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Building Credit Insurance and Credit Information in the Electronic Age: Rationale and Support Measures for Africa

By Rouben Indjikian,
Head, Banking, Payments and trade Finance Unit
Electronic Commerce Branch
U N C T A D

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By Rouben Indjikian, UNCTAD[1]

1. Africa in the world trade and finance: need for credible reforms and institutional building.

Africa's share in the world population is currently estimated around 15% and that figure is expected to grow. At the same time in 1990`s the continent was producing only around 2% of the world output and exports. While in 1980 the sub-Saharan Africa had 2,5 % of the world domestic product in 1996 it's share more than halved to 1,1%. Meanwhile the bulk of African exports goes outside the continent and the intra-African trade constitutes only around 10% of its trade. During the last decade the exports of the African countries was mainly stagnating or even falling in countries trapped by internal conflicts.

Severe debt crises and failures to pursue consistent economic policies in the majority of African countries *inter alia* due to political crises and military conflicts in the 1980s and the 1990s have greatly diminished the capacity of Africa to participate in the relatively dynamic growth and globalisation of the world economy.

Increased share of foreign trade in GNP and higher volumes of international financial flows of primarily private capitals were among the characteristics of the emerging world economy. In that economy countries achieving higher levels of economic growth were normally among those performing as dynamic and increasingly diversified exporters *inter alia* as a result of attracting more foreign capital, including trade and project finance, foreign direct and portfolio investment. The recent and rapid introduction of Internet as an opportunity to communicate and network at a fraction of until very recently acceptable transaction costs gave a new impetus to growth, globalisation and liberalisation of the world economy. Yet being outside of above processes are further aggravating the risks of marginalisation.

At the same time multilateral and bilateral financial assistance and in some cases unilateral transfers of expatriates cannot hide the failures of effective governance and reforms. Although they contribute to maintain some level of effective demand in some African economies they are not instrumental to increase their productive and export capacities and to improve considerably their access to the international financial markets. In many cases foreign trade liberalisation brought about mainly an increase in market shares and even substitution of local production by imported goods. Due to lack of consistent stabilisation and structural reforms the demand leakage was not compensated by the corresponding increase in supply of local goods and services.

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[1]Rouben Indjikian is the Head of Banking, Payments and Trade Finance Unit, Electronic Commerce Branch, UNCTAD. The paper reflecting his expert views is prepared for the UNCTAD and ITC conference "Developing Credit Insurance in Africa and Mediterranean", Tunis, 23-24 October 2000 organised under the aegis of the President of Tunis and in association with COTUNACE, AIO, Dakar Union and Jean Bastin Foundation.

In many countries this trade deficit gap is not diminishing and the sources of current account non-debt financing are not sustainable in the long term. As a result the external accounts are being deteriorated and further accumulation of external debt is taking place in spite of debt forgiveness process within the framework of HIPC Debt Initiative. As far as the latter is concerned the creditors countries and international organisations are very late and slow in alleviating the external debt burden on African economies. As a result many African countries are taking the risk of facing new financial crises and sharp devaluations of their national currencies.

Hence the design and implementation of a credible production and exports growth strategy in those countries becomes a central duty for the authorities and a vital task for the society at large. Only well concerted internal policy framework and external support to facilitate the capacity building could bring a remedy to current dramatic situation.

Development and restructuring of local productive capacity through revitalising traditional commercial links and finding new markets is a big challenge. For the moment overwhelming African and Mediterranean governments are trying to attract foreign investors *inter alia, via* their participation in the privatisation process.

At the same time market economy legal and partly institutional frameworks are more or less present in many countries and internationally recognised business practices are increasingly taking root. The region is equally rich with relatively qualified, versatile and low cost local workforce. However the lack of political stability and frequent economic policy and regulatory shifts are deterring foreign suppliers, financiers and investors from many otherwise promising African markets.

