Special reports: Financing power projects

Export financing in France

A review of market conditions, credit types, and the OECD "Consensus"

by Jacques Richard-Mounet

Methods of financing large investments have changed during the industrial era, and without going into excessive detail about the early days, it might be worth considering these changes briefly.

Such investments used to be financed either by "entrepreneurs", who embarked with their own capital on industrