EXPORT CREDIT FINANCING: THE OECD ARRANGEMENT AND NEW ZEALAND PARTICIPATION

INTRODUCTION

As the term suggests an export credit is a credit or loan advanced on an export good. The credit is usually arranged by the exporter to secure the sale of an export good when the buyer has insufficient finance to pay for it and has difficulty arranging the finance. However, the credit may also be arranged by the buyer (a buyer credit) through a bank either in the buyer's country or in a third country.

Export credit finance has also been made available by governments (termed *official* export credit) either directly or by refinancing credits extended by banks and the amounts and the competitive terms on which they have been offered have caused sufficient concern for the OECD countries to draw up a set of guidelines. Adopted in July 1976, they are called the Arrangement on Guidelines for Officially Supported Export Credits. This Arrangement essentially requires participants to ensure that the terms of its *official* export credits conform to agreed guidelines or, if otherwise, to notify other participants so that they can decide whether or not to offer matching terms.

BACKGROUND

Export subsidies have been available for many years and are now used in one form or another by most industrialised countries. Export credits are of particular significance since they are probably the most acceptable form of subsidy available to exporters. This encouraged the governments of the major industrial countries to become directly involved by providing long-term finance and guarantees for them. Official support for credits quickly spread to other industrial countries and even some developing countries. This was of concern to the OECD who felt that the situation could become difficult to control as countries offered increasingly generous terms in competition with one another. It was considered that Government assistance to exporters by providing subsidised export credit or credit insurance and guarantees would lead to excessive and unfair credit competition which would distort trade patterns. This concern led to the adoption of the *OECD Arrangement on Guidelines for Officially Supported Export Credits* in 1976 and its implementation was effected on 1st April 1978. From the outset the Arrangement applied to most manufactured and capital goods but some classes of goods were excluded because agreement on the terms for their inclusion could not be reached. These included nuclear reactors, some types of ships, aircraft, agricultural commodities and military supplies. There have been attempts to include other sectors, particularly agricultural commodities in the years since implementation of the Arrangement.

Official support for export credit is widely recognised as taking three forms: export credit insurance to cover the risks involved in financing the export; interest rate subsidies; and aid grants to finance a portion of the export.

1. The most widely used form of support by participants is export insurance. Some participants use private companies to insure, e.g. Germany and United States, while others use State-owned corporations.
2. Interest rate subsidies evolved in the 1970s when market rates rose while export credit rates were left unchanged. The unwillingness by governments to raise export credit rates effectively introduced subsidised interest rates into the Arrangement.
3. The other form of support is the aid grant where a part of the credit is given in the form of aid. These are termed tied-aid credits or mixed credits. They appeared to originate in France, but recently other major countries (Japan, Canada and Australia) have announced their intention to offer these credits also.

THE OECD GUIDELINES

The OECD Arrangement is a 'gentlemen's agreement' which establishes internationally agreed guidelines on the terms to be applied to export credits which are accorded official support. It requires participants to ensure that the terms of official export credit conform to the Guidelines or otherwise to notify other participants of the specific departures to enable them to offer matching terms.

The salient features of the Guidelines as they currently apply are:

— purchases of exported goods and services are required to make cash payments equal to a minimum of 15 per cent of the export contract value;

— minimum terms are set for credits of two years and up to 8½ years (or 10 years for developing country recipients) with the minimum interest rates varying between 7.5 per cent and 8.75 per cent depending on the length of the credit and the classification of the recipient country. (See matrix table).

— repayments are required to be made in equal and regular instalments not less frequently than every six months and commencing no later than six months after the starting point;

— special terms apply to some sectors (conventional power plants, satellite tracking stations and most ships);

— participants are required to adhere to the 'best endeavours' clause which requires them to observe customary trading terms where these are less generous to buyers than those set out in the Guidelines;

— participants who do not follow the normal practice with respect to the Guidelines' terms are required to notify other participants *prior* to issuing a commitment. Any other participant has a right to offer matching terms;

— a participant supporting a tied-aid credit with a grant element of less than 15 per cent is required to follow prior notification procedures.