Currently external finance inflows are limited to a very narrow group of countries. At the same time to achieve real long term growth and to make external balances more sustainable the majority of African countries need to get access to various sources of financing trade and production. However to achieve that stage a great deal of work should be done to improve the state of local governance on both public and private levels. So the African countries should get seriously engaged into a credible structural reforms and institutional building process. On macro level it involves a policy of relatively stable internal prices and local currencies and of building local financial services industry *inter alia* through greatly improved supervision practices. A well-organised and transparent public finance with relatively low and enforceable taxes should be also the part of those policies. That in its turn should accelerate the market institutional building process, giving incentives to local companies to move away from informal economy to the official one. The creation of credible and verifiable databases on corporate financials and their current payments behaviour might greatly improve their access to trade finance and bank loans. Developing such institutions as company registries, an independent arbitrage with publicly available court decisions, legal, accounting and audit services would be the elements necessary to ensure a required level of corporate governance. Creation of local economic and especially credit information databases on corporate risks would in that case become a credible exercise thus ensuring the corporate`s access to finance.

2. Why Credit Insurance?

Inadequate trade finance and in particular the lack of one of its main forms, credit insurance, in the majority of countries are still among the important bottlenecks for the development of foreign trade in Africa. The local traders are in great need of trade finance and credit insurance facilities and instruments so widely available to their developed country counterparts. The introduction of modern trade finance and credit insurance services in those countries could also contribute to further development of their national banking and insurance industries.

The credit insurance is frequently mixed with other types of insurance and particularly with cargo insurance which is also strongly related to export-import operations. At the same time the traders frequently associate export credit with a purely bank product i.e. just with a bank credit to an exporter without relating it to the insurance as a security for the financier established by the credit insurer.

Although the analysis of the essence of credit insurance and the structure of this industry are not the main purpose of this paper it is important to stress some of its essential characteristics. Currently the bulk of credit insurance is concentrated in OECD area and is related to protecting sellers from non payments of buyers through issuing mainly short term insurance policies protecting from political (policy related restrictions and failures or natural disasters) and commercial (protracted buyer's default to pay due to financial difficulties or outright bankruptcy) risks. Of course the Export Credit Agencies (ECA) are doing much more than that, however all of them have started their business from above mentioned covering of short term trade or so called supplier's credit, which do not actually involve a bank credit. It is hard to give the exact volume of short-term trade credits extended by exporters themselves. However it is known that open account trade constitute the bulk of USD 5,5 trillion strong world trade. It is interesting to note here that the members of the biggest association of credit insurers, the Berne Union, which includes nearly all OECD and some developing and transition countries, are covering approximately 10% of the world trade. In its turn 80% of credit insurance business is still insuring buyers risks in intra OECD, short term, open account trade transactions.

The bank credit is more related to medium long term credit insurance business associated with the purchase of equipment and project finance by mainly developing countries. Here the ECAs are either financing directly (more related to Anglo-Saxon type of Eximbanks) or giving a conditional insurance cover (Continental European traditional credit insurance) to lending banks against their bank loan to the buyer`s bank normally financing the imports of complex equipment.

One should also stress that the literature on the subject is not particularly extensive and there are only few books written on credit insurance.[2] Recently the Berne Union has started to publish its annual the Berne Union Yearbook, devoted to the problems of the export credit, project finance and investment insurance industry.[3]

There is a set of gentlemen agreements known as OECD Consensus between the main credit insurers – the members of the Berne Union – concerning the rules governing the tenure and terms of those insurance policies in different products including consumer goods and equipment. As the insurance policy secures indirectly or directly finance the members of the same association are agreeing on terms of financing to avoid subsidies and tied aid in export credits.

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[2] See for example Malcholm Stephens. *The changing Role of Export Credit Agencies*. IMF Washington, 1999; Jean Bastin. *La défaillance de paiment et sa protection, l'assurance-crédit*. Paris, L.G.D.J, 1993; Geneviève Barral. *L'assurance des crédits à l'exportation.* Paris Coface-Nathan, 1987

[3] the Berne Union. *the Berne Union Yearbook. Newsdesk Communications, London*1998-2000

The service of insuring exporters from high-risk countries importers non-payments risks from might be either very expensive or a non-existent one. At the same time prepayments coming from those importers are relatively small due to their very limited financing capacities. In case of lack of prepayment the risk takers are getting engaged into a try and error period with the buyers from developing or transition countries until they manage to establish relations with local distributors and eventually take their risks on a short term basis. But even then they are exposed to the financial fragility of their local partners. While in many of those countries local financial guarantees are very expensive and credit insurance doesn't exist, the foreign suppliers cannot recourse to that otherwise valuable tools to diminish their risks.

