CHALLENGES GOING FORWARD…

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An Australian colleague retired recently to a farm in the outback, in rolling hills that shield from sight the nearest village 20 minutes away which consists of four houses and a general store that becomes a pub after 5.00 pm. The weatherboard farmhouse is wrapped by a timber porch that overlooks the hills and is surrounded by a high fence that encloses a flock of sheep.

Our colleague removed the fence first thing; it would improve the view and let the sheep roam. He visited the pub that evening to celebrate his triumph of city-ingenuity over the inertia of the country. "Oh yes", said the locals, "removed the fence, eh? Let the sheep roam away from the house then? You'll have snakes in the house now. When the sheep are grouped close to the house, the snakes don't like it and stay away. Remove the fence, the sheep roam, and the snakes come into the house." The next day the fence was reinstated and the sheep were penned!

Achieving policy consensus in dynamic markets

Without taking the allegory too literally, there is an echo of our efforts as guardians and public agencies to impose disciplines on export credits; to create a framework that is commercially responsive but without the volatility of commercial markets. We would not be the wolves in any narrative, but we do gather to exercise some authority in maintaining a fence of market discipline. We protect the house behind the guidelines developed in the OECD Arrangement on Officially Supported Export Credits. Any fence needs maintenance though, and sometimes a new fence is required to satisfy new neighbours.

There have been significant changes over the years in the disciplines of the Arrangement (*e.g.* project finance rules, special terms under sector understandings, adjusted local cost rules and, recently, buyer risk pricing rules). At every stage of fundamental change, there has been broad agreement on the need for progress. My personal history in export credits began in 1987 when I joined the Canadian Export Development Corporation (EDC), the Canadian export credit agency (ECA) as a freshly minted MBA with a background in finance theory. I recall confronting the matrix of lending rates that governed our work, which had no relationship to finance theory whatsoever; however, it was a starting point, a basis on which authorities could agree to extend export credits. Dedicated work by successive colleagues continues to adapt that framework to the demands of our diverse stakeholders.

These changes to the Arrangement have transformed it to a more market reflective instrument, but not to the degree that export credit activity precisely and immediately mirrors the movements in commercial markets. I recall the comment of a former global head of export finance of a major European bank that "… sticky ECA pricing and conditions sometimes help us to avoid rushing into mistakes." Our shareholders now are confronting the challenge that financial markets can systematically misprice risk and the consequences for governments in fiscal and regulatory terms. "Behavioural economics" as a discipline is attracting more attention, particularly in application to financial markets and the tendency of these markets to herd behaviour. Despite these challenges, there is a remark that I have heard attributed to Edward Demming, the American quality management guru, that "… all models are wrong, but some models are useful" and from our perspective, the market interplay of supply and demand for capital is the appropriate basis for the decisions we take about risk and pricing in export credits, as a business that itself uses capital.

From the perspective of our clients, the transformation of the Arrangement has been welcomed but there is concern with the pace at which changes have been adopted. We have been seen as slow to adopt new tools in the market, which in some cases has been our good fortune, but we have lost opportunities as well. Inevitably, the cycle will turn and we will be called to embrace new tools and approaches. We must be prepared to respond responsibly drawing on the successes and lessons in our industry and in the financial sector generally.

Maintaining the integrity of the Arrangement

One challenge will be to maintain the integrity of the Arrangement as we adapt to the legitimate concerns of new members welcomed into the OECD export credit community. It is a significant challenge also to "socialise" the OECD disciplines by drawing in non-OECD countries, and in particular Brazil, Russia, India and China, who have become major providers of export credit support, but this challenge must be met for the Arrangement to remain relevant. Otherwise, matching terms may become more prevalent and in turn render the disciplines of the Arrangement less relevant, which would undermine the collective benefit of the group.

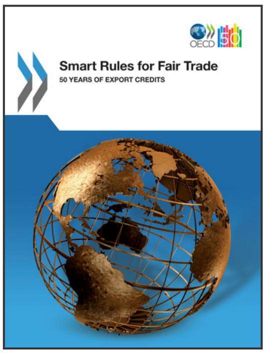
So how should we continue our engagement with the non-member economies? We could tap into the G20 as a forum through ministerial discussions on international economic policy initiatives; or possibly elevate capacity building as part of our outreach programme, in line with ongoing work in monitoring implementation of guidelines on the environment, anti-bribery/ corruption and sustainable lending measures. A consensus on the best approach to answering this question will develop over time.

Other developments may potentially influence the development of the Arrangement. A current topic of discussion is ECA support that falls outside the Arrangement, such as untied loan/ guarantee programmes and a push for transparency of these programmes *via* the OECD Working Party on Export Credits and Credit Guarantees. Currently, transparency is confined to untied aid transactions but there is a reasonable basis to consider expanding such transparency to untied loan programmes.

ECAs also must adapt to the strategic initiatives of international financial institutions (IFIs) and multilateral agencies (MLAs) in trade finance. MLAs appear to be re-inventing themselves with changes to their offerings or existing conventions. This is desirable if it creates a more responsive and market-oriented product but it also may represent a more attractive alternative for banks than ECA backing (*e.g.* through participation in MLA "B" loans and the advantage of preferred creditor status afforded to MLAs). IFIs and MLAs are not subject to the disciplines of the Arrangement; from a borrower's perspective, the attraction could be lower funding costs, albeit some MLAs are mandated to support only projects with a developmental impact.

Finally, as new normal market conditions return, how will the role of the ECA evolve? Increasingly, as institutions we talk about the globalisation of our clients, not just their exports. In the world of integrated supply chains, what role will we play in mobilising global trade and investment? How will we complement the private market, given the landscape created by the financial crisis and the regulatory changes we anticipate? How will the essential element of collaboration continue to be achieved in the field of medium- and long-term official export credit support?

The energy and diligence shown by our colleagues in the OECD, our guardian authorities and the practitioners who have devoted their time to the framework issues confronting our industry, are an inspiration for us to pursue the answers to these questions and more. Those of us who work in this field, or those who have benefitted from export credits, are grateful for their continued dedication.



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