA has offered in its annual reports a wealth of statistical information such as we do not possess for any comparable institution: this is presented extensively in Appendix IV, and I shall try here only to comment on the main points. The data present the record of AKA as of December 31, 1957; the sum of the credits granted during the six years of its activity amounted to DM 2,868 million for all three credit lines, A, B and PJ together. The three lines accounted respectively for DM 429 million, 2,195 million, and 43 million. These credits had financed export orders of the total invoice value of DM 6,409: the discrepancy between the two figures — credit granted and invoice value of the exports — is due partly to the self-financing quota left to the exporter, and partly to the fact that the credit granted to the buyer, even at its peak (which usually comes at the time of shipment of the goods), may fall considerably short of the invoice value, on account of prepayments and partial payments during the development of the transaction (see the prospectus in footnote 115 above).

To judge the extent to which the funds available on the credit lines were committed, we must take contracts in course of development at year-end: these amounted to DM 217 million for the A line, 358 million for the B line, and 0.9 million for the PJ line, a total of 576 million. To these must be added advance commitments (*Finanzierungszusagen*) of DM 99 million for the A line and DM 103 million for the B line.

The situation at the end of 1957 is not quite representative, however, of the conditions that had obtained in previous years, since the B line engagements had at that time been reduced to the new ceiling of DM 500 million, according to the directives of the

BdL. In general, both the A and the B lines have been committed fully, or nearly so, during the whole existence of AKA. This does not mean that credit actually outstanding has at any time reached 270 million and 600 million respectively for the two main lines. Even after a credit contract has begun to run its course, the funds may be drawn on only gradually, as needed (thus paying a minimal commitment charge instead of the full rate on the credit still to be utilized) according to the financing plan. Yet credit ceilings are blocked to the full extent of the contracts concluded (even if not utilized) and also of the binding advance commitments, as far as the B line is concerned.

One cannot help feeling that a more economic exploitation of the limited funds available to AKA would be possible. The first step in this direction might be the extension to the B line of the permission, obtained for the A line, to grant advance commitments in excess of the ceiling, with the understanding that actual credit will nevertheless be kept within the given limits. Secondly — and this would be a more important and more radical modification of the present set up — AKA credits could be reserved for the financing of the credit period proper, after shipment of the goods, while prefinancing could be left to the ordinary banking system which, thanks to the security provided by Hermes insurance, could still offer better conditions for this than for normal commercial credits. Provision could be made for help from AKA even for prefinancing, in cases with which the banks might be reluctant to deal at their own risk: such help might take the form, for instance, of a direct guarantee of the credit, without engaging the A or the B line.

The geographical pattern of the credits at the end of 1957 showed a share of more than 50% for European countries: the European share, after a peak in 1954, seems however to be declining. Latin America, which took more than 30% of the early credits, thanks particularly to large orders for tractors and trolley-buses from Argentina, has also decreased in importance; it now accounts for only 15.5% of credit outstanding. The share of Asia (now 24.8%), has instead shown a steady increase.

A detailed breakdown by industry appears in Appendix IV. Here I need only point out that over 85% of the credit outstanding at the end of 1957 had been devoted to the financing of capital goods exports. The average size of the credits varied from DM 1.8 million for the A line, to DM 0.9 million for the B line.

It is interesting also to note that 64% of the credits were to run for periods longer than two years, and of these, most were probably for the full four years allowed as a maximum. Finally, the data show that 96% of the total was being used by large firms — with a turnover exceeding DM 15 million; this is not surprising in view of the structure of the capital goods industries.

6. Participation of Banks and Industry in Export Finance

The facilities amounting to 3% of savings deposits put at the disposal of AKA by the main credit institutions for the A line, represent by no means the only contribution of the German banking system to medium term export finance. This fact is evident from the accounts of AKA itself. Credits granted on the B line and the PJ line may be rediscounted at any moment by the exporter's bank with the endorsement of AKA, but when they are not thus rediscounted, the bank is financing the exporter with its own funds. While in 1952 more than 65% of the B line credits were rediscounted to ease the banks' cash position, by 1957 the percentage had dropped to only 5%. Further, the larger part of this 5% was placed by AKA in the money market — in practice with banks other than the presenting bank — and the rediscount facilities of the BdL were used only to a negligible extent. Thus the banks were contributing to the tune of over DM 550 million to the financing of the AKA credits that were actually outstanding at the end of 1957.

A further call on the resources of the banks often comes from the industries that have been granted an AKA credit and need help to finance the 20% or 40% quota of the contract not taken up by AKA itself. Should a large part of such quotas be financed indirectly through the banks — by means of ordinary medium or short term loans — we might have an additional DM 200 million or so of commitments in support of exports.

Even so we are probably far from having included all the bank resources used to finance exports with deferred payment terms exceeding one year. Direct inquiries among responsible representatives of German industry have convinced me that a very substantial amount of credit is being granted *outside* the AKA system, for transactions with terms that do not much exceed two years: in

fact, the majority of such transactions is probably refinanced by industry directly with ordinary commercial banks.

Indirect evidence of this comes from occasional announcements concerning the settlement of commercial debts owed Germany: the Argentine settlement revealed that in August 1957 private claims of exporters with payment terms exceeding one year were about DM 550 million (117). Of these AKA was certainly financing not more than DM 95 million (the total credit outstanding at the end of 1956 on South America) and probably a good deal less (considering the importance of Brazil and other countries). Therefore industry and banks together had committed some DM 500 million in Argentina alone. Of course much of this sum consisted of debts that should already have been regularly amortized, but the figure is striking nevertheless as an index of the willingness of German exporters to make sacrifices in order to retain their hold on an important market. The moratorium granted to India at the end of 1957 has also revealed credits of a staggering magnitude — over DM 570 million — of which, however, a large part is accounted for by a steel mill financed through channels we shall discuss later on (118).

How much of all this is bank credit, direct or indirect, and how much comes instead from industry's own resources, is impossible to say. Certainly, however, the liquidity position of industry has not been brilliant in the postwar years, and it is hard to believe that exporting firms can have devoted very substantial resources to financing deferred payments without at the same time increasing their indebtedness towards the banks. This may not be true for certain important groups, such as Krupp and Demag, with exceptional resources: these have been known to engage in transactions which actually involved a combination of credit and share subscription, and which tied up substantial funds for long periods. The terms of such contracts, however, have been misquoted so often that it is hard to know exactly what the true amounts involved are (119).

(117) *Frankfurter Allgemeine Zeitung*, August 5, 1957.

(118) *The Financial Times*, November 16, 1957.

(119) The cases I refer to include the steel mill at Rourkela, India, mentioned above, and a further steel mill to be built in Iran, both of which benefit from financial assistance from Krupp and Demag and from the Kreditanstalt für Wiederaufbau (see below). A similar contract concerns the development of mineral resources in Greece.

We must now ask why the German banking system came to commit such substantial resources to export credit finance on its own, and how it was able to do so. The first question can be answered only with reference to the general development of German foreign trade after 1953: the refusal of the BdL to accumulate further bilateral claims, plus the increasing unbalance between import capacity and import programs in a number of countries that are potentially interesting customers for the German capital goods industries have had the consequence of shifting an undiminished burden of export financing to private lenders. Given the well-known links between banks and industry, and the huge credit needs of the latter for investment and for working capital, the task of providing the additional resources naturally fell on the banking system.

The reason why the banks have not chosen to provide them by increasing the rediscount facilities granted to AKA — the A line — is probably that this method has largely outlived its usefulness. The consortial guarantee which the banks obtain through the AKA system is probably thought unnecessary in many cases in which there is Hermes insurance, or at least not worth the difference in rates compared with what they can earn by lending on their own. Also, a major justification of AKA, the pooling of scarce personnel with wide experience of foreign trade financing, is by now no longer relevant, after the reconstitution of the "Grossbanken". Finally, an increase of the A line would represent a firm commitment which some or most of the participants would not willingly take on, in view of the variable money market conditions.

This brings us to the second point, the enabling factors. Here we cannot, certainly, attempt to review the complex situation of the money and capital markets in postwar Germany (120); we shall only indicate briefly what it is that has permitted the banks to engage in substantial lending on medium term. The steady growth in "Geldkapital" — savings and fixed term deposits, bank bonds, and special funds lent by Governmental bodies — has provided the banks with a mass of resources that could be considered less volatile than ordinary sight deposits. The commercial banks proper have

(120) For a penetrating analysis of these, see: H. C. WALLICH, *op. cit.*, pp. 178 ff.; an interesting comparative study is that of A. BOCCON-GIBOD, "Structures bancaires comparées en France, en Grande Bretagne et en Allemagne Occidentale", *Banque*, July 1954, pp. 434-8.

benefitted by these perhaps less than the savings banks, but have nevertheless achieved a liabilities structure in which such resources represent some 65% of the total (Table 11). This does not mean that the banks could therefore engage in medium and long term lending to an equivalent extent in perfect safety: the possibility of a withdrawal of savings and fixed term deposits as a consequence of a balance of payments drain or an increased preference for other assets is not to be dismissed lightly. Even though in the latter case the banks could recoup the deposits in other forms (and not forgetting that the extensive branch system of the Grossbanken protects them against sudden redistributions of funds), very definite limits appear to exist for the longer term engagements they can afford. It is particularly relevant to mention that among the causes of the accumulation of "Geldkapital" have figured prominently in the past the surplus in the Federal Government budget and the virtual discrimination of German tax laws against the securities market. Therefore, the long term growth of the banks' resources and their ability to extend medium term credit, is likely to be unfavorably affected by the prospective cash deficits in the budget, under the impact of rearmament expenditure, and by the improved status of shares and bonds under the new legislation now being prepared.

There is a further source of funds on which German commercial banks have been able to draw, especially with the great improvement in their international status that attended the return to the scene of such names as those of the Deutsche Bank, the Dresdner Bank and the Commerz-Bank group, formerly split up in a number of successor institutions. This source consists of various forms of refinancing credit taken up for the benefit of German exporters and importers in Switzerland, the United States, Great Britain, and even France. These facilities are in principle of a short term character (up to 180 days) and it is impossible to know to what extent they are actually used on a medium term basis through renewal of acceptances or in some other form, such as the utilization of credit lines from United States and Swiss banks (121). It must be remembered that such practices were quite common in

(121) In fact, even their total amount is quite difficult to ascertain: the Bundesbank report for November 1957 mentions explicitly DM 748 million of reimbursement credits for the peak of September 1957. This is probably only a part of the total refinancing facilities used.

pre-1931 days, when German banks made use of the credit they enjoyed abroad to secure for their customers convenient bank accommodation for which they lent their own names.

In spite of the publicity which German unorthodoxy in the banking field has received abroad, it cannot be said that, even with the banks' willingness to help, a satisfactory solution to the financial problems of the export trade in capital goods has yet been found. The insecurity of the present arrangements, as regards both cost and availability of credit, needs no further comment: what does still need to be stressed is that the demand for credits for periods longer than two or three years cannot be satisfied through these channels unless the exporters are ready to run very high liquidity risks by "borrowing short and lending long". AKA is not sufficiently equipped to take care of the credit demand entailed by the growing volume of German exports. In fact, as regards credit length, AKA cannot match the facilities offered in Britain and in France: the exporter cannot in practice grant the theoretical maximum five-year credit to the customer if it takes him any considerable time to prepare the goods for shipment and, even if he could, he would have to wait a full year for his money, which is no small inconvenience to him.

7. Special Facilities and Proposals for Reform

The German Government has not been unsympathetic towards the exporters' demand for facilities permitting the provision of longer credit in the case of transactions of special significance from the viewpoint of commercial policy. The institution chosen to help in this task has again been the Kreditanstalt für Wiederaufbau. This choice was made necessary by the problems peculiar to relatively long term (eight years or so) export finance, problems which AKA would have been unable to face. The funds obtained on long term by the lending institution must be promptly re-lent so that the interest due on the loan may be earned from the very start: but such a swift sequence is particularly difficult to achieve with export finance, where the exporter needs a promise of credit at the moment he starts negotiating with the foreign customer, but may not actually use the credit until one or two years later. The credit institution must therefore have a broadly based general business in

which the funds borrowed for eventual use in export finance may find a temporary remunerative employment. For this the KfW was uniquely well equipped and it already had experience in export finance besides.

In 1953 the KfW had only retained the administration of the rediscount line granted by the BdL for the financing of business with Yugoslavia, which is still currently being used. During 1954 DM 100 million were earmarked by the ERP Special Fund out of interest and amortization payments expected to accrue in 1958 and 1959. These could be used to finance the later maturities of three large credits granted for a period of eight years on the occasion of important contracts obtained by Krupp and by the Bochumer Verein for a steel mill in India and other business in Pakistan. These credits amounted to a total of DM 79.5 million (122).

By the end of 1956 the KfW had also been able to grant credits to a total of DM 144 million out of funds which institutional investors had agreed to put at its disposal at a cost of $5\frac{1}{2}\%$. Here too it was possible to enter into commitments for the future use of funds due to come back later from past lendings; thus the contracts approved were to be financed at the outset with ordinary bank credit and only later taken over by the KfW. The cost to the exporter is in the neighborhood of 7% and the utilization of the credits takes place through techniques similar in those of AKA (i.e. with the endorsement of the exporter's bank on "eigentrassierte Wechsel"). Recently, however, fiscal reasons have made it advisable to use ordinary advance techniques for some of the loans.

The KfW has also been able to obtain funds from various sources to provide a credit line of DM 150 million for exports to Turkey under an agreement concluded in December 1954 between the two countries. These facilities had been used only to the extent of DM 59.4 million by the end of 1956; this low figure reflected the peculiar difficulties of the Turkish trade situation.

Altogether, the KfW had provided by the close of its 1956 financial year lines of credit for a total of DM 483 million, of which about 385 million had already been used; they represented a very sizable addition to the resources available in Germany for export financing.

(122) See the *Annual Reports* of the Kreditanstalt für Wiederaufbau, 1953 to 1956.

There are signs, however, that the role of the KfW may become even more significant in the future. In April 1958 an interesting experiment has been launched with the issue of medium term securities by the KfW, which thus hopes to increase the scope of its export financing facilities. The formula is a new one for postwar Germany: three year bonds, restricted to bank purchasers (and to that extent a real money market security), redeemable at par on maturity but accepted for repurchase also at any time before maturity.

The bonds will bear interest at $4\frac{3}{4}\%$, which — considering the issue price of 98 — gives an effective yield of $5\frac{1}{2}\%$ approximately. This is quite favorable for the KfW, since the current yield for comparable government securities is now $4\frac{3}{4}\%$. The bonds are also eligible for Lombard loans at the Bundesbank and possess therefore maximum liquidity.

The first lot placed in the market has been of DM 75-80 million, but the issue will total 250 million. The funds obtained in this way will help in the first place to finance the steel mills being delivered to India. If the market will respond favorably to the experiment, the new facilities will probably have a revolving character, although the specific conditions of issue of the bonds — and therefore of the credit offered to exporters — will vary with the state of the money market. It is interesting to note that even on this occasion the flexibility and the easier conditions of the money market have provided sufficiently convincing arguments to induce the KfW to forego the many advantages which recourse to the long term capital market might have offered. This is a central theme in the history of export credit in Germany and it can be said that almost all proposals for reform have aimed at putting medium term export finance on a more stable basis by securing better refinancing conditions for the specialized institutions.

The most vigorous campaign for better facilities has been conducted by the Confederation of German Industries (Bundesverband der deutschen Industrie), whose 1956 memorandum to the Government proposed the creation of an institution modelled on the Export-Import Bank of Washington to grant credit for periods of over five years. Credit should be available from the new institution only for the period after shipment; its funds should be raised on the capital market by the issue of bonds with special features as to interest and safety designed to make them attractive. I have already

discussed the difficulties presented by schemes of this sort; in this particular case they were multiplied by the weakness of the capital market, and the project was never carried out. Recently, the Bundesverband der deutschen Industrie has advanced a less ambitious proposal (the first one envisaged a fund of DM 600 million) which is substantially a request for an extension of the KfW's activity through the allocation of an additional DM 300 million in ERP counterpart funds for the support of capital goods export activities. With demand from overseas apparently declining and with rising political preoccupations on account of Soviet economic penetration in the Middle and Far East, this proposal stands a fair chance of being implemented (123).

Finally I should mention a third proposal, presented in January 1957 by the then Vice-Chancellor Blucher, which aimed at supplementing the AKA facilities with one further credit line of DM 300 million for longer credits. The idea was to grant special guarantees from the Finance Ministry or from Hermes for these credits, and to split projects requiring longer-term finance into several short term projects that could be financed in the money market. The scheme appears, however, not to have been caferully thought through in the light of the dangers presented by the ever-changing conditions on the money market. It met with severe criticism, particularly on the part of banks, and never received serious official support.

(123) See particularly the 1956 report of the BdL, p. 109, its Memorandum of February 1956, "Möglichkeiten der Exportfinanzierung" and, for the latest proposal, *Frankfurter Allgemeine Zeitung*, December 12, 1957.

CHAPTER VII

POTENTIALITIES AND PROSPECTS

1. Long Term and Medium Term Loan Capital

Although the forms of financing which I have been examining appeared at the outset as emergency expedients, it can be assumed by now that they are here to stay. A significant revival of the traditional flow of loan capital towards countries in process of industrialization — with the exception of a few Commonwealth countries — is an unlikely development. In addition to the increasing awareness of the risks involved, two other factors seem to militate against this possibility. The channeling of a large share of total investment into fixed interest securities through institutional investors, now generally subject to legal restrictions in the selection of their portfolios, means that individuals' savings will not be able to play a large role in this field. On the other hand, European governments appear inclined to permit only such capital exports as are considered expedient in the national interest — both for political reasons and as a means of increasing employment. This tendency is not altogether new: even at the height of foreign lending in Great Britain there remained an undercurrent of feeling that capital could have benefitted national welfare more if it had been invested at home rather than abroad, or if it had at least served as a direct stimulant for the country's exports (124). The Macmillan Report expressed this feeling in clear terms by stressing that it would be more desirable, in the future, for Britain to invest abroad in enterprises which were "tied" to her, and not in bonds which "absorb our available foreign balance while doing little for our industry and commerce" (125).

(124) See on this point: J. Viner, "International finance in the postwar world", *Journal of Political Economy*, April 1947, pp. 97-107; A. K. Cairncross, *Home and Foreign Investment, 1870-1913*, Cambridge, 1953, Ch. 9.

(125) Cmd. 3897, p. 165.

Such pronouncements contained a fallacious element insofar as the objection to loans abroad was that they did not promote British exports. Sometimes, however, more than a grain of truth could be found in two other arguments: first, that the return on foreign loans — the *private* marginal product of the capital invested — might easily be inferior to the *social* marginal product obtainable from home investment; second, that the exports induced by foreign lending were not necessarily demanded at the time and in the forms which were most advantageous to the lending country.

These objections lose much of their validity in the case of medium term credit extended abroad. The investment in the revolving fund needed to finance exports is evidently not made for the sake of the interest it yields: its results are instead to be measured in terms of the advantages which the exporting industries and the rest of the economy derive from it, through the expansion and the stabilization of sales abroad. From this viewpoint, this method of finance is superior to the traditional loans and direct investments, because of the comparatively fast turnover of capital employed in granting medium term credit. In the face of political difficulties and of the suspicion in which foreign capital is often held, direct investment itself seems to be gradually giving way to new forms which stress the trade aspect and reduce to a minimum the actual investment of capital. These forms combine technical assistance during the planning and construction stages and the instruction of local management in the operation of the new production facilities, with financial assistance through medium term credit for the importation of capital equipment. Even when limited participation in the form of shareholding is accepted (126), the investor is certainly more interested in the complementary trade advantages than in the dividend income he may eventually earn.

Even more important perhaps is the fact that medium term credit leaves the lending country more or less in control of the nature and the timing of the exports it finances: this is of course not necessarily the case with ordinary loans. The cyclically stabilizing effects of export credits — the problem of timing — will be considered in the next section of this chapter. Here I shall only point out that export credits offer interesting possibilities for the

(126) As German firms are reported to have done in the case of large contracts for the construction of steel mills in India and Iran.

selective encouragement of exports that appear particularly desirable for the economy on account of their high labor content, low import content, the existence of unused productive capacity in particular manufacturing fields, etc.

Considering their wider implications, we see that international capital movements in the form of medium term export credits also have interesting peculiarities concerning the relations between lending and borrowing countries. Credits allowed for relatively short periods of time have the important advantage of permitting the lender to follow closely the economic and financial policies of the borrower, and to modify his own lending accordingly. Thus "good debtor policies" are likely to carry their own reward in the form of a steady and increasing inflow of foreign capital; actually, a good record in medium term indebtedness may also have favorable effects on the willingness of foreign countries to lend on longer terms.

It has been objected that the availability of suppliers' credit encourages overborrowing and ultimately has harmful effects on the borrower's situation. The case, however, offers a close parallel to that of domestic instalment credit. For the reasons stated in the preceding paragraph, and on the basis of experience in the domestic field, we can be confident that increased borrowing will generally be matched by more careful budgeting of foreign exchange resources, by the establishment of stricter priorities, and eventually by increased savings.

This must not be taken to mean that medium term credit is a satisfactory alternative to long term capital movements under all circumstances. During the so-called pre-industrialization period, the balance of payments of the borrowing country will not generally be able to bear the burden of amortizing rapidly whatever foreign loans are forthcoming. Hence these loans ought to be obtained for longer terms than are customary for suppliers' credit. Only at the end of the gestation period of the basic investments, when the economy appears to have begun a process of sustained growth, can medium term credit perform a useful function by quickening the pace of growth itself.

As was pointed out in Chapter II, the appropriateness of medium term financing should be determined with reference to the balance of payments aspects of the growth process, and not to the rate of turnover of capital in particular investments. The relationship between medium- and long-term capital is therefore one of comple-

mentarity, not of competitiveness. An inflow of foreign long term capital will make it possible for the balance of payments of the developing country to withstand the initial stresses; the availability of suppliers' credit, on the other hand, will stimulate investment and with its more stringent repayment terms will put pressure on the country to plan carefully for best possible utilization of the resources obtained from abroad.

2. Cyclical Problems of Export Credits: their Use as an Instrument of Economic Stabilization

The problem of whether suppliers' credit is a good way of financing the industrialization of less developed countries must also be looked at from the cyclical point of view. The instability of export credits has been particularly stressed: "the exporting countries may experience payments difficulties that force them to insist on cash payment... or a boom in the world or home market may make it possible to sell for cash and reduce the need to extend credit. There is the risk... that the borrower may have raised his rate of investment only to find that he must later make perhaps a drastic cutback" (127). The point is, in other words, that export credit is subject to fluctuations determined by conditions in the lending countries. While this point may be granted in principle, it does not appear to me to constitute a case against the use of medium term credit in international trade.

In the first place, such fluctuations are often due to changes in the availability of exportable capital goods, and not of credit, when a domestic investment boom is under way in the industrial countries. Lengthening delivery terms are symptoms typical of such situations and plentiful credit might not help much to sustain the rate of investment in importing countries. Secondly, long term capital exports and direct investment have themselves proved to be quite volatile, and often perversely so, rising during booms and falling off in recessions (128).

(127) International Bank, 1954 Report, *op. cit.*, pp. 9-10.

(128) This implies, of course, particularly delicate theoretical question, given the difficulty of ascertaining the relations of causes and effects between home and foreign investment; from the purely factual viewpoint, however, the point appears well established. See: CARRIN-CROSS, *op. cit.*, *passim*; Macmillan Report, *op. cit.*, pp. 78-80.

These considerations raise the question whether there is necessarily something basically wrong, with the type of fluctuations mentioned earlier. If we adopt the customary schematic view of the international aspects of business cycles — primary producers' earnings rising and falling concurrently with the rise and fall in business activity in industrial countries — such fluctuations appear to be, if anything, a stabilizing factor. The decline of export credit in time of boom is likely to coincide with the greater affluence of the primary producing countries and therefore not to curtail their import capacity; conversely, the increased availability of credit in time of recession should help the borrowing countries to maintain their investment activity. As Prof. Nurkse has shown (129), stabilizing the import capacity is not equivalent to stabilizing the rate of capital formation, unless the domestic income effects of fluctuations in export proceeds are properly controlled. But this is clearly a problem for the importing country alone and the failure to solve it merely points to shortcomings in investment programming, not in foreign financing.

The point presented here is thus that if stabilization is needed and is possible, it should concern in the first place long term capital movements. These are often linked to broad structural transformations of the economy that extend over a period of years and cannot be made dependent upon a volatile source of finance. Medium term credit can instead serve also as a flywheel for investment and it is therefore important that the maximum flexibility be maintained in the projects to be financed in this way; they should typically be investments additional to the basic program.

If export credits were to follow the cyclical course just indicated, they would go a long way towards providing the type of stabilizing mechanism for international trade that has often been recommended (130); whether or not they do in fact follow such a course depends naturally on the lending countries. The latter clearly have an interest in extending credit to support their exports in time of recession. This is particularly true for the capital goods sector, which usually suffers most from a contraction in activity and may

(129) R. NURKSE, *Problems etc.*, *op. cit.*, p. 127.

(130) See for instance, VINER, *op. cit.*, United Nations, *Measures for International Economic Stability*, New York, 1951, pp. 27 ff. These proposals envisaged however the creation of an international mechanism rather than the use of national export credit systems.

benefit only slowly from domestic counter-cyclical policies. The possibility of extending credit abroad in such circumstances may have rapid and direct effects on the activity of this key sector and hence on the whole economy.

The analysis carried out in Chapter II has shown, however, that granting medium term credit abroad involves at the outset a strain on the balance of payments of the lending country and hence on its foreign exchange reserves. The possibility of resorting to export credit as a counter-cyclical measure presupposes therefore either a positive effect of the fall in activity on the balance of payments, or a strong initial reserve position. I cannot discuss at length either point; I can only hint at the fact that for European countries a recession in the United States might be imported precisely through balance of payments deficits, thus making it difficult to extend export credit to third countries. Depressive tendencies originating at home would instead be likely to result in an export surplus and could be effectively countered by means of export credit. In either case the possibility of refinancing in third money markets or with international institutions would greatly reduce the obstacles arising from the weak balance of payments or reserve position of the exporting country. I shall return to this point later in the chapter.

3. The Future of Export Credit Systems: National Measures

We must now inquire whether the export credit systems reviewed in the preceding chapters are likely to perform adequately as instruments of economic stabilization. The fact that in the field of export credit there appears to be an "unsatisfied fringe" of would-be borrowers broader than in most other fields points to the possibility that a slackening of domestic demand for credit in a recession might quickly result in the extension of credit abroad and in additional exports. In the case of Britain, a response from the commercial banking system was already observable at the time of the decline in activity of 1952. The improvements introduced in ECGD's facilities have since then expanded the circle of banks likely to be interested in this alternative outlet for funds in times of falling demand. A similar response is also likely in Germany and France, though to a more limited extent, given the role played by the specialized institutions. Banks appear as credit suppliers on

their own account only for comparatively short term contracts or for the quotas that cannot be financed through official channels.

Yet, whatever counter-cyclical automaticity there may be in the various export credit systems still needs to be supplemented by positive action on the part of the authorities. The availability of credit for exports can be increased in recession and checked in boom by acting first through credit insurance, and secondly through monetary measures. The implementation of policy directives in the insurance systems is facilitated, in France and Germany, by the direct powers of decision making possessed by government representatives, and, in Great Britain, by the possibility of recourse to the Special Guarantees system. So far as measures affecting the credit supply are concerned, Germany seems to be in a position to take prompt action by raising or lowering the credit ceilings of the *Ausfuhrkredit A.G.* In France the availability of credit for transactions that have been approved by the insurance institution could hardly be improved for counter-cyclical purposes, as it is not at present subject to ceilings or other restrictions; it could, however, easily be reduced in case of need by abolishing the preferential treatment now granted to export credit. Finally, the British authorities would have to rely mostly on general credit controls, but may find the system of informal directives from the Chancellor of the Exchequer useful in this field in the future as in others in the past.

On the whole, closer links between domestic credit and export credit would probably result in a better utilization of resources and contribute to stability by further integrating the banking system into the mechanism of the balance of payments. If progress is to be made on these lines, a deeper understanding of the policy problems of medium term credit for exports must be accompanied by institutional reform. The country studies have presented detailed criticisms of the various national systems and I shall limit myself here to summarizing the principles that should inspire such reform.

The wider use of the direct guarantee system and its extension to smaller transactions would help to muster larger bank resources for export credits by establishing, in the medium term field, facilities more closely approaching those offered by the London acceptance market for short term credits. At the same time, the presence of insurance coupled with high liquidity of the credits would make it possible for the exporter to sell the buyer's promissory notes

without recourse (except of course for the customary uninsured 15-20%), and enable him to avoid worsening his balance sheet merely for the reason that his turnover is expanding.

It would also be appropriate, in my opinion, not to try to keep the rates charged for export finance at excessively low preferential levels, which discourage the banks from participating in the provision of funds and put a premium on the deflection to purposes other than export finance of the credit facilities exporters may obtain. As has happened in France, low rates tend to result in excessive recourse to the central bank and in the need for burdensome controls to prevent misuse of credit.

Finally, a plea for administrative simplification of the insurance and credit schemes is hardly necessary, in view of the earnest efforts that governments have been devoting to this task. There still seems to be room for improvement, however, especially in France, where a certain overlapping between the responsibilities of the Banque Française du Commerce Extérieur and those of the COFACE, in the field of guarantees, does not appear objectively justified.

4. Opportunities for International Action

The desirability of organizing an international scheme for export financing has been pointed out on various occasions in the past (131); today, the structural changes in world trade and the successes of the International Bank in the cognate field of long term credit lend this possibility added interest.

The case for putting export financing on an international basis rests on three main arguments concerning, respectively, the cyclical problems of export credits, the effects of those credits on the allocation of resources, and their long run growth. I shall review each of these arguments in turn, and shall go on to consider the practical problems of organization.

(131) For the prewar period, particularly relevant are: International Financial Conference, *A summary of schemes for remedying the present financial difficulties*, Brussels, 1920, and: League of Nations, *International credits* (the "Ter Meulen Scheme"), London, 1921. For recent years I have found stimulating an article by P. SARACENO, "The Development of Export Trade in European Industrial Products and its Financing", *Banca Nazionale del Lavoro Quarterly Review*, March 1950, pp. 11-21, and a memorandum by P. N. ROSENSTEIN-RODAN, *The need for international financing of exports*, Cambridge, Mass., July 1953.

We have already seen that the counter-cyclical use of export credits might be severely limited by the possible association of a fall in employment with balance of payments difficulties. International refinancing facilities, limited perhaps to a share of the contract value equivalent to the impact of the additional exports on imports, might be appropriate to meet this problem. If such facilities were sizable enough to be a significant factor in international finance, they would also provide a basis for ensuring that the trade expansion programs of the main exporting countries in times of recession should develop constructively, rather than destructively in a "competitive credit race".

A tie-up between the export of goods and that of capital is not an unmixed blessing. While it may enable industrializing countries to supplement their inadequate capital supply from other sources, it may also prevent them from buying in the cheapest market. On the other hand, countries which are efficient producers of capital goods may be handicapped in expanding their exports by the difficulty and the cost of devoting sufficient resources to export finance. Thus the pattern of trade is distorted by the need for exporting countries to carry out simultaneously two operations — production and finance of the buyer's investment — whose optimum performance may require totally different factor endowments. It would be a significant step forward if the link between commodity markets and capital markets could be broken, and buying and borrowing each be allowed to take place under optimum conditions. This would be one of the achievements of an international scheme that drew its resources from the best supplied capital markets and offered its facilities to the capital-goods exporting countries.

Such a scheme would also help solve the longer run problem of financing the growth of trade in capital goods. If the demand from developing countries is to be satisfied and the export potential of European industry to be fully exploited, the volume of resources available for medium term international finance will have to increase significantly in the future and it seems improbable that European countries will be able to stretch their present effort much further. It is also worth remembering that the maximum length of credit generally allowed for export financing in Europe has proved insufficient in numerous cases, and an international scheme

might be able to provide credit with somewhat longer maturities, without straining the individual members' money markets.

Coming now to the actual provisions that an international scheme for medium term export financing might adopt, we must examine two points: the type of operation to be carried out and the possible sources of funds to be tapped.

The operations should consist of the rediscount of medium term paper evidencing credits granted by banks or specialized institutions in the various exporting countries. Only a part of the paper thus created should, in accordance with the principles reviewed earlier in this study, be eligible for rediscount. Depending upon the structure of its liabilities, the institution could limit eligibility to either the earliest or, preferably, the latest maturities; if it could obtain sufficient long term funds, it might even take for rediscount paper falling due beyond the traditional five years, perhaps up to a maximum of eight years.