It is also important to stress here that above prepayments have nothing to do with currently very popular pre-export financing of the commodities or so called asset based structured finance. The latter also reflects financial difficulties or needs of developing exporters to extract and transport the commodities to their final destinations. However the risk of pre-payments undertaken here by a well known commodity trader or a bank is limited and the risk management is concentrated around the short term control over the transaction itself through ceding title over the commodity to the financier and controlling the transportation risks of a given amount of commodity for a short period of time. In fact the only trade finance growth industry today is the commodity structured trade finance.

With all its merits the commodity pre-export financing is not really contributing to the diversification of the developing countries exports. One of the ways to achieve this end is to start from financing local exporters working capital needs and protecting them from non-payment risks related to foreign buyers mainly form higher income economies. In parallel by gradually developing credit information on local companies the local export credit insurer might start practising credit insurance for domestic trade and eventually enter into the credit information networks and partly reinsurance business with Western ECAs while assisting to protect foreign exporters from local buyer's risks

It is rather difficult to assess the state of credit insurance in Africa. Local credit insurance entities exist in around 10 countries and are created either by governments or together with private sector participation. In some cases they are in-house credit insurance branches of general insurers. South Africa and Zimbabwe have one of the highest in the world penetration of credit insurance in exports. It was used as defence mechanism to overcome the limitations of the embargo imposed due to apartheid regimes in those countries. Another relatively developed credit insurance systems covering more than 10% of exports are in Tunis and Morocco, while in Egypt it is covering less than 5% of exports. In Sub-Saharan Africa one could give the example of Sonac of Senegal. Senegal s at the same time the host of ACT credit insurers association – the Dakar Union.

At the same time the process of creation and development of credit insurance facilities in some African, Arab and Mediterranean countries, including fully-fledged ECAs are currently under way. However the majority of them do not have credit insurance facilities while credit information basically run by local banks is in a nascent stage. Many countries are just starting to take steps in building credit information, credit insurance and other trade finance related facilities. The others are already engaged in that path but still need a real impetus to make those institutions operative and viable ones. The majority of countries also realise that well functioning national credit information systems and efficient linkages with information sources on foreign risks are primordial to manage financial risks and in particular to create credit insurance facilities in developing and transition economies.

Given high domestic interest rates in the majority of those economies it is also hard to overestimate the potential benefits from access to various international trade finance and credit insurance options at relatively reasonable cost for reliable local exporters as well as importers.

As UNCTAD research shows partnerships between international and national public and private institutions could play a big role to fill existing institutional hiatus in the area of credit insurance and credit information in the majority of developing and transition economies. UNCTAD equally stresses the importance to facilitate trade finance and credit insurance in conjunction with the active introduction of electronic databases, communications and commerce. UNCTAD could actively participate in designing blueprints to create credit information, credit insurance and export credit facilities linked to national regional and global electronic networks of credit insurance and information through the active use of Internet.

2.Credit information infrastructure as a precondition for credit risk management.

In developed economies businesses and consumers have a relatively easy access to finance. One of the reasons for this is the ability of the financier to assess the credit risk of the applicant in a quick and efficient manner. This ability results from the highly developed systems of formatted and standardised information on the financial state and behaviour (primarily as a debtor but also as a supplier, trustee etc) of companies and individuals in the hands of specialised information companies, credit insurers, banks, credit card companies and other creditors. In particular the existence of credit bureaux permits banks to evaluate potential debtor's exposure with other banks as well as his credit history and current state of debt repayments before extending any further credit to a debtor in question. Tradition and adequate regulatory requirements to disclose financial state and payments records of corporate and individual debtors contributed to a creation of highly sophisticated credit information industry particularly in the USA. Without the existence of this highly developed system of credit reporting and information, the credit industry in developed countries would, arguably, have been of a much smaller size. Given the importance of credit in creating the effective demand one could also argue that without access to credit, it is doubtful whether those economies would have enjoyed dynamic growth rates and have been as mature as they are today.