The operation of the Guidelines was first reviewed in October 1978 and since then has been reviewed annually in May of each year. During the reviews various aspects of the Guidelines have been discussed. The major issues have been the interest rate matrix, the sectoral coverage

and tied-aid credits. Each of these will be discussed in turn.

TABLE 1

Interest Rate Matrix
(Applicable from 1st July 1980)

Classification of Country	Number of Years in Maximum Repayment Term 2 to 5	Over 5 to 8.5	Over 8.5 to 10
Relatively Rich	8.5	8.75	...
Intermediate	8.0	8.5	...
Relatively Poor	7.5	7.75	7.75

INTEREST RATE MATRIX

One of the most contentious aspects of the export credit system and specifically the OECD Arrangement concerns the rate of interest charged on export credits. During the last few years the interest rate has become the main source of subsidy for an export credit. The lower the interest rate is set compared with the market or commercial rate, the greater is the subsidy.

Prior to the OECD Arrangement the competitive nature of exports led to competition in interest rates offered on export credits. Since the Arrangement was instituted market rates have tended to both rise and become more divergent among different countries (see table 2). This has increased the amount of subsidy required and the scope for subsidising by denominating credits in currencies with higher rates, e.g. U.K. pound, U.S. dollar, than in currencies with lower rates, e.g. Swiss franc, Japanese yen.

It has been estimated[1] that the annual subsidy cost of all export credits outstanding (by the twelve major OECD countries) at the end of 1979 would amount to US$5,526 million. The magnitude of this figure has been of concern to many countries and has resulted in considerable debate on ways to reduce it. One obvious possibility is to raise the matrix of rates. This option has only been adopted once following the 1980 Third Annual Review where it was agreed that the minimum interest rates for all new commitments would increase from 1st July, 1980, by 0.75 per cent for relatively rich and intermediate countries and 0.25 per cent for relatively poor countries. However most OECD countries still have market rates above the Arrangement's interest rate minima.

The other means by which the OECD attempted to reduce the subsidisation was by considering the various alternative interest rate concepts suggested by the Wallen Report. (The Wallen Report was a study commissioned by participants in the Arrangement to look for ways of overcoming the interest rate problem.) The report proposed two alternatives: a uniform moving matrix (UMM)[2] and a differentiated rate system (DRS)[3]. These systems have been acceptable to most OECD members with the exception of EEC members.

Of the EEC countries it is understood that France has been the country most strongly opposed to a new matrix. The fact that one country is effectively preventing a new system being adopted which is designed largely overcome the subsidisation problem has been of concern to other members. It has led the United States to strongly criticise the EEC and expose France's position. The United States' persuasive approach failed to get the EEC to

(1) See Annex II to OECD document TD/CONSENSUS/80.9

(2) In the uniform moving matrix proposal one basic minimum interest rate would be applied for all currencies and would be calculated as a weighted average of market rates.

(3) In the differentiated rate proposal, each currency has its own basic minimum interest rate which would be closely related to its market rate

TABLE 2

Yields on Government or Public Sector Bonds

	1980 June	Sep.	Dec.	1981 Mar.	May	Annual Change May
Austria	9.27	9.61	9.66	10.33	10.55	+1.29
Belgium	11.84	12.43	13.04	13.57	13.85	+1.59
Canada	10.74	12.7	12.63	13.61	15.09	+4.01
Denmark	19.3	18.9	18.4	18.4	19.4	−0.50
Finland	10.48	10.41	10.46	11.01	10.92	+0.43
France	13.34	13.85	14.31	14.98	17.25	+3.76
Germany	8.1	8.1	8.8	10.1	10.5	+1.90
Italy	15.20	15.96	16.3	17.67	19.66	+4.70
Japan	8.61	9.21	9.41	8.29	8.81	+0.06
Netherlands	9.86	10.25	10.51	11.42	11.91	+1.91
New Zealand	13.46	12.99	12.85	12.88	12.85	−0.55
Switzerland	4.72	4.87	4.73	5.47	5.85	+1.03
United Kingdom	13.67	13.47	13.78	13.66	14.40	+0.29
U.S.A.	9.40	10.94	11.89	12.15	12.96	+3.14

accept the UMM or DRS alternatives and in December 1980 the U.S. announced it would depart from the Guidelines by increasing the maturities of its credits (up to 20 years) to offset the higher interest rates it would charge. This policy is understood to be selective in nature, i.e. designed to be directed against French derogations (as deviations from the agreed guidelines are known). At this stage it remains unclear how effective this action will be and whether other countries will follow the United States lead. However, it would appear likely that participating countries will eventually work out a compromise, particularly since the cost of interest rate subsidies is now very high. Governments are conscious of high-budget deficits and recognise the need to reduce them.

SECTORIAL ISSUES

The OECD Arrangement could be more comprehensive in its coverage. As mentioned a number of significant sectors remain outside the terms of the Arrangement, the most discussed of them being agricultural commodities. It is this sector which has attracted the most attention from the Secretariat and member countries in attempts to get a wider coverage for the Arrangement. The other sectors have not been extensively discussed by participants, the entrenched positions adopted by certain countries making it highly unlikely that any agreed middle ground could be reached.

INCLUSION OF AGRICULTURAL CREDITS

The exclusion of agricultural commodities from the Arrangement has been of some concern to major agricultural exporting countries. The major objective of their inclusion would be to prevent subsidisation of agricultural products through the availability of generous credit terms in the official support of agricultural export credits. Those not convinced of the desirability of such a course were concerned that its inclusion would lead to an erosion of the customary terms for agricultural exports. This concern has led members to agree that if agricultural credits are to be included then the terms used in normal commercial practice should be regarded as the standard. Just what is understood to be normal commercial practice is, however, subject to dispute.

The Secretariat has proposed the following:

(a) normal commercial terms should be cash or up to 180 days credit;

(b) credits in excess of 180 days and up to two years should be listed and reported retrospectively every six months;

(c) credit terms of over two years should be subject to consensus Guidelines and prior notification procedures.

While some countries (Australia and the EEC) generally agreed to these proposals the United States expressed some disagreement and Canada was opposed to this idea. Unfortunately, the failure to resolve the interest rate issue has slowed the impetus to discuss even this issue.

TIED-AID CREDITS

A tied-aid credit is defined in the Guidelines as 'a credit with a grant element of less than 25 per cent which is provided for development aid purposes and which is financed either exclusively from public funds or, as a mixed credit, partly from public and partly from private funds.'

Tied-aid or mixed credits are considered a matter of concern by both officials and exporters for the functioning of the Arrangement. The number of participants offering tied-aid credits increased during 1980/81 as well as the amount of funds earmarked for this purpose. The danger posed by mixed credits is seen when participants use the option to offer a special interest rate that undercuts the interest matrix as such options can seriously distort trading patterns.

The United States wants to abolish all mixed credits with a grant element of less than 25 per cent and to make other mixed credits available only to the developing countries. France is opposed to any changes to the Guidelines for mixed credits. It considers mixed credits are a major instrument for development assistance as they are generally only given to public entitles in the poorest countries (usually former French colonies). However, it is widely recognised also that most of France's mixed credit packages are for high-technology exports from industries the French government is trying to encourage.

Although many other countries are now offering mixed credits, they have declared they would be willing to abandon them if France would. The current position represents a stalemate. In this situation an escalation in their use cannot be ruled out.

ECONOMIC EFFECTS

The export credit has emerged as a means for providing a substantial export subsidy and as such falls into the category of non-tariff distortions of trade. Countries attempt to justify the use of such subsidies by reference to a short-term problem in their balance of payments or the need for assistance to be given to the export sector to encourage or stimulate production. However, it can be argued that such aims can be better achieved through other more permanent and less discretionary means, such as changes in the exchange rate.