The paper presented for rediscount should be backed by the guarantees of the exporting country's credit insurance institution. Every effort should be made to limit the administrative burden imposed on the rediscount scheme and to use instead the existing private and national credit institutions for routine work. The latter would actually see the scope of their activities widened by the new refinancing facilities.

It would certainly be desirable that access to rediscount facilities were granted on an automatic basis, whenever the paper could qualify in view of the credit terms, the quality of the debtor etc. This would help dispel the atmosphere of suspicion that reigns in the field of medium term export credit; if no distinction were made on account of the nationality of the presenting institution, the fears of a competitive use of credit would be allayed and the facilities could be better adapted to needs.

An international consortium of banks could perhaps operate on such a basis, but it is — in my opinion — excessively optimistic to believe that the conditions for the formation of a purely private international rediscount system already exist. We should rather expect for the future a system which would be only partly automatic and in which governments and the existing international organizations would play an important role.

From the technical viewpoint there is much to be said for organizing the rediscount institution as an affiliate of the Inter-

national Bank, on the model of the International Finance Corporation. Since, however, the beneficiaries of its facilities would be almost exclusively European countries (except for Japan) it might be more advisable to adopt at least at the beginning a regional scheme organized as an adjunct to the European Economic Community, or better still to OEEC.

The member countries would subscribe the institution's capital, only part of which would be paid in. The bulk of the resources should, however, be procured in other forms. I do not think it would be expedient for the institution to seek to rediscount its portfolio of medium term paper: the uncertainty concerning the volume of resources actually available at any given time would be too great, and the system would lack the necessary flexibility in case of advance repayments, possible grace periods to be granted to the debtor, and other such contingencies. Above all it is doubtful whether such an initiative could be successful; the International Bank itself seems to have found it easier to obtain direct finance than to rediscount debtors' obligations.

If, then, the institution is to finance a portfolio of medium term bills, the first problem to be solved is that of securing a sufficient volume of long term funds to provide a "hard core" for the institution's financial structure. There exists here an interesting precedent, that of the allocation of E.R.P. funds to the European Payments Union, to serve as the Union's working capital. Conditions have of course changed and recent pronouncements on the part of the United States have shown a definite opposition to earmarking repayments on dollar loans for predetermined purposes: it is felt that Congress should retain authority on the use of the return flow on interest and amortization account and that any decisions on relending such funds should fit into the overall system of priorities in the goals of American policy.

The United States cannot therefore be expected to consent "sic et simpliciter" to the diversion of repayments on dollar loans in order to build up the export credit institution's lending potential. There is no reason to suppose, however, that Congress and the Administration would not see the advantages of cooperating in financing economic development abroad in a form which would not arouse the political suspicion with which foreign aid is now often regarded. Another problem, that of avoiding the resentment of competing industrial countries that have often felt tied loans from the

United States to be a form of unfair competition might also be given serious attention.

On the strength of such considerations, an American participation, perhaps on the basis of contributions matching those of European countries, does not appear to be wholly outside the realm of possibilities. The oft-proclaimed American interest in effectively multilateral trade could not be better evidenced than by active support of a multilateral system of finance such as the one under discussion. The novelty of such arrangements should not obscure the fact that the United States, by lending to European countries which were in turn granting export credit abroad, has already provided in the past resources for the latter purpose. The proposed system would simply give a multilateral basis to such an economic reality and would therefore be a definite improvement.

Although it would certainly be desirable, an American contribution is not strictly indispensable. The institution could probably float a loan on the capital market and rely for further finance on the money market. Once a solid basis in the form of long term capital had been provided, it would become possible to obtain substantial resources by issuing comparatively short term debentures — real money market instruments — to American and Swiss banks, or by accepting fixed term deposits from them. The interest taken by United States banks in Export-Import Bank and International Bank loans, and the willingness of Swiss banks to lend abroad even on rather long terms (132) make this a very real possibility. It might also be possible to obtain from the participating countries an agreement to invest in the institution part of the reserves at present they hold in New York and London, provided a formula could be found, perhaps in cooperation with the International Monetary Fund, for ensuring the availability of such funds in case of need.

The medium term credits taken for rediscount by the institution would then be financed partly with resources borrowed on shorter terms from commercial banks and central banks and partly with longer term resources. It would be possible to tap the money markets — at present much better supplied than the capital markets — and still maintain a satisfactory financial structure.

(132) See for instance: International Monetary Fund, *International Financial News Survey*, April 9, 1954, p. 311, and July 9, 1954, p. 9.

The greater threats to the institution's liquidity would no doubt come from the possibility of default or undue delay in the servicing of debt by the borrowing countries. Here the guarantees given by the exporting countries' credit insurance schemes would come into play. Since, however, this would generally involve the direct disbursement of dollars by the institutions concerned, their present structure would have to be modified to enable them to meet such contingencies.

In fact, the intervention of credit insurance in case of balance of payments difficulties in the debtor countries is not the most appropriate way of adding to the total of international liquidity. This is a task within the responsibilities of the International Monetary Fund. Yet its present technique of operation does not permit the Fund to intervene with the promptness necessary to avoid hardship to the creditors. The need for measures designed to ensure the timely settlement of international obligations in cases where delay would otherwise arise from such factors as miscalculation in the assignment of import licenses, unforeseen falls in receipts, congestion at ports and customs, and administrative difficulties in exchange control, has been recognised within the I.M.F. itself. The establishment of a prompt remittance system with I.M.F. assistance (in the form of stand-by credits, for example) to help the debtor countries pay off outstanding arrears and henceforth keep on a current basis in their payments abroad, would limit the need for recourse to the export credit insurance institutions to cases of outright default and of probable loss, which — as was pointed out earlier — account for only a low percentage of total claims. At the same time, the over-all credit-worthiness of capital goods importing countries would improve, with favorable repercussions on the prices and interest rates charged to them by the exporters (133).

A system of international credit organised on such lines, with provisions for participation of both capital goods exporters and third money markets in the supply of the funds necessary to finance the importers, and with the assistance of the International Monetary Fund to ensure the liquidity of the credits, would represent a

(133) I owe much to the kindness of Mr. E. M. BERNSTEIN, formerly of the IMF, who discussed with me in detail the problems outlined in this paragraph.

significant improvement upon the present state of affairs. Not only would a powerful instrument for the expansion of world trade be created but also the multilateralization of trade and payments would receive a new impulse. A contribution would thus be made to the optimization of the pattern of trade, to the development of still unexploited resources in backward areas, and to the full utilization of the industrial potential of the more advanced countries.

New York

CLAUDIO SEGRÉ

T A B L E S

COMPOSITION OF WORLD TRADE IN MANUFACTURES
(in per cent)

TABLE 1

	1899	1913	1929	1937	1950
Textiles	33.5	28.8	24.1	18.9	17.3
Other consumer goods (a)	26.8	23.1	20.5	18.9	15.1
Capital goods (b)	12.5	18.5	25.8	28.7	37.7
Manufactured materials	27.2	29.6	29.6	33.5	29.9
of which: iron and steel	6.0	7.7	7.8	9.9	8.1
other	21.2	21.9	21.8	23.6	21.8
	100.0	100.0	100.0	100.0	100.0

(a) Including goods reported by Tyszynski as "not classified".

(b) Including motor vehicles and other engineering products sold to final consumers.

Source: A. K. CAIRNCROSS: "World trade in manufactures since 1900", *Economia Internazionale*, November 1955, p. 730, on the basis of Tyszynski's data.

TABLE 2

SHARE OF ENGINEERING PRODUCTS (a) IN TOTAL EXPORTS (b)
OF MANUFACTURES FOR TEN LEADING EXPORTERS, 1899 AND 1953
(in per cent)

	1899	1953
United Kingdom	17.5	44.9
United States	27.9	54.2
France	5.7	25.7
Germany	8.9	45.7
Belgium, Italy, Sweden, Switzerland	8.9	25.3
Canada	30.2	18.5
Japan	0.2	18.1
Average	13.4	39.5

(a) Machinery, other than electric, electrical machinery, transport equipment (Divisions 71, 72, 73 of S.I.T.C.).

(b) Value data.

Source: CAIRNCROSS, *op. cit.*, p. 731.

TABLE 3

EXPORTS OF ENGINEERING PRODUCTS (a) AND SHARE OF THE SAME
IN TOTAL EXPORTS FOR OEEC COUNTRIES, U.S.A., CANADA AND JAPAN
(in per cent)

	1950	1951	1952	1953	1954
Exports of engineering products	7,392	9,754	10,888	11,043	11,795
Percentage share	35.9	33.8	37.8	38.7	38.2

(a) See Table 2, note (a).

Source: CAIRNCROSS: *op. cit.*, p. 733.

TABLE 4
EXPORTS OF ENGINEERING PRODUCTS (a) AND SHARE OF THE SAME
IN TOTAL EXPORTS FOR OEEC COUNTRIES
(millions of dollars)

	1951	1952	1953	1954	1955	1956	Jan.- June 1957
Engineering products	5,637	6,571	6,631	7,367	8,434	9,690	5,430
Total exports	26,687	26,590	27,012	29,298	33,028	36,214	19,630
Share of engineering products in total exports	21.0	24.5	24.5	25.2	25.5	26.7	27.6

(a) See Table 2, note (a).

Source: OEEC Statistical Bulletins, *Foreign Trade*, 1957, No. 2.

TABLE 5
SHARE OF CAPITAL GOODS (a) IN IMPORTS (b) FOR SELECTED
LATIN AMERICAN COUNTRIES, INDIA AND PAKISTAN
(in per cent)

	1928	1950-51
Argentina	19	37
Chile	19	35
Brazil	18	36
Mexico	21	32
Colombia	19	27
Cuba	8	14
Peru	19	29
Uruguay	12	35
Venezuela	21	25
India and Pakistan	23	39

(a) Machinery and transport equipment other than passenger cars. For India and Pakistan crude and finished steel are also included.

(b) Imports from Europe and the United States only. For India and Pakistan, Japan is also included.

Sources: United Nations (ECLA, ECE and FAO), *A Study of Trade between Latin America and Europe*, Geneva, 1953, and United Nations (ECAFE, ECE and FAO), *A Study of Trade between Asia and Europe*, Geneva, 1953.

TABLE 6
RATIO OF IMPORTS TO EXPORTS OF MANUFACTURES BY MAIN CATEGORIES
FOR OEEC COUNTRIES, USA, CANADA AND JAPAN 1954
(in per cent)

Engineering products	50
Textiles	51
Metals	96
Chemicals	62
Other manufactures	66
Average	62

Source: CAIRNCROSS, *op. cit.*, p. 735.