In a broader sense the credit information industry ranges from information and scoring on payments behaviour to a comprehensive rating of companies and countries to assess the so-called commercial and political risks. In fact insurers - the main users of these risk assessments - are undertaking different procedures to cover these two types of risks. While they take the commercial risks themselves the political risks are mainly on the account of the exporter's government. In the 1990s the developed private insurers and reinsurers have dramatically changed their attitudes and have manifested a considerable risk appetite for political risks. However the magnitude of political risks covered by exporter's governments are of still much higher magnitudes.

The fundamental aspect of finance is the risk management. In spite of limitations of imperfect information, externalities, trade cycles (i.e. uncertain future) it is still of primordial importance the ability of a contracting party (supplier and buyer) or its financier or insurer to identify, assess and manage the risks involved in the transaction in question. This process requires relatively accurate, up-to-date and readily available information on various risks on a continuous basis. Financial institutions that lack the capacity to evaluate risks due to the scarcity of reliable data will be reluctant to grant loans or extend cover. Similarly, financial institutions that have seriously mismanaged risks involved will probably face deterioration of their capacity to finance and/or insure present and future transactions and projects. As a consequence businesses and trade would suffer. At the same time the age of information economy and means of electronic communications are opening unique opportunities to the credit information industry worldwide where Internet permits instant online access to various databases on various commercial and political risks.

In developed countries other than the USA, the availability and the transparency requirements for credit information varies from country to country, in line with their respective legislation. However, in Europe and Japan the credit reporting system though well developed is less extensive than that in the USA. In developed countries the applicants (corporates and countries alike) with a good credit profile are beneficiaries of the credit reporting system and have access to credit in time. Here the credit information providers and financial institutions are putting on notice those applicants whose borrowings have earned them a poor reputation.

In developing and transition economies the system of organised credit information is still at its nascent stage. The absence of standardised and detailed credit reporting is one (though not the only) limiting factor to the development of a modern financial sector. Simple bank lending or the financing of a SME is still problematic in most cases. The absence of trade finance hinders exports, and such commonplace instruments in developed countries as credit insurance are currently used by only a handful of developing country exporters of manufactures.

The introduction of credit reporting systems and credit bureaux in these countries would certainly help to strengthen risk management, by corporates and local financial service providers. That in its turn will improve a degree of confidence amongst foreign institutions which might be interested in investing in those countries and to provide specialised forms of finance including credit insurance, bonding and other sureties, factoring, leasing and other forms of modernrisk management in international trade, project finance and investment.

More transparent and equitable banking and data protection legislation, debtor and creditor related laws permitting enforcement of bankruptcy and some other regulatory requirements are prerequisite for the creation of effective credit information systems. In particular the regulatory system should include:

- effective commercial legal and judiciary systems including registration laws, bankruptcy laws, court registers;
- adequate and timely disclosure standards by private sector operators;
- adequate public data dissemination and publishing requirements;
- possibility to collect, process and disseminate public records, suits and judgements;
- permission to access companies track records with banks (for at least authorised institutions) and other creditors.

In developing and transition economies domestic providers of credit information could include public entities, banks, credit and other insurers, debt collectors, specialised information companies, including IT related companies. Foreign entities such as international specialised information companies, credit insurers, banks, credit card companies, IT companies, international organisations could also be major information providers on local and foreign commercial and political risks.

Those involved in the creation of local credit information facilities should have a possibility to collect information from the commerce registry, pension fund, tax, statistical and other information related public offices. They should also have an authority (for example given by clients) to make enquiries using bank's and other private information provider's databases. Local debt collectors and credit insurers (if any) would be the most natural parties interested in the creation of a national credit information facility.

Given economies of scale considerations it also makes sense to create regional networks for national credit information providers, which in their turn could be linked by Internet with the technical assistance of the global players. Such arrangements could also be more attractive to international well-established credit information providers that might be interested in entering into joint ventures and/or providing technical input.