The major difficulty with the export credit subsidy is that it frequently prompts retaliatory subsidies to be introduced by other countries which only leads to what was to have been a temporary state becoming a permanent feature of world trade. In this way subsidies, once introduced, are difficult to remove.

The export credit subsidy has been no exception. Government support for export credits quickly developed and this was followed up by a proliferation of the terms being offered. Although the OECD Arrangement restricted the opportunity to compete in this way, it was not long before some member countries were looking for loopholes. These they discovered in the form of tied-aid credits and the lower than market rates of interest.

However, the authorities in most countries are aware that no real advantages are gained from competitive subsidisation. When a subsidy from one country is matched by another country then each country loses the cost of their subsidy and gains nothing because their relative competitive position is unchanged. Instead the buyers or importers are the winners. However, efforts to reduce these export subsidies have encountered difficulties, as already explained. No major country appears willing to take the initiative on this issue for fear of losing a competitive edge to others.

Other effects on the country providing the subsidy also need to be considered. They are who pays for the subsidy and what are the macroeconomic implications. Initially it is the government that pays the subsidy either directly through its own corporation or indirectly to a private institution. The effect of this will be to increase government expenditure. In times of high inflation an increase in government expenditure is likely to aggravate the economic situation by creating additional inflationary pressures. Inevitably at some time in the future the domestic consumer will have to finance this increased expenditure:

1. The government may decide to increase taxes in which case the burden will either directly or indirectly fall on the domestic producer. This raises the producers' costs, makes their products more expensive and competing imports relatively cheaper.
2. Alternatively the government could let its deficit rise and finance it in an inflationary way — by borrowing from overseas or increasing the money supply. This only postpones the solution while creating further problems for the future.

Clearly then the general effect of export subsidies can include a less efficient export sector, a higher cost domestic sector, higher taxation, increased government administration costs, higher inflation and a less competitive economy.

NEW ZEALAND'S INVOLVEMENT WITH EXPORT CREDITS

New Zealand has avoided becoming heavily involved with official financing of export credits (particularly long-term export credits), but this is partly because New Zealand's export sector has been assisted through various other export incentive schemes. For example, in 1979 New Zealand gave commitments of US$2.0 million compared to total OECD commitments in excess of US$40 billion. Nevertheless, New Zealand has developed three schemes to ensure creditworthy exporters are not denied post-shipment finance. The schemes are primarily to refinance the trading banks and are administered by the Reserve Bank: a short-term export credit-assistance scheme a 'back to back' facility for long-term export finance and a rediscount facility for developing markets. The first two schemes enable banks to refinance export term bills which they have discounted for the customer and the third scheme provides finance for the goods when neither the exporter nor the bank is willing or able to make credit available on the terms demanded by the overseas buyer. Details of the three schemes are outlined in the appendix.

From May 1978, when New Zealand joined the OECD Arrangement on the Guidelines for Officially Supported

Export Credits, it has conformed to the terms set out in the Arrangement. New Zealand officials have also contributed to the group discussions and have taken a close interest in the major policy issues, particularly the inclusion of agricultural credits within the terms of the Arrangement. New Zealand supported a review of the interest rate matrix and expressed an initial preference for the differential rate system (DRS) as proposed in the Wallen report. When it became clear that France was strongly opposed to a system which had a different rate for each currency and more generally to any market rate system, New Zealand supported a compromise proposal based on the uniform moving matrix (UMM). Other countries including the United States which initially supported the DRS alternative also agreed to support the compromise UMM variant. New Zealand officials consider there has been excessive subsidisation occurring which can only effectively be reduced by a more market-oriented interest rate matrix. Furthermore, it is believed the system should be equitable for all currencies. This is not the case at present as some currencies have domestic market rates below the matrix minima.