TABLE 7
CREDIT GRANTED BY BANKS (a) AND RECOURSE TO REDISCOUNT
AT THE BANK OF FRANCE
(billions of francs)

	1953	1954	1955	1956	1957	Outstand- ing at end of 1957
Short term credit	+ 134	+ 202	+ 273	+ 453	+ 243	3,156
Medium term credit	+ 113	+ 139	+ 166	+ 272	+ 310	1,421
<i>Total</i>	+ 247	+ 341	+ 439	+ 725	+ 553	4,577
Recourse to rediscount at Bank of France	+ 54	+ 124	+ 140	+ 575	+ 122	1,959

(a) The fact that banks only are included in this table accounts for the difference existing between the data for medium term credit appearing in this table and those in Table 8.

Source: Bank for International Settlements, *27th Annual Report*, 1956-1957.

TABLE 8
SOURCES OF FUNDS FOR THE FINANCE OF MEDIUM TERM OPERATIONS
IN FRANCE (a)
(billions of francs)

	Outstanding at year end			Changes during year		
	1955	1956	1957	1955	1956	1957
In portfolios of original credit givers and financed:						
with savings resources	59	65	64	+ 31	+ 6	- 1
with bank deposits	213	75	83	+ 45	- 138	+ 8
In portfolios of rediscounting institut- ions and financed:						
with savings resources	94	57	60	+ 10	- 37	+ 3
with bank deposits (b)	7	-	-	+ 7	- 7	-
with money creation	619	1,036	1,338	+ 114	+ 417	+ 302
<i>Totals:</i>						
with savings resources	153	122	124	+ 41	- 31	+ 2
with bank deposits	220	75	83	+ 52	- 145	+ 8
with money creation	619	1,036	1,338	+ 114	+ 417	+ 302
Total medium term credit	992	1,233	1,545	+ 207	+ 241	+ 312

(a) Including export, construction, investment, agricultural credit, etc. granted by banks and by specialized institutions.

(b) "Pensions dans les banques", that is, temporary borrowing against medium term paper.

Source: Conseil National du Crédit, *Rapports Annuels*, 1955 and 1956.

TABLE 9

REDISCOUNT MARGINS AVAILABLE TO BANKS AT YEAR END IN FRANCE
(billions of francs)

	1955	Changes during 1956	1956	Changes during 1957	1957
Eligible commercial bills					
(a) rediscount					
ceiling	586		612		447
utilized	535		589		401
available	51	— 28	23	+ 23	46
(b) access to money market					
ceiling	70		62		63
utilized	28		56		49
available	42	— 36	6	+ 8	14
Government bills and bonds held in excess of legal minimum	112	— 86	26	+ 17	43
Medium term paper rediscountable at Crédit National, Caisse des Dépôts etc. (indirectly to the Bank of France)	220	— 145	75	+ 8	83
<i>Total</i>	425	— 295	130	+ 56	186

Source: Conseil National du Crédit, *Rapport Annuel*, 1956.

TABLE 10

NET FOREIGN ASSETS OF THE BANK DEUTSCHER LÄNDER
(millions of DM)

	1951	1952	1953	1954	1955	1956	1957 Oct.
Gold	116	587	1,367	2,628	3,862	6,275	10,700
Convertible currencies	1,418	2,087	3,543	5,451	5,788	7,426	7,224
Credits towards EPU members	100	1,177	2,369	2,330	2,605	3,888	5,544
Credits on bilateral payments agreements	111	786	895	544	394	67	— 35
Credits on transferable DM agreements	—	—	—	8	157	245	252
<i>Total foreign assets</i>	1,523	4,637	8,174	10,945	12,806	17,901	23,685

Source: Deutsche Bundesbank, *Monatsbericht*, Nov. 1957.

TABLE 11

LIABILITIES STRUCTURE OF GERMAN COMMERCIAL BANKS
(in per cent)

	1953	1954	1955	1956	1957 Sept.
Sight liabilities (a)	35.5	36.0	35.7	35.0	32.7
Savings and fixed term deposits, bank debentures and other liabilities	64.5	64.0	64.3	65.0	67.3
<i>Total</i>	100.0	100.0	100.0	100.0	100.0

(a) About one-third of fixed term deposits are for less than 6 months.
Source: Deutsche Bundesbank, *Monatsbericht*, Nov. 1957.

APPENDIX I

THE EXPORT CREDIT INSURANCE SYSTEMS OF GREAT BRITAIN,
FRANCE AND GERMANY

This Appendix is designed to complement the discussion of Chapter III, by presenting in a condensed form further relevant information concerning the structure and activities of credit insurance schemes. The premium schedules applied by the various institutions are presented, however, in Appendix II and other information appearing elsewhere in the text has been omitted.

1. Great Britain

a. Organization and finances

The Export Credits Guarantee Department is an independent Government Department. It was preceded by various other insurance schemes (134) and its present activities are regulated by the Export Guarantee Act, 1949, as amended in 1951, 1952 and 1957. The statutory limits on the risks it may assume are of 750 million pounds for Commercial Guarantees and of 250 million for Special Guarantees.

An annual budget is presented to Parliament, setting forth expected premium and interest income, claim payments and administrative expenses. Should outlay unexpectedly exceed income in the course of the year, a "supplementary estimate" would be needed to fill the gap. Surpluses accrue to the Exchequer, and the Department has no accumulated reserve but only computes a "notional balance" with the Exchequer.

An Advisory Council of ten members representing banks, industry, labor, and the Board of Trade acts as a consultative body for transactions under the Commercial Guarantees Scheme; for Special Guarantees the Department has full discretion, subject, however, in all cases, to Treasury consent and after consultation with other interested Government Departments.

b. Policies delivered and risks covered by ECGD

Some twenty different types of policy, divided into four main groups, affording cover for a wide variety of transactions, are delivered by ECGD. The main types are:

(134) See: Overseas Trade (Credits and Insurance) Act, 1920, 1921, Export Guarantees Act, 1937, 1939, 1945, 1948.

SHORT TERM: *Comprehensive Guarantees* are used for most transactions with credit terms of up to 180 days (with the "extended term endorsement" they may actually cover credits of up to three years) and apply to the whole turnover of the exporter or at least to a majority of markets. "Shipments policies" take effect on the date of shipment, and "Contracts policies" as of the date of contract. *External trade policies* cover intermediation trade carried on by United Kingdom firms between foreign countries. *Processing policies* concern instead the processing abroad of goods for the account of British firms. In all these cases commercial risks, political and transfer risks and catastrophe risks are covered: In the case of *C.I.F. Policies*, the economic risk of a rise in freight and insurance costs between the date of contract and that of shipment is also covered.

MEDIUM TERM: Here too the two varieties of "Contracts policies" and "Shipment policies" are available. Insurable credit terms may not normally exceed five years, and the policies concern individual transactions.

DOLLAR MARKETS: Special facilities are offered for business with the United States and Canada. Besides granting more favorable conditions on its credit insurance policies by permitting a selection of risks and covering the possibility of repudiation of the contract, ECGD is willing to help exporters in their efforts of penetration on these markets. The Department will, therefore, bear 50% of the losses which exporters may incur in case their expenses on this account are not rewarded by a satisfactory progress of their sales. The policies available in this field have self-explanatory names: *Market Survey policies*, *Products Test policies*, *Advertising policies*, *Stocks policies*, *Joint Ventures*.

SPECIAL: These policies include *Direct Guarantees to banks* and others that permit the insurance of earnings on *Constructional Works* and on *Services* rendered abroad.

The other activity of ECGD, direct loans in the national interest to countries in need of *Economic Assistance* has already been discussed fully in the chapter on Great Britain.

c. Percentage cover and conditions for the payment of claims

Losses due to insolvency or default of the foreign customer are covered to the extent of 85%. The Department will pay exporters' claims immediately upon declaration of the buyer's insolvency; claims for protracted default will be honored six months after due date.

Political, catastrophe and transfer risks referring to the period after shipment can now be covered to the extent of 95%. Claims will be paid four months after due date.

Direct guarantees to banks cover 90% of the contract value. The guarantee is unconditional and will be honored three months after failure of the debtor to effect payment at the due date.

2. France

a. Organization and finances

The Compagnie Française d'Assurance pour le Commerce Extérieur (COFACE) is the main agency for export credit insurance. It acts for its own account for the insurance of ordinary commercial risks and for the account of the state for all other risks. Insurance against cost increases in the case of long term contracts (*garantie de prix*) and against losses for unsuccessful attempts at penetration on dollar market (*assurance-prospection*) are delivered, however, by the state without the intervention of COFACE.

An insurance program for export credits has existed in France since 1928, but it has undergone a radical reorganization in the postwar years with the creation in 1946 of a company acting as sole agent for the state.

COFACE is a private law corporation, with a capital of Frs. 100 million held by the Caisse des Dépôts et Consignations, the Crédit National, the Banque Française pour le Commerce Extérieur, the Société Française d'Assurance pour favoriser le Crédit, and the nationalized insurance companies. Its activities are regulated by the following legislative texts: Laws 45-015 of 12-2-1945 and 49-874 of 7-5-1949, and Decrees 46-1332 of 6-1-1946, 48-719 of 4-16-1948, 49-1077 of 8-5-1949, 57-317 and 57-318, both of 3-16-1957.

COFACE enjoys a guarantee from the state for net deficits in excess of 10% of premiums received, and is allowed recourse to the Treasury to meet temporary cash needs. On the other hand, 5% of premiums received by COFACE are turned over to the Treasury. No limits have been fixed to the volume of risks it is allowed to assume.

An interministerial committee (Commission des Garanties et du Crédit au Commerce Extérieur) has authority over guarantees delivered for the account of the state and also supervises COFACE's activities for its own account.

b. Policies delivered and risks covered by COFACE and the state

Credit insurance proper, *Assurance-Crédit*, is granted in the form of global policies for short term credits and individual policies for medium term credits. The former also cover ordinary insolvency risks (but not default) and are limited to credits not exceeding six months. Medium term policies generally have a maximum duration of five years and cover political and transfer risks and

catastrophe risks only. Cover can be extended to pre-acceptance risks by a special endorsement (*Garantie Risque de Fabrication*).

Exchange risks can be covered by a special policy, *Garantie de Change*, with the stipulation that both losses and gains on the conversion of foreign exchange proceeds that cannot be sold in the forward market will be taken over by COFACE, provided they exceed .1%.

Possible increases in the costs of raw materials and of labor in excess of 20% will be borne by the state on the basis of the *Garantie de Prix*. This is only possible, however, when the manufacturing period requires at least six months and when the goods have been invoiced in a foreign currency. The latter provision enables the state to counterbalance the risk of having to indemnify the exporter with the possibility of realizing an exchange profit, should the national currency be devalued. Thus the exporter is guaranteed relatively stable costs and a stable price for his goods.

Finally, the *Assurance-Prospection* applies to initiatives taken to increase sales in the dollar markets: for a moderate fee the state will bear 50% of the losses which may thus be incurred, if sales do not show the expected progress.

c. Percentage cover and conditions for the payment of claims

Commercial risks are covered for a quota varying between 70 and 80%. As soon as insolvency proceedings begin, the exporter can obtain from COFACE 70% of the indemnity to which he will presumably be entitled. The rest will be liquidated at the close of the proceedings.