Eventually the emerging credit information services of credit bureaux, information companies, credit insurers and banks could become vast depositories of information on companies located in developing countries. Data management on such a scale could only be accomplished efficiently by utilising modern preferably Internet based information technologies. Furthermore such networks need to be connected to each other on national, regional and global levels. In this case the information flows will greately facilitate the developing transition economies access to international finance as well as to foreign markets of goods and services.

The standardisation and unification of credit information documents and formats in the electronic commerce era could constitute a breakthrough in the financial services industry equal to Edifacts of the UN or the Letter of Credit of the ICC. UNCTAD might play a role of a catalyser and standard bearer in defining with the help an authoritative international expert group the format and contents of credit information data sheets. The latter could be eventually endorsed by main players in the industry and become industry standards.

The active use of Internet by information companies, banks, credit insurers and other trade finance providers could also give to UNCTAD's electronic Trade Points a role of Internet hubs receiving and distributing standardised credit information to the local end users. Trade Points will have a possibility to forward, at a small fee information coming from different networks without actually mixing them together and thus maintaining the rule of confidentiality. Meanwhile if necessary the user will have an opportunity to compare credit information coming from various sources.

Thus a country ready to develop the credit information infrastructure will also be the one that can develop in particular a credit insurance system as one of the key instruments of trade facilitation. The following chapter will discuss conditions for introducing credit insurance to developing and transition economies.

3. Credit insurance and export credit facilities as a crucial part of an export oriented development strategy.

The development of export oriented growth strategy in the emerging economies include fiscal, financial and trade policy measures to expand and diversify exports. They could be implemented through active interaction of public and private sector institutions such as ministries of finance and commerce, investment and trade promotion agencies, development banks, chambers of commerce, trade financiers, credit insurers, credit bureaus, investment and venture funds, etc. In other words the establishment of export credit and investment insurance, financing and guarantee facilities are the key elements of the export growth, diversification and expansion to new markets.

International support measures by WB, EU, regional banks include various regional credit and insurance and guarantee facilities. Besides capital this involves bringing expertise from various sources related to credit insurance and guarantee arrangements and other instruments. Coordinated international cooperation in setting up such operations is crucial at least at the initial stage of their inception.

External finance for many less developed countries is still largely coming from bilateral and multilateral donors and is basically used for economic stabilisation and structural change. Therefore it is not directly linked to the development of exports. At the same time export production lines established by foreign investors normally have access to less expensive foreign private financing and do not face serious marketing and payment problems abroad. So their need for local credit and insurance facilities is relatively limited, unless their plans include penetration into the local and regional markets. Therefore the major potential users of local credit insurance are local producers and exporters. Whilst initially they could be covered for short term trade credit risks, in the longer term the financial system should be able to address the local producers and exporters needs for working capital and prompt payment for the supply of their goods and services.

The prevailing financial conditions for doing business in the majority of developing and transition economies are still characterised by high interest rates and relatively low capacity of local financial intermediaries to provide credit, guarantees or insurance facilities for foreign trade operations. So existing and potential exporters cannot yet depend on the local banking system and have to obtain either foreign pre-financing or face themselves the credit risks related to foreign importers deferred payments. In those circumstances the role of short term trade finance insurance from a local entity working in close collaboration with similar regional and international credit insurers and reinsurers is becoming important for the development of local export capacities. Given the high cost of managing credit or guarantee risks related to both local and foreign borrowers, the local exporters and banking communities need solid sources to insure their trade and bank credits, corporate bonds and guarantees issued in favour of or by local producers and exporters.

Hence the primary *raison d'être* for locally available credit insurance facilities. As the local banks and insurance companies are yet not in a position to offer internationally acceptable documentary credit, export credits and guarantees, the establishment of a national Export Credit Agency should be envisaged. National institution(s) dealing with credit insurance, as well as guarantees and export finance could eventually assume a role of a local counterparts for international development banks, foreign ECAs, international commercial banks and other financial institutions, in the framework of managing the risks related to trade, project finance, and investment.

