

Debt-creating aspects of export credit as a particular concern in developing economies

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Export guarantees and investment insurance provided by the Export Development Corporation are designed to promote trade on behalf of companies based in Canada, rather than to operate as instruments of Third World development. The EDC is not a development agency, and it does not have a mandate to ensure equity and growth in those countries in which it has a lending or investment guarantee relationship. Yet the EDC, along with other export credit agencies, must bear responsibility for the promotion of sustainable and equitable development in poor countries, regardless of the domestic priorities that emphasize sales, exports and the realization of maximum profit.

The EDC is an agency that depends on public support, with its existence deriving from public monies. As a Crown corporation it reflects the policies of the government of Canada as they relate to the expansion of Canadian business abroad. It has obligations similar to other Canadian enterprises, and more because of its relationship with Parliament as a created body with public responsibilities. These responsibilities are all the more acute with its relations with the poorest nations on earth, and the impact EDC lending has in these countries.

Unlike commercial bank loans, or official bilateral development lending made on behalf of the government, EDC lending has an ambiguous characteristic in that its lending may result in private claims being transformed into public ones. The guarantees that are provided by the government create, in effect, subsidies to Canadian businesses seeking to export, encouraging them to engage in trade and exports that would otherwise be economically unviable. To an extent, the increase in export credit lending reflects an "export driven" desire for expanded business rather than a need for funding on the part of the borrower.

This encourages a process of excessive and unproductive lending, unchecked by a lack of transparency and responsibility to local or global communities. This operates against a process by which export credit can serve as a catalyst for private sector activity along with the protection of objectives of sustainable development and the enhancement of life at the community level.

Export credit, especially compared with the financing available from the international financial institutions (IFIs) like the World Bank, has grown to predominate in developing economies. While lending from IFIs has remained relatively stable in recent years, export credit lending has soared. Export credit agencies globally increased their commitments fourfold in eight years, from US\$26 billion in 1988 to \$105 by 1996. The role of export

credit in those countries considered "heavily indebted and poor," in which the level of external debt is now widely recognized as unsustainable on both an economic and a social level, is cause for greater concern, especially as the problem of indebtedness in these countries becomes more widely understood as an impediment to economic and social progress.

Efforts to address the debt crisis in the poorest countries have been centred in the Paris Club of creditor countries and, more recently, through the Heavily Indebted Poor Country (HIPC) Initiative of the World Bank and IMF, which now seek to address the bilateral and multilateral levels of debt of these countries, respectively, in a coordinated fashion.

For those countries that have completed the HIPC Initiative debt reduction process (or expect too soon), World Bank staff members have recently reported a growing pressure to take on more debt, as the financial situation of these countries becomes more viable. The demands of debt service to the IFIs and to the countries of the Paris Club will be subsiding, to some extent, as debt reduction programs take effect, and so there is a renewed interest in these countries as contractors of new loans, even on non-concessional terms.

This repeats a concern expressed in the mid-1980s, when the IMF reported that official export financing agencies had "rushed in where commercial banks fear to tread" following the debt crisis of 1982 and the drying up of commercial lending to Third World countries. The restoration of some level of credit worthiness in those countries that have, or will soon, receive debt reduction through the HIPC Initiative process, raises new concerns about the quantity and quality of new loans that will arrive.

With the drafting of an "enhanced" HIPC Initiative process in the summer and fall of 1999, there is a renewed interest in seeing debt relief result in enhancements in the standards of living for the most vulnerable in the poor countries. There is considerable skepticism that competition among export credit agencies for new loans would lead to such an outcome, but that it will bring a return to unsustainable levels of indebtedness without either a commensurate improvement in conditions of life or a reduction in levels of poverty.

Recommendation: The terms and conditions of new lending by the EDC must be made in consideration of the context of poverty and indebtedness that is the reality in the poorest countries, which necessarily affect the desirability and feasibility of new lending, especially on non-concessional terms, to these countries. Assessments of loans must be made that take social conditions, including poverty, of a country into consideration. Loans should not be contracted in situations where it cannot be determined that they will support efforts to bring a degree of quality growth that will affect living standards, especially for the most vulnerable, in positive ways.