A cover varying between 80 and 90% can be granted for political and transfer risks, the lower percentage being usually applied to contracts with private buyers. Claims will be settled six months after the date on which payment was due to take place.

3. Germany

a. Organization and finances

Export credit insurance is granted in Germany by the state, through two private insurance companies, Hermes AG and Deutsche Revisions-und Treuhand AG. Contacts with the public and administration are kept by Hermes alone, that had already served as agent for the state since 1925, when an export credit insurance scheme on different bases was first established.

The basic law for the present system was passed August 26, 1949: it has been modified several times by increases in the maximum volume of risks the state may take on, which now stands at DM 9.5 billion.

Funds are appropriated annually on the state budget to cover expected claim payments and the fees to which the two agent companies are entitled; while premium income accrues directly to the Federal Treasury.

The two companies have purely executive functions: decision-making powers are vested in an interministerial committee assisted by representatives of manufacturers, export merchants and banks, with advisory functions.

b. *Policies delivered and risks covered by Hermes*

In the case of contracts with private buyers, cover (*Ausfuhrgarantie*) can be obtained for the buyer's insolvency (not for simple default), for political and transfer risks and for catastrophe risks. Contracts with public bodies receive substantially identical cover (*Ausfuhrbürgschaft*) except for the fact that default is considered in such cases a political risk and is therefore covered. Exchange losses cannot be covered, but if the exporter has been compelled to accept payment in a currency other than the contractual one or has accepted it with the agreement of the German authorities and has incurred losses thereby, these will be covered by the insurance contract.

Pre-shipment risks (*Fabrikationsrisiko*) are covered by a separate policy which is, however, generally taken together with the credit insurance policy in order to benefit from a reduction in the premium rate.

Policies can be obtained for single transactions, for all transactions with a given buyer (*revolvierende Deckung*), for transactions with several buyers in one or more countries (*Ausfuhr-Mantelgarantie*) or for the whole turnover of the exporter (*Ausfuhr-Pauschalgarantie*).

For consumer goods a limit of six months' credit is generally observed while for capital goods the limit is set case by case.

A special guarantee introduced in 1953 (*KT-Garantie*) covers transfer and conversion risks only, at considerably cheaper rates than those applying to the full cover. It can be obtained for single transactions (*KT-Einzelgarantie*) or for several transactions (*KT-Pauschalgarantie*).

Credits arising from construction work abroad, other services, transit trade, and the processing of goods in Germany for the account of foreign customers can also be covered, and so can the creation of stocks abroad to ensure prompt delivery.

c. *Percentage cover and conditions for the payment of claims*

Insolvency risks are covered up to a maximum of 70% of invoice value. Claims will be paid only when the buyer's insolvency has been proved and the final loss has been ascertained; a provisional settlement of the claim, however, is possible if insolvency proceedings have not yet been concluded after six months from due date.

Political risks are covered to the extent of 80% and conversion and transfer losses only to the extent of 75%. In case of war, confiscation or moratorium, payment will take place six months after the event. Conversion losses will be liquidated immediately and transfer losses four months after the importer has made an unsuccessful application for the foreign exchange needed to pay the exporter.

All pre-shipment risks are covered up to 80% of production costs or, in the case of export merchants, up to 80% of the price of the goods.

APPENDIX II

INSURANCE PREMIUMS AND INTEREST RATES
APPLYING TO EXPORT CREDITS

1. Great Britain

a. Insurance

The premium schedules of ECGD are not published and rates are communicated to exporters only in the form of quotations on specific business for which insurance is sought. In 1953, however, on the occasion of a study of ECGD by the Select Committee on Estimates (Subcommittee F), the premium rates which were being currently applied by ECGD were presented as part of the evidence and made public.

TABLE 12
PREMIUM RATES CHARGED BY ECGD, 1953
(in per cent)

Country's grading	Raw materials		Non-essential goods	
	C. A. D.	180 days credit	C. A. D.	180 days credit
Highest . . . . .	.20	.875	.20	1.025
Lowest . . . . .	.60	1.575	.625	2.10

Source: Fourth Report from the Select Committee on Estimates, House of Commons Paper 149, Session 1952-53.

Since 1953 the above schedule has been revised several times, so that it cannot be taken as representative of the present situation. In particular, the spread between the highest and the lowest rates has been further widened, both by raising the former and by lowering the latter. On the average, premium rates have been lowered.

For medium term credits, insurance rates vary between .5% and 3% a year, computed on the face value of the policy, but with a credit period reduced so as to take account of the gradual amortization of the credit.

The direct bank guarantee involves an additional flat charge of about .75%.

b. Credit

Given the habit of charging .5% to 1.5% above bank rate for medium term export finance, the cost of credit would appear to have been:

1952: 4.5-5.5%; 1953: 4.5%; 1954: 3.5-4.5%; 1955: 5.6%; 1956: 6.7%; 1957: 5.5-6.5%; 1958 (until March 20): 7.5-8.5%.

These data are based on the bank rate prevailing over the greater part of the year under consideration, when a change has occurred during the year. The spread between maximum and minimum rates has probably also varied with bank rate.

Direct guarantees can be said to result in a saving of some ½% on interest charges.

Merchant banks receive a fee varying between ¼ and ½% for performing the tasks described in the text.

2. France

a. Insurance

For the insurance of political and transfer risks, premiums applied by COFACE consist of a basic rate applied to the guaranteed portion of the contract value and an annual rate applied to the guaranteed portion of the credit actually outstanding at any given time. The two rates are identical and may vary from .4% to 1.5%.

For example, let us assume that a medium term transaction is assessed at a rate of 1% for the insurance of political and transfer risks, and that credit is granted for five years, subject to regular amortization in five equal annual instalments. The total premium on the guaranteed portion of the contract would then come to 4%.

The insurance of commercial risks (short term credits only) is granted by COFACE at a flat rate which may vary between .60/∞ for C.A.D. sales and 1% for six months' credit.

Insurance against exchange losses can be obtained at a rate of .40/∞ for transactions with payment in dollars or Swiss francs, and 40/∞ for transactions with payment in other agreed currencies.

Insurance against losses due to a rise in internal prices (garantie de prix) carries a premium of .250/∞ of the guaranteed sum.

b. Credit

The rates charged for export finance are nominally tied to the discount rate of the Bank of France. In reality, they have not varied together with this

discount rate, since increases in the latter have often been accompanied by reductions in the other elements entering the cost of credit, so that this has not reflected the full extent of the increase. In other cases, preferential discount rates have been granted by continuing to apply the rate obtaining before the increase. Before August 12, 1957, the total cost of credit to the exporter in the various cases analyzed in the following table was, respectively, 5.30, 5.30, 6.50, 5.00, 5.10, .50 and 5.40. Prefinancing was therefore considerably cheaper and short term and medium term credit somewhat more expensive during most of the period under review.

TABLE 13

COST OF EXPORT CREDIT IN FRANCE, AS OF AUGUST 12, 1957
(in per cent)

Rates and commissions	Prefinancing			Export financing proper			
	With firm order		Without Order	Short term		Medium term	
	Aval	Cross Acc.		Aval	Cross Acc.	Waiting period	«Mobilization» period
Commitment commission:							
Crédit National . . . . .						.05	.125
BFCE . . . . .						.15	.15
Exporter's bank (a) . . . . .						.25	.50
BFCE aval commission:	1.00			.90			.30(b)
(mobilization quota)	(.10)			(.30)			
(risk quota) (c)	(.90)			(.60)			
Acceptance commission		1.20	1.80		1.20		
Endorsement commission . . . . .	.30	.60	.60	.10	.40		.10
Discount rate	5.00	5.00	5.00	3.00	3.00		3.00
Additional discount to exporter's bank . . . . .	.50			.50			.50
Total cost of credit	6.80	6.80	7.40	4.50	4.60	.45	4.675

(a) The exporter's bank can be the BFCE itself, if it finances the transaction as one of its normal banking operations.

(b) This commission applies in the case of sales to governments and public bodies; for sales to private firms the commission is .90, divided into a .30 mobilization quota and a .60 risk quota. The total cost of credit in such a case amounts, therefore, to 5.275%.

(c) The risk quota is generally shared between the exporter's bank and the BFCE, in agreed proportions.

Source: Banque Française du Commerce Extérieur.

In July 1957 the prime loan rate for unsecured advances was about 7%. This rate should be taken as a point of reference in reckoning the cost of credit for the quotas financed through ordinary banking channels without the intervention of BFCE.

3. Germany

a. Insurance

Pre-shipment risks: 1% of the guaranteed sum. If insurance against post-shipment risks is obtained at the same time, the premium is reduced to .75%.

Credit risks: for sales to private buyers the premium is .75% if C.A.D. payment has been stipulated. If there is deferred payment instead, there is a basic rate of 1.5% on the guaranteed sum plus a premium "pro rata temporis" of 1^o/₀₀ for each month in excess of six, on credit actually outstanding.

For sales to governments or public bodies the basic rate is graduated according to the face value of the policy:

for the first DM 3 million: 1%;

for the next DM 2 million: .75%;

for the amounts in excess of DM 5 million: .50%.

The premium "pro rata temporis" applies from the first month on credit actually outstanding in the measure of: .5^o/₀₀ a month for payment terms not exceeding two years, and .4^o/₀₀ a month for payment terms exceeding two years.

Let us assume a contract for a sale to a Government on five years' credit with regular annual amortization and a face value of the policy of DM 10 million. The premium for credit insurance only would amount to DM 214,000 or 2.14% of the amount guaranteed. This would be, however, close to the minimum rate; in general the rate would be somewhat higher.

The special insurance against transfer and conversion risks is granted at a cost of:

.4% for single transactions (KT-Einzelgarantie);

.3% for the maximum sum agreed under global guarantees (KT-Pauschalgarantie);

plus .2% for any amounts that may exceed the agreed maximum.

b. Credit

Prefinancing and short term credit: Up to May 19, 1956, export drafts and foreign acceptances could be rediscounted at the Bank deutscher Länder at a rate equal to that obtaining in the country of destination of the goods, if more favorable than the BdL domestic rediscount rate. Since then, the rate applied to such bills has been the domestic rediscount rate:

1956, from May 19: 5.5%; from September 6: 5.0%;

1957, from January 11: 4.5%; from September 19: 4.0%;

1958, from January 16: 3.5%.

The exporter had to bear an additional charge of .5% before May 1956, and since then a charge of 2%.

Medium term credit: Credits on the A line are granted by AKA at a cost to the exporter which is generally 3.5% above the Bundesbank rediscount rate, including the AKA's endorsement commission. Credits on the B line are granted at a cost 1.5% p.a. above the Bundesbank rediscount rate, including the AKA's 0.5% p.a. endorsement commission and the discounting bank's 1% p.a. endorsement commission.

After the fall in the bank rate to 3.5% in January 1958, the rates charged are therefore: 7% for the A line, and 5% for the B line. The cost of A line credits has varied in the past between 6.75 and 9%, and that of B line credits between 4.5 and 7%.