The questions of capitalisation, proprietary and functional structures for these agencies must be adequately addressed from the outset. World experience suggests a variety of solutions. Given the shortage of financial resources in many developing and transition economies the owners of these institutions besides local governments could include local private sector as well as foreign and international public (World Bank, regional MDBs, EU, USAID, public ECAs etc) and private sector (private ECAs, insurance and reinsurance companies, banks, funds, etc). The active Government involvement in the capitalisation and functioning of the ECA at its inception and for its further evolution seems to be necessary.

In key Western European countries credit insurance covers around 10% of exports. The coverage of outgoing investment is even less. So the most optimistic estimate for credit insurance penetration in developing and transition economies will hardly exceed 10 % of exports - a target, which could be reached only as a result of a serious evolution of the industry in above countries.

Initially credit insurance will barely cover a few percentage points of the local exports. So the premiums collected would be very modest and any facility would have to solicit national and international public support while graduating along its learning curve. To increase the mass and the spread of credits insured and hence the premiums collected, one probably should include domestic credit insurance into the equation. However in some key European countries domestic credit and export credit operations are separated from each other institutionally and the export credit insurer is considered as a specialist on foreign buyer's risks.

It is well known that the creation of and access to reliable credit information systems are the key to success for the ECAs as well as private credit insurers, reinsurers and brokers. Normally while a big European export credit insurer is providing credit information to a credit insurer from developing or transition economies it also tries to offer a reinsurance capacity to them. Some of them are building up their databases on debtors by accumulating in-house information and buying the missing parts in the credit information market. The others also add to this various co-operative arrangements. Thus COFACE Group managed to pool credit information capacities in a network of credit insurers called Credit Alliance. The latter was a closed electronic Intranet network covering partners from 29 countries. Those countries in their turn account three quarters of the world trade. By running the network COFACE and its partners are constantly refining their databases on commercial as well as country risks, while COFACE itself is backstopping the network partners by proposing them reinsurance capacity by giving at a short notice it's cover limits on each request for credit advice within the network. Last year COFACE made a step forwards towards Internet and introduced the so called @rating system. Based on a vast credit information database COFACE considers itself to be in a position to give trade credit limits to companies world-wide. The innovation here is the overcoming of the limitations of country risk considerations while analysing the quality of the corporate risk.[4] In fact this private system has incorporated in itself some essential functions proposed by UNCTAD back in the 1970s and 1980s of a project for a global public export credit guarantee facility[5]. The possibility of realisation of

[4] See www.coface.com
[5] See UNCTAD document TD/B/C.3/183, 19 January 1983

this type of arrangement by a private sector operator is coming not only due to the increased role of private sector in the world economy and finance, but also thanks to the e-commerce giving qualitatively new opportunities to apply in Internet sophisticated data mining and risk management techniques at a low cost.

In the case of relatively small developing and transition economies, seeking credit information on foreign buyers and obtaining international reinsurance capacity to cover locally issued credit insurance policies is primordial for the sustainability of local credit insurance schemes. If export flows are concentrated primarily at the regional level then not only the creation of an export credit insurance facility, but also the development of a regional network of national credit insurers should be on the agenda of the authorities. Only by pooling their capacities to cover the buyer's risks the emerging national ECAs would be in a position to achieve economies on scale and simultaneously to facilitate the development of the regional trade. Ideally the creation of national ECAs should be clustered regionally so as to go hand in hand with the creation of regional information and reinsurance capacity sharing arrangements. The development of similar national credit insurance facilities in a given region should at some stage bring about a reliable regional network including regional credit information databases. The rationale for such an approach is determined by a necessity to attract reinsurance capacity for high-risk regions. Today it is much easier to get reinsurance cover from a well-established international reinsurer for exports to the OECD area. The problem is to get cover and reinsurance capacity for the regional trade. Meanwhile finding ways to obtain technical assistance from these institutions and at later stage to get access to their information and reinsurance networks should be on agenda of the emerging national and regional credit insurance arrangements.