The other major policy issues that New Zealand has been involved with are tied-aid credits and the inclusion of agricultural credits in the terms of the Arrangment. New Zealand does not offer tied-aid or mixed credits. Official development aid funds are provided by New Zealand in response to requests from developing countries to meet their own development objectives. These are provided totally in grant form and are not linked to commercial credits. New Zealand considers the continued use of tied-aid credits should be restricted.

The issue involving agricultural credits has been of concern to New Zealand. This is understandable given the importance of the sector to the economy. The major issue in this respect involved the question of whether or not agricultural credits should be covered by the terms of the Arrangement. The issue has not yet been resolved. However some participants have stated their official views. The only countries to have stated that they have objections have been Canada and Austria. New Zealand's policy, formulated earlier this year, generally confirmed its support for the OECD Secretariat's proposals to include officially supported agricultural export credits in the Arrangement on the terms specified by the Secretariat.

Table 3 details the export credits offered by New Zealand. From the table it can be seen that most credits have been to countries in the Pacific and Asian regions and the average value of all credits extended by New Zealand is $94,000.

The interest rate charged by the Reserve Bank has gradually increased since 1970 (5.25 percent to a rate of approximately 11 per cent in 1980).

The other form of official support for export credits in New Zealand is export insurance. The New Zealand body responsible for providing the service is a Government owned corporation, the Export Guarantee Office (EXGO). EXGO operates under the administration of the State Insurance Office. Any surpluses it has from its operations are paid into the State Insurance account to cover losses in other years' operations. When claims are in excess of funds available in the account these are met from the Consolidated Revenue Account of the Government.

EXGO gives cover on contracts for the sale of goods and services wholly or partly produced in New Zealand provided the terms of payment conform with internationally recognised terms for the particular product. The premium and guarantee fees charged by EXGO depend upon the categories of risks covered, the creditworthiness of the buyer, the country of destination and the period of credit. In 1981, the scale of fees ranged from 1.5 per cent for a best market, short-term credit to 5.1 per cent for a worst market long-term credit. Official export credit financing requires the exporter to take out insurance cover (with EXGO) on the goods to the maximum extent possible.

CONCLUSION

New Zealand has offered relatively few long-term official export credits in the past (it has averaged six credits per year since 1970), in part because of an awareness and acceptance of the problems that can arise from an extensive use of these credits as a form of subsidisation for exports. However it is also probably partly due to the fact that substantial assistance is already given to New Zealand companies to encourage exports by way of various export incentives.

TABLE 3

New Zealand's Long-Term Export Credits 1970–1981

(by destination)	*0– $30,000*	*$30,000– $50,000*	*$50,000– $100,000*	*$100,000– $200,000*	*Greater than $200,000*	*Total No. of Credits*	*Total Value ($000)*
Australia	4	2	2	4	3	15	1,994.5
Fiji	4	5	6	5		20	1,592.5
Hong Kong				1		1	180.0
Indonesia	1				1	2	295.0
Kenya		1				1	44.0
Malaysia		1				1	50.0
Papua New Guinea	3		3			6	329.5
Scotland		2				2	63.8
Singapore		1				1	40.0
Solomon Islands			1			1	80.0
South Africa	1					1	20.0
Tanzania	1	1				2	57.0
Thailand					1	1	4,890.3
Tonga			1			1	51.0
United Kingdom	2	1	3			6	259.0
West Germany					1	1	740.0
West Indies	1					1	22.2
	17	14	16	10	5	63	10,708.8

APPENDIX

NEW ZEALAND'S EXPORT CREDIT FINANCING SCHEMES

The Reserve Bank administers three schemes designed to assist the export of New Zealand made goods by the provision of post-shipment finance through the trading banks.

The schemes aim to ensure that, in normal circumstances, trading banks will not refuse to provide post-shipment finance, either through the discount of export bills or otherwise, to creditworthy customers because of the bank's own liquidity position. The schemes are not intended to provide funds for exporters at concessionary rates.

The first two schemes enable banks to refinance export term bills which they have discounted for customers. The third scheme deals with the situation where the exporter himself is unwilling or unable to be a party to the provision of the credit and the bank is not prepared to make credit available directly to the overseas buyer because either softer terms are required or the credit-worthiness of the buyer is in doubt.