Between the authorization of the credit and the first drawing, AKA charges a commission of .5% for the A line and .1% for the B line.

For promises to grant credit at a future date (Finanzierungszusagen), AKA's commitment charges amount to:

.5^o/_{oo} for each of the first two quarters;

1.0^o/_{oo} for the third quarter;

2.0^o/_{oo} for the fourth quarter;

2.5^o/_{oo} for each quarter thereafter.

The longer term credits granted by the Kreditanstalt für Wiederaufbau carry rates of about 7%.

In July 1957 the prime loan rate for unsecured advances was 9%. This rate should be taken as a point of reference in reckoning the cost of credit for the quotas financed through ordinary banking channels.

APPENDIX III

THE FINANCIAL RECORD OF EXPORT CREDIT
INSURANCE SYSTEMS

1. Great Britain

From the accounts of the Export Credits Guarantee Department the following prospectus of the financial operations of the Credit Insurance Scheme

FINANCIAL RESULTS OF ECGD OPERATIONS

TABLE 14

(in thousands of pounds)

Financial Year	Premiums (a)	Recoveries of payments	Interest (b)	Total Income 1+2+3	Payment of Claims	Administration	Net result 4-5-6	Cumulative (c) result
	1	2	3	4	5	6	7	8
<i>Commercial Guarantees</i>								
1950-51	2,391	1,080	238	3,709	2,359	415	935	8,697
1951-52	3,130	1,976	337	5,443	606	487	4,350	13,046
1952-53	2,769	196	330	3,205	14,410	557	-11,672	+ 1,375
1953-54	2,478	4,804	- 83	7,199	11,414	692	- 4,907	- 3,531
1954-55	2,896	5,355	58	8,309	4,626	763	2,920	- 611
1955-56	3,614	4,656	304	8,575	2,300	883	5,392	4,781
1956-57	3,690	5,397	632	9,719	5,411	965	3,343	8,124
1957-58	n. a.	4,864	n. a.	n. a.	4,675	n. a.	4,480	12,924
<i>Special Guarantees and Economic Assistance</i>								
1950-51	275	3	1	279	13	55	211	197
1951-52	519	1	13	533	14	69	450	648
1952-53	304	5	25	334	61	60	214	861
1953-54	297	1	26	324	1,125	69	-869	- 8
1954-55	690	4	2	696	298	93	304	296
1955-56	909	5	23	937	51	87	797	1,093
1956-57	804	16	52	872	433	109	330	1,423

(a) Including, for the Economic Assistance Scheme, net interest earned as difference between lending and borrowing rates.

(b) Net interest resulting from the difference between interest earned on notional balance at Exchequer and on recoveries of payments under guarantees, and interest paid on overdrafts at Exchequer.

(c) Not identical with notional balance at Exchequer, but smaller only by minor amounts owing to the different accounting technique used here.

Source: *Trading Accounts and Balance Sheets, 1950-51 to 1956-57*, published as "House of Commons Papers" by HM Stationery Office, London, 1957-58, data: ECGD Press Release.

and the Special Guarantees Scheme (including the Economic Assistance Scheme) has been derived. The data have been rearranged so as to simplify the presentation.

2. France

The following tables present the financial results of three branches of credit insurance operated by COFACE for the account of the state:

TABLE 15
COFACE, CUMULATIVE RESULTS FOR THE PERIOD
FROM JANUARY 1, 1929 TO DECEMBER 31, 1956
(Fr. million, revalued for years before 1952)

	Political and transfer risks		Exchange risks on credit granted abroad
	Medium term	Short term	
Premiums received	6,393	338	1,588
Claims paid, of which	7,663	3,329	63
Irrecoverable	822	1	63
Recoverable, of which	6,841	3,328	
Actually recovered	3,888	768	
Still to be recovered	2,953	2,560	
Profits on recoveries and exchange profits	6	—	28
Net proceeds of insurance schemes (a)	2,624	- 2,222	1,553
Claims still to be settled	5,728	248	—

(a) To have the net cumulative financial results for COFACE one should deduct administration expenses (Fr. 467 million) and add interest earnings (122 M) which concern, however, other branches of the company's activity as well, and cannot be separated out for the activities covered by the table. For 1955 and 1956 the data for administration and interest earnings are, respectively: Administration, Francs 96 m., 156 m.; Interest 21 m. and 29 m.

Source: Compagnie Française d'Assurance pour le Commerce Extérieur, Report for 1955 and for 1956; figures may not add up exactly due to rounding.

COFACE, RESULTS FOR THE FINANCIAL YEARS 1955 AND 1956

	1955	1956	1955	1956	1955	1956
Premiums received	1,778	1,690	68	60	223	293
Claims paid, of which	1,760	2,576	1,218	433	19	16
Irrecoverable	—	—	—	—	—	—
Recoverable, of which	1,760	2,576	1,218	433	—	—
Actually collected	942	1,597	376	312	—	—
Still to be collected	818	980	842	121	—	—
Exchange profits					1	21
Net proceeds of insurance schemes (a)	960	711	- 733	- 61	204	298

(a) See footnote (a) on p. 258.

Source: Compagnie Française d'Assurance pour le Commerce Extérieur, Report for 1955 and 1956.

3. Germany

In 1958 a full analysis of the accounts of the credit insurance scheme has been presented for the first time by the German Government in the comments to the draft budget, on a cumulative basis from 1949 up to June 30, 1957.

The premium income of DM 132.4 million was insufficient to cover the total outgo of DM 195.1 million and left a deficit of 62.7 million, to be covered out of budget appropriations. However, a breakdown of the outgo shows that after deduction of administration costs of 20.4 million, claim payments amounted to 174.7 million and that of these, only 7 million could be considered irrecoverable losses (2.3 million for commercial losses, 4.7 for exchange losses). The remaining 167.7 million consisted of claims due mainly to transfer difficulties, almost one half of the total referring to the commercial debts of Turkey and Yugoslavia.

The percentage of total claim payments to insurance contracts that have run their full course can thus be established at 1.8% and that of irrecoverable losses at as little as 0.07%. After June 1957, however, the negotiations for the settlement of commercial arrears accumulated by two foreign countries have shown the likelihood that an additional DM 168 million of claims may be forthcoming in the near future.

EXPORT CREDITS GUARANTEE DEPARTMENT: GENERAL STATISTICS 1930-31/1956-57

(millions of pounds)

TABLE 16

APPENDIX IV

STATISTICAL INFORMATION AVAILABLE ON INSURED EXPORT
BUSINESS AND ON EXPORT CREDIT OUTSTANDING

1. Great Britain

No data are collected in Great Britain on credit granted to finance export transactions. Evidence can be gathered only indirectly from statistics concerning the activities of the Export Credits Guarantee Department.

The data published regularly by ECGD in its press notices and in its annual accounts, however, are also fragmentary and do not give a complete picture of the Department's operations. I owe to the courtesy of ECGD's officials the possibility of obtaining a full documentation, which is presented in the following two tables.

In the first table, medium term operations are not shown separately, while the second (referring only to the last four years) analyzes the data in greater detail. For the purpose of this study, the most revealing figures are those referring to new medium term business concluded during the year (Guarantees Issued) and to shipments under existing guarantees. The latter data are those that come closest to indicating the credit granted in a given year by the banking system on a medium term basis, except of course for the fact that they exceed such credit to the extent of the quota that is financed out of the exporter's own funds. It must be added also that business transacted on credit terms of over one year is certainly larger than appears from the data for medium term policies; this is due to the inclusion of some contracts with credit terms of up to three years, among those covered by short term policies, thanks to the "extended term endorsement". This is used mainly for shipments of vehicles, agricultural machinery and light industrial equipment.

Financial Year	Section 1 of Export Guarantees Act, 1949 (a)				Section 2 of Export Guarantees Act, 1949 (b)				Sections 1 and 2		Total U. K. Exports	Percentage covered by E. C. G. D. (d)
	G'tees Issued (Face value)	G'tees current at end of year		Business declared as shipped (d)	G'tees Issued (Face value) (e)	G'tees current at end of year		Business declared as shipped	Total business declared as shipped (d) (cols 5+9)	Total U. K. Exports Insured (d) & (f)		
		Face value	Dept's liability (c)			Face value	Dept's liability (c)					
1	2	3	4	5	6	7	8	9	10	11	12	13
1930/31	8.3	7.0	4.3									
1931/32	11.9	13.2	8.4									
1932/33	7.6	14.1	8.6									
1933/34	7.5	10.0	5.0									
1934/35	15.0	15.9	6.5									
1935/36	20.6	22.5	7.5									
1936/37	35.2	35.8	13.2									
1937/38	42.9	45.0	17.1									
1938/39	49.9	53.2	23.5									
1939/40	63.2	70.6	29.2									
1940/41	94.2	86.8	37.2									
1941/42	108.0	94.7	49.9	38.4					38.4	37.0	365.0	10.1
1942/43	64.0	70.6	42.1	25.5					25.5	24.4	364.2	6.7
1943/44	50.2	54.6	29.2	30.5					30.5	29.7	239.2	12.4
1944/45	50.5	55.1	25.6	32.2					32.2	31.2	280.7	11.1
1945/46	71.8	77.5	35.6	52.2					52.2	49.8	450.3	11.1
1946/47	138.6	137.8	68.1	87.4					87.4	82.9	1036.3	8.0
1947/48	186.2	201.3	107.0	114.7					114.7	108.3	1297.1	8.3
1948/49	280.3	319.4	182.9	183.6					183.6	168.6	1754.3	9.6
1949/50	262.0	367.4	207.6	258.9	2.3	1.6	1.2	0.7	259.6	218.4	1901.4	11.5
1950/51	466.0	501.0	282.2	317.4	44.5	40.5	35.2	29.1	346.5	288.0	2335.2	12.3
1951/52	599.3	602.7	332.5	440.9	67.0	70.8	53.5	46.4	487.3	299.8	2866.4	13.9
1952/53	524.8	555.1	315.2	387.9	25.9	49.9	39.9	18.1	406.0	355.1	2575.4	13.8
1953/54	509.4	528.3	293.9	380.4	35.6	58.4	44.8	16.4	396.8	343.8	2733.2	12.6
1954/55	543.6	550.7	300.8	381.0	97.3	96.2	70.1	33.3	414.3	366.4	2046.8	12.9
1955/56	485.7	575.2	318.0	394.6	68.0	96.4	75.2	32.7	427.3	388.3	3066.6	12.7
1956/57	726.0	655.4	362.7	450.2	85.2	88.3	71.2	47.1	497.3	465.3	3377.3	13.8

(a) Commercial Guarantees.

(b) Special Guarantees, including the Economic Assistance Scheme.

(c) The Department's liability is much smaller than the face value of Guarantees current, not only because cover is limited to a percentage between 80 and 95%, but also because the liability refers to credit actually outstanding at a given moment which, for short term policies that cover a whole year's turnover, is generally smaller than face value.

(d) Figures for earlier years not available.

(e) This type of guarantee has become a separate category only since 1949.