The expected initially low level of premiums received from insuring foreign buyers risk in small and medium sized countries would probably make it necessary to include into the activities of a future ECAs a role of a local counterpart for the World Bank Guarantee Facilities as well as for similar regional MDB or EU programmes. If and when a local Government will consider starting an Eximbank type of operation then the scope for institutional building and hence the starting capital of a new institution should be considerably larger.

4. Credit information and credit insurance: the current state of international cooperation.

As was already mentioned the scale and scope of international support measures to develop credit insurance varies from one region to another. Thus the World Bank and EU was undertaking activities to develop trade finance and in particular credit insurance in Africa and Eastern Europe. Given the increased privatisation of financial flows to and from developing countries the global private players including Dun & Bradstreet, COFACE, Gerling Namur Hermes, Euler, NCM were more actively making inroads into those economies. Recently the World Bank has developed a programme, guaranteeing political risks for the Western suppliers of capital goods envisaging that local governments would play a role of a counter-guarantor, while a public operator would handle the processing of these counter-guarantees.

UNCTAD's activities including fact finding missions to individual countries and in-house research show that there is an acute need to develop credit information and credit insurance facilities especially in second tier (the have-nots) developing and transition economies.

UNCTAD is currently discussing with other UN bodies and sister international organisations as well as with relevant national authorities and private sector players including International Union of Credit and Investment Insurers (the Berne Union), International Credit Insurance Association and major international public and private credit insurers and brokers to make possible an international co-ordinated action plan to build national credit information and credit insurance facilities in selected countries expressing their clear interest and capable to ensure efficient local participation in that process.

In its turn UNCTAD's Secretariat should be in a position to participate in such technical assistance efforts primarily through analysing and proposing policy guidelines and activities in the main areas of trade related finance. An important area should be proposing agenda and convening expert group meetings and seminars to give recommendations for the development of credit information and trade related finance arrangements for developing countries and counties in transition. Those recommendations should lay ground for practical solutions and projects in member countries and further activate intergovernmental discussions of development issues in UNCTAD.

ANNEX. How to start a credit insurance facility: some options

In this annex we try to propose various options for proprietary and functional structures of a national ECA. **Our recommendation goes for a creation of a multiple function ECA regardless of the local or international character of its proprietary structure. The credit information could precede or become a part of the newly created ECA.**

As far as the proprietary structure is concerned one could consider following options:

Facility's proprietary structure

A. National

(a) A purely public national ECA owned by the Government agencies: Normally they might include the Ministry of Economy and Finance and the Ministry of Industry and Trade. The board of Directors and hence public shareholders could also include interested agencies such as Central Bank, Ministry of Industry, Ministry of Agriculture etc.

(b) A national ECA owned by local public and private entities. Given the scarcity of "free" public funds in many countries a national ECA could well be established as a corporation with a mixed proprietary structure where shares could be distributed among local insurance companies, banks and other private entities. A clear and transparent presentation of activities of the future national ECA and a predictable behaviour of national authorities could become factors encouraging private entities to participate as shareholders in ECA.

B. International

Foreign participation in the capital is more problematic and needs a very elaborate strategy. In that respect the following options could be considered:

(a) An Export Credit Agency with the participation of international financial organisations such as World Bank and /or regional MDBs;

(b) An ECA with a proprietary structure which alongside with above shareholders will also include foreign ECAs, insurance and reinsurance companies, international banks, other foreign private entities. This is the most difficult but not necessarily only possible way to achieve various forms of co-operation between the national ECA and other parties.

In many middle income developing and transition economies, the national ECAs are fully state owned entities. At the same time splitting the ownership in various proportions between four players: the Government, the local insurers, banks and other private entities, the international financial institutions and other private international entities including private insurers, banks etc could also be envisaged. However it is evident that with or without other than national government shareholders, the creation of a national ECA as an instrument of an export led economic growth strategy is a very important policy priority.

Without downgrading the importance of calling private and foreign capital to set up a new ECA, we nevertheless stress at this stage the importance to define the national ECAs functional structure. In that respect we suggest to consider the creation of the following departments:

Facility's functional structure

A. Credit insurance and guarantees

(a) Credit Insurance Department: in small countries credit insurance operations could start with a small office including say the General Manager, 2-3 underwriters and a small back office. To start only short-term credit insurance operation a capital of USD 3-5 million could be enough. The operation could start from insuring local producers and exporters from both local and foreign buyer's non-payment risks. The use of both local and export credit insurance is important for the development of expertise on local risks for foreign credit insurance and other partners. Reinsurance from foreign buyer's regions should be possible in order to substitute the need for larger capital. The more difficult part here will be to cover exports to risky markets where the sophisticated international reinsurers do not usually give reinsurance cover. In this case the burden of eventual credit insurance claims will have to be shared by the government and the local insurers and reinsurers Hence the importance of regional networking, risk sharing facilities (reinsurance capacity) and other co-operation. Participation in bonding operation for local pre-export and project financing also could come at a later stage.

(b) **Political Risk Counter-Guarantee Department:** another activity which could be started from the outset is the development of counter-guaranteeing arrangements on behalf of national governments for World Bank Group or other MDB Guarantees covering local political risks for foreign investors and project and trade financiers. To avoid conflict of interest a very stringent agreement between the World Bank and MDBs from one side and the local Government from the other should be envisaged for the implementation of these programmes. Another facility proposed by World Bank in that respect is a partial guarantee to cover working capital financing requirements of reliable exporters. However this pre-export financing guarantee facility is related closer to the discussed below Eximbank type of activities.

B. Export finance (in case of availability of enough share capital)

(c) **An Eximbank Department or a sister National Eximbank**: will undertake very important tasks such as issuing financial guarantees and promissory notes as well as providing export credits to strategically important local exporters of manufactures and providing co-guarantees to foreign companies involved in export oriented investing and project financing. In spite of initial difficulties related to the necessity to find a source of finance to capitalise an Eximbank, this approach could ensure in the medium to long term a commercial success for the Eximbank as well as for the local exporters of manufactures. However to start an Eximbank the Government of a small and medium sized country needs to start from USD 5-10 millions from the beginning. Given the stringent fiscal situation in many countries one might envisage seriously the possibilities for international involvement in the capital of the ECA as well as international co-operation in setting up the above mentioned departments for the future ECA.

(d) **Credit Information Department:** Collecting data on the financials and payments behaviour of local companies is the least capital intensive and the most labour intensive operation compared with the above ones. Hence it could be started in those countries independently, before the efforts to establish a fully fledged ECA, with or without the government involvement. The credit information could find demand from customers other than ECAs including local and foreign banks and sellers. However if the service is not there it should be a part of newly started ECA.

Whilst the departments (a) and (b) are closely related to the credit insurance and guarantee operations and could become integral parts of a Credit Insurance Facility, the department (c) dealing with medium to long term export finance could constitute the beginning of a national Eximbank activities. At the same time grouping credit insurance, guarantees and export finance as well as credit information under the aegis of one holding company could be dictated by the necessity to avoid unnecessary rivalry among departments for initially limited amounts of business. In the beginning the credit information fees and premiums from credit insurance cover for local exporters will not be enough to cover the operational expenses, which will include the cost of running a small office, costs of information gathering, risk analysis, participation in international buyer's risk information networks and reinsurance schemes.

The main international fafcilitators including World Bank and EU could help to start the above facilities by developing for each individual case the concept of the future institutional design and by facilitating the process of bringing together all important players and co-ordinating the whole technical assistance programme. This will involve staff training and transfer of credit insurance and reinsurance know-how. The experience of the Berne Union and its members and the involvement of Western ECAs in this operation with extensive advisory services is equally important. Meantime at the initial stages of discussions UNCTAD might bring together all parties in workshops and expert group meetings to discuss in detail the arrangements described above.

With the success of a few pilot projects, similar projects could be developed for a larger group of developing and transition economies. In this case the newly trained experts of ECAs could become national consultants for the development of similar projects in other countries.

As soon as national ECAs will be set up an active work to develop regional arrangements would be necessary to create an efficient credit insurance operations network at regional level.