It is emphasised that all three schemes apply only to post-shipment finance and that normally all appproaches for the use of the facilities should come from the banks' New Zealand Head Offices.

1. Short Term Export Credit Assistance Scheme

(a) Under this scheme, the Reserve Bank is prepared to make loans to banks against schedules of certain export bills discounted by the bank within the previous seven days.

(b) To qualify for refinancing under this scheme the bills must be drawn in respect of commodities covered by the 'Increased Export Tax Incentive Scheme' (i.e. all manufacuture goods and most commodities other than meat and wool).

(c) There is also a limitation that at any one time, a bank may not refinance qualifying bills drawn by any one exporter which exceed the lesser of 50 per cent of that exporter's exports for the last twelve months or $3 million. The Reserve Bank will, however, consider exceptions to this rule where its effects are unduly onerous on a specific exporter.

(d) The refinancing loans are made for terms to coincide with the terms of the bills.

2. 'Back to Back' Facility for Long Term Export Finance

(a) Where a trading bank makes available post-shipment finance for terms in excess of twelve months to an exporter of New Zealand made goods, the Reserve Bank is prepared to make 'back to back' loans to the bank to replace the funds lent to the exporter.

(b) Loans will not normally be made under this scheme to cover payments falling due in the first twelve months but, where they qualify, these may be refinanced under the Short-Term Export Credit Scheme outlined above.

(c) Generally loans to finance exports of any manufactured goods with a predominant New Zealand content for which terms in excess of twelve months would be permitted will qualify for refinancing under this scheme. (It should be noted that the Reserve Bank's consent is required under the Exchange Control Regulations before any goods may be exported if the sale proceeds will not be received in New Zealand within six months of the date of export. Consent is normally given where extended terms are usual for the goods concerned or where an export sale would not take place without extended terms.

(d) The Reserve Bank loans are for a minimum of $20,000 and repayment terms must be the same as those granted by the exporter to the overseas buyer.

(e) If a bank wishes to make use of this facility, application must be made to the Reserve Bank prior to arrangements being completed with its customer. The Reserve Bank will give a commitment as to amount, term and interest rate which will remain open for six months. No security is required by the Reserve Bank on its loan to the trading bank.

(3) The Rediscount Facility for Development Markets

This scheme enables overseas buyers of New Zealand made goods to obtain long term export credit in circumstances where neither the exporter nor his bank is willing or able to make credit available on the terms demanded by the overseas buyer.

The scheme is limited to financing exports of New Zealand made goods to developing countries or to new markets in other countries where soft terms are necessary to make the initial sale and where there is a real prospect of making further sales on normal commercial terms once the product has been accepted.

As with the 'Back to Back' Facility mentioned above, the prior consent of the Reserve Bank must be obtained to the proposed long term credit arrangements before any deal is concluded. The terms of the sale must normally require the buyer to make a cash deposit of at least 15 per cent on shipment of the goods with the balance payable within five years. Usually bills must mature at regular intervals over the period of the credit.

Where approval is given for the use of this facility, the following general arrangements will apply:

(a) The Reserve Bank will rediscount for a New Zealand trading bank, export bills of exchange drawn under irrevocable letters of credit acceptable to the Reserve Bank.

(b) The bills will be rediscounted by the Reserve Bank without recourse on either the exporter or his bank.

(c) The bills must be rediscounted immediately they are purchased by the trading bank.

(d) The letter of credit must be expressed in New Zealand currency or some other currency which is freely convertible.

(e) The discount rate charged by the Reserve Bank will normally be set after reference to rates being charged by other countries exporting goods of a similar type and from it the Reserve Bank will meet any document handling charges levied by the New Zealand trading bank.

(f) The exporter is required to take EXGO insurance cover to the maximum extent possible at his expense and assign the policy to the Reserve Bank.

(g) The Reserve bank will give commitments which will remain open for six months.