(f) Column 11 excludes business transacted under External Trade, Processing and other types of Guarantees which do not cover direct exports from the United Kingdom.

Source: Export Credits Guarantee Department.

TABLE 17

EXPORT CREDIT GUARANTEE DEPARTMENT: ANALYSIS OF BUSINESS INSURED,
BY TYPE OF POLICY, 1954-55 TO 1957-58 (a)
(millions of pounds)

	Guarantees issued		Guarantees current		Business declared as shipped	
	Section 1 commercial guarantees	Section 2 special guarantees	Section 1 commercial guarantees	Section 2 special guarantees	Section 1 commercial guarantees	Section 2 special guarantees
1954/5 Short term (b) . . .	495.8	57.3	481.7	49.3	334.6	24.1
1954/5 Medium term . . .	31.7	19.0	59.6	20.6	33.4	5.2
1954/5 Misc. (c)	16.1	21.0	9.4	25.0	13.0	4.0
1955/6 Short term (b) . . .	433.3	45.5	489.5	43.1	350.5	22.2
1955/6 Medium term . . .	45.0	18.2	77.5	27.2	39.7	8.4
1955/6 Misc. (c)	7.4	4.3	7.9	26.7	4.4	2.1
1956/7 Short term (b) . . .	619.5	27.6	525.8	26.5	394.3	3.7
1956/7 Medium term . . .	106.5	57.6	129.6	62.3	55.9	43.4
1956/7 Misc. (c)						
1957/8 Short term (b) . . .			544.5			
1957/8 Medium term . . .	158.9				480.7	
1957/8 Misc. (c)			221.4			

(a) Data for "guarantees issued" and "guarantees current" refer to the face value of policies.

(b) Short term policies may be provided with an "extended term endorsement" under which credits of up to three years may be insured. This item includes therefore an unspecified amount of business which is properly medium term in nature.

(c) This item includes "dollar drive" policies and other policies designed to meet special requirements.

Source: Export Credits Guarantee Department.

2. France

The Compagnie Française d'Assurance pour le Commerce Extérieur (COFACE) does not publish statistics on the volume of risks it insures. For medium term policies outstanding, the following data were obtained directly from COFACE.

December 31, 1953	Frs. 129 billion
" " 1954	" 249 "
" " 1955	" 246 "
" " 1956	" 305 "
May " 1957	" 275 "

Data on the volume of medium term export credit granted with the intervention of the BFCB and outstanding at year end can instead be found in the Annual Reports of the Conseil National du Crédit. The amounts involved were:

December 31, 1953	Frs. 12 billion
" " 1954	" 30 "
" " 1955	" 41 "
" " 1956	" 52 "
" " 1957	" 58 "

The discrepancy between the volume of credit insured by COFACE and that actually financed through the official channels is due to the following reasons:

(a) The dividing line between short and medium term is set by COFACE at six months, and by BFCB at two years.

(b) While the insurance policy is taken out for the whole amount involved in the contract concluded with the foreign buyer, the data reported here for credit outstanding refer only to sums actually utilized and not yet repaid; for transactions which develop gradually over a certain number of months, or even years, credit outstanding is likely to remain considerably below the total amount of the contract.

(c) Besides credit granted with the intervention of BFCB, medium term financing of export orders often involves the commitment of considerable sums by private banks and by industry itself, on which no statistical information is available.

The capital devoted by France to the financing of exports with payment terms of more than one year is therefore likely to have been considerably larger in recent times than might appear from the data reported above.

It should also be added that on March 31, 1957 the first census carried out by the "Centrale des Risques" of the Bank of France showed that pre-financing credits outstanding amounted to Frs. 32 billion, and short term credits to Frs. 36 billion.

Additional facilities provided by the "Ligne Grands Ensembles" have also been widely used, within a ceiling of Frs. 15 billion (now 25 billion).

Further details are available on the activity of BFCB:

(a) At the end of 1956 the Frs. 52 billion of medium term credit reported by the Conseil National du Crédit as still outstanding concerned for 42.5 billion sales to Governments and public bodies, and for 9.5 billion sales to private purchasers.

(b) An analysis of the geographical distribution of the credits outstanding at the end of 1955 shows the following countries to have accounted for more than 80% of the total:

Colombia	21.0%	Yugoslavia	6.2%
Brazil	18.4%	Israel	6.2%
Spain	12.1%	Peru	4.7%
Turkey	10.4%	Chile	4.1%

(c) Taking medium and short term export credits together, the operations of BFCR in the course of recent years appear to have taken place in the following forms:

(in billions of francs)

TABLE 18

Nature of operations:	1952	1953	1954	1955	1956	1957
« Avals »	78.8	84.9	150.8	155.2	113.2	118.4
Discounts and secured advances	13.5	14.4	20.9	29.1	32.7	38.8
Unsecured advances	10.4	12.4	20.1	28.2	24.5	28.2
Guarantees to third parties for account of customers	6.1	6.4	8.2	9.1	10.2	10.9
	108.8	118.1	200.0	221.6	180.5	196.3

Source: Banque Française du Commerce Extérieur, *Annual Reports*.

3. Germany

Extremely scanty information is published in Germany on the risks insured by Hermes A. G. for the account of the Federal Government. The only source is the commentary to the draft budget presented annually to the Bundestag (Erläuterungen zum Entwurf für das Bundeshaushalt) and only in 1958 have the data on credit insurance been presented in a reasonably satisfactory form.

It is possible to relate exports covered by government guarantees to total exports, although leads and lags distort somewhat the situation presented here:

Year	Total Exports (in billions of DM)	Insured Exports	%
1950	8.4	0.3	3.6
1951	14.6	0.8	5.5
1952	16.9	1.7	10.1
1953	18.5	1.8	9.7
1954	22.0	2.2	10.0
1955	25.7	3.2	12.5
1956	30.9	2.6	8.4
1957 (6 mos.)	17.3	2.2	12.7

By June 30, 1957, credit insurance contracts for DM 14.8 billion had been concluded and of these 5.2 billion were still outstanding, with an additional 1.4 billion in course of approval; the comparable data for June 1956 were respectively DM 11.2 billion, 4.4 billion and 0.9 billion.

With the increase in the ceiling on export credit guarantees from DM 7.5 billion to 9.5 billion, approved in 1957, Hermes' commitments are known to be increasing rapidly, although no exact data are yet available.

For judging of the importance of the facilities offered by the Bank deutscher Länder for prefinancing and for short term financing, the following data are relevant:

TABLE 19

EXPORT DRAFTS AND FOREIGN ACCEPTANCES PURCHASED
BY THE BANK DEUTSCHER LÄNDER
(billions of DM)

	1951	1952	1953	1954	1955	1956
Export drafts (Exporttratten)	1.678	2.373	1.979	1.547	1.820	2.504
Foreign acceptances (Auslandswechsel) . . . . .	.438	.602	.650	.754	.934	.906

Source: Bank deutscher Länder, *Annual Reports*.

As far as medium term credit is concerned, the Ausfuhrkredit A.G. publishes a very detailed annual report on its activities: the following four tables have been compiled from data contained in such reports. The first (Table 20) presents for each year total credit contracts current at year end, the extent to which they have been drawn on, and the utilization of the AKA rediscount facilities available for the B line and PJ line. It is important to note that the medium term export paper rediscounted with the BdL and with the consortium of central savings institutions was actually less, because paper received by AKA from commercial banks could often be rediscounted by AKA itself in the money market, rather than with the central banks. The last item presents the advance commitments entered into by AKA and not yet cancelled or converted in actual credits: these commitments help explain the fact that credit granted never seems to reach the maximum allowed for the three credit lines.

AKA CREDITS
(thousands of DM)

TABLE 20

Year	Credit Contracts	Credit drawn on	Rediscount with AKA	Advance commitments
1952	577,553 (a)	460,235 (b)	257,664 (b)	139,751 (a)
1953	572,525	455,564	55,174	226,206
1954	664,034	441,910	55,236	224,467
1955	719,635	573,527	162,789	154,997
1956	708,021	577,107	46,152	84,059
1957	574,134	411,470	12,881	202,429

(a) March 31-December 31, 1952.

(b) March 31, 1952-March 31, 1953.

Source: Ausfuhrkredit AG, *Geschäftsberichte*, 1952-57.

The following table compares AKA financing used in the course of each year with invoice value of the contracts financed: the reasons for the discrepancy between the two figures — gradual utilization of the credits and partial self-financing — have been discussed in the text. The ratio between the two figures shows a decrease in 1956 on account of the authorities' decision to raise the self-financing quota to 40% for all B line credits. The first line in the table refers to credits actually granted by the Kreditanstalt für Wiederaufbau before the creation of AKA and taken over by the latter.

(thousands of DM)

TABLE 21

	AKA financing	Invoice value of export contracts financed
1952 (KfW credits)	293,883	602,326
1952 (AKA credits)	366,111	800,395
1953	453,212	856,199
1954	466,265	848,608
1955	402,031	864,727
1956	489,772	1,254,850
1957	396,637	1,182,869
Total	2,867,911	6,409,974

Source: AKA, *Geschäftsbericht* 1957.

The following table shows the geographical distribution of the AKA credits outstanding at the end of each year, and the distribution of German exports as a whole.

(in per cent)

TABLE 22

	1953		1954		1955		1956	
	AKA credits	Total exports	AKA credits	Total exports	AKA credits	Total exports	AKA credits	Total exports
Europe	41.40	54.1	62.47	52.8	59.42	53.0	51.15	66.8
Africa	6.52	9.0	3.20	8.1	6.56	7.2	8.61	4.8
Asia	10.17	11.7	11.45	10.7	12.30	10.6	10.76	10.5
North America	5.56		4.70		3.67		4.38	
Central America	1.29	22.7	1.91	26.0	0.87	26.7	3.00	16.0
South America	32.60		15.45		16.43		13.50	
Australia	1.91	2.4	0.81	2.4	0.75	2.4	0.55	1.2
Other	0.55	0.1	1.01	0.1	—	0.1	3.04	0.7
Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

Source: AKA, *Geschäftsbericht* 1956; BdL *Annual Reports*, 1953-56.

The fourth and last table (Table 23) concerns the distribution of AKA credits among exporting industries. Data are presented for the years 1956 and 1957 only, as distribution appears to be fairly stable.

(in per cent)

TABLE 23

	1956	1957
Machinery	34.7	45.3
Electrical machinery	23.5	19.7
Vehicles	14.4	16.8
Shipbuilding	10.7	9.5
Chemicals	7.9	3.0
Iron, steel, and fabricated steel	4.0	2.6
Other	4.8	3.1
Total	100.0	100.0

The available evidence on the export financing activities of the Kreditanstalt für Wiederaufbau has already been discussed in the text, and I shall just mention again here the total of its outstanding commitments, about DM 385 million at the end of 1956. As has been explained, however, some of these commitments will become effective only in the future, as some credits have been granted partly on the basis of funds expected to accrue to the KfW in 1958 and 1959 from amortization and interest payments on credits granted by the institutions in the past.

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