Recommendation: With regard to countries classified by the World Bank as "heavily indebted and poor," common standards of behaviour should be agreed upon by export credit agencies which aim to restrict new loans that serve to increase a country's indebtedness without substantially contributing to quality growth and social improvement. The objective is to establish processes of evaluating the viability of export credit in terms of social progress and economic stability in countries where these are fragile, and to cease export credit lending where this viability cannot be demonstrated.

Approximately 15% of EDC loans are non-performing. The corporation has written off commercial debts that it cannot collect, but the situation is different for sovereign loans. In these cases, the EDC relies on "certain arrangements" within the Paris Club. Referring to sovereign debts that are non-performing, Mr. A. Ian Gillespie acknowledged that EDC relies on the government of Canada to cover its losses: "EDC doesn't write them off, but because of its international obligations Canada may look at reducing the obligation for certain countries."

Recommendation: New loans should not be contracted with an expectation of reimbursement by the government of Canada in the case of default, or in the case of sovereign loans, where the debt situation of a country is recognized to be unsustainable. In other words, the EDC should not expect to be "bailed out" on its loans to poor countries, as has happened in the past.

Considering that EDC sovereign loans that have gone sour have been reimbursed by the government, and obligations under Paris Club or HIPC Initiative agreements have been absorbed by the government on behalf of the people of Canada, serious concern about the availability and appropriateness of the ready availability, nature and terms of EDC credit to these and other poor countries is warranted.

A summary of concerns about export credits provided to Third World countries includes:

- a tendency to support projects (especially large "mega-projects") that do not serve the poor in a country
- lack of support for provision of basic needs
- concessional financing as it distorts trade patterns and development programs, especially when there is an obligation to purchase Canadian goods which would not have been done under regular market conditions. The tied aid that accompanies export credit involvement in development projects operates against local partnership or ownership in planning and implementation, and undercuts local producers and suppliers

The parameters for EDC lending were laid out by A. Ian Gillespie, EDC President, when he stated that "so long as we're working within the government-announced policy, our job is simply to assess the ability of those foreign obligors to repay their debt to EDC or to pay the account receivable a Canadian company might have". Any loan assessment would be "confined to the ability of the sovereign [country] itself" to honour its obligations.

Recommendation: In the promotion of private sector investment, the EDC should consider its service to be in the public interest in Canada and in developing countries, especially as it derives from public financial support. The use of public funds, guarantees and risk insurance should not contribute to impoverishment in developing countries, or to the impediment of their development. EDC involvement should take into due consideration the macroeconomic conditions of the borrowing country, not only in terms of the risk assessment related to the ability to repay, but also the wider considerations of how higher levels of indebtedness may adversely affect quality economic growth. Because of the nature of the social and economic contact with the governments and people of poor countries, lending should be restricted to that in which it can be demonstrated, on a case by case basis, that there is a net positive benefit to communities affected, and no net negative impact on the most vulnerable in a society, and which operates in a positive manner in conjunction with efforts to enhance the provision of basic needs and the efforts of local producers and suppliers in their efforts at self-sufficiency.

The position of the government of Canada was most recently enunciated in March 1999, when the Prime Minister announced the intention to cancel all debts of the poorest countries, including export credits and outstanding debts to the Wheat Board. The position of the government is that all development assistance funding to the poorest countries will, in the future, be as grants rather than loans.

It has been the practice for the EDC to provide both concessional and non-concessional loans to the poorest countries. As of March 1999, export credit related debt (excluding Wheat Board debt) formed 95% of the \$2.5 billion debt owed Canada by the 55 countries that are worst off in terms of human development. Almost all of this debt was owed by governments; sovereign debt formed 90% of Canada's export credit claims on these, the world's poorest countries.

In other words, debts to the EDC form the bulk of debts owed to Canada by the governments representing the poorest people on earth (according to UNDP "quality of

life" indicators). Of these debts, \$76 million is publicly recognized to be in arrears - debt that is, essentially, uncollectible and, for these countries, unpayable.

The policy of the government is to provide all development assistance to the poorest countries as grants only, rather than loans. The EDC does not provide grants; all financing is in the form of loans, most of which are on non-concessional terms. Of the \$2.5 billion owed to Canada - including the \$2.38 billion owed the EDC - \$2.29 billion is non-concessional, ie. at market rates, designed to generate income for the EDC (as of March 1999). If the agency is to be guided by government policy, ie. operating in a manner consistent with the government of Canada's policies with regard to aspects of social protection and human rights, it follows that it will avoid providing new loans to heavily indebted poor countries.

Recommendation: The EDC should restrict its lending in heavily indebted poor countries in compliance with the spirit of government policy with regard to Canada's assistance, so as not to promote or provide financing that increases indebtedness of these countries.

The process of lending to developing countries is generally in the form of a contract between engaged parties, whether private or sovereign. The inclusion of community leaders or representatives has not been a feature of export credit lending, regardless of negative impact that may result, or positive outcomes that can proceed from their inclusion. The fragile nature of locally derived culture, social practice or economic relationships, have not been given due regard in a process that prioritizes sales of Canadian goods and services abroad.

Recommendation: The EDC and contracting companies should ensure that their operations provide a net positive benefit to local communities in which they operate, and do not have a negative impact on social well-being in these communities. Community leaders should be consulted in an assessment of the impact of activities on the broader community, and programs developed that encourage community development, including education and training by appropriate actors.

The inclusion of concern for the particular social and economic vulnerabilities of the poorest countries in EDC activities does not imply that the EDC should operate as an agency for delivering development assistance. It is more a matter of finding ways by which it can be ensured that EDC complies with government policy with regard to indebted poor countries, so that its operations are consistent with the stated policy guidelines, and with the spirit of their intent, which is to avoid unnecessarily burdening these countries with unproductive debt.

Considering that lending to developing countries is occasionally classified as Official Development Assistance (ODA), the importance of ensuring consistency with government policy on delivering support to the poorest is perhaps of particular importance in these types of loans. Even beyond this, however, is the overriding concern that the EDC mandate is support of Canadian exporters, not the provision of development assistance. The use of ODA funds through EDC channels is inappropriate, given the priorities of the agency.

Recommendation: EDC should not be understood to be an agency for development. The agency needs to ensure that there is compliance with government policy regarding financial supports and lending, and consistency with its broader goals of development assistance. Mechanisms should be developed to enable that EDC adheres to government policy with regard to developing countries.

Recommendation: Concessional lending of the Canada Account should not be fuelled with Official Development Assistance funds.

Recommendation: EDC should work toward the establishment of formal guidelines for ECAs in all OECD countries, with regard to ensuring common standards for loans to developing countries. These include standards of prudence in ensuring that debt is not contracted without due regard for the overall economic and social situation of a country, and that loans will contribute to quality growth with a positive impact for the poor.

As the Brundtland Commission noted more than ten years ago, "The heaviest burden in international economic adjustment has been carried by the world's poorest people." The concept of "sustainable development" as it was described then aimed at ensuring that the needs of the present were achieved without compromising the ability of future generations to meet their own needs. "Such equity would be aided by political systems that secure effective citizen participation in decision making and by greater democracy in international decision making." The support of concepts of "sustainable development" has been absent from EDC projects, subsumed by the desire to expand export of goods and services of Canadian origin, regardless of the long-term consequences, both environmental and social. The underwriting of private risk using public funds encourages lending that is ill-judged, adding to a country's indebtedness without positive local development impacts.

Recommendation: The EDC should provide an impact assessment as to whether a project is consistent with sustainable development objectives, ie. pro-poor, quality growth that is of local benefit, inclusive of participation and

of a fashion that does not compromise the needs of future generations. Such an effort should not suggest that the EDC become in any way a development agency, but would require the assurance that the agency operates within the context of broad sustainable development objectives, as indeed should all our government agencies.

Standards of economic feasibility and social impact should be applied in projects that expect public guarantees and financing. Export-promoting financing that is backed by our government should assess the consequences for the people in the relevant country, taking human development fully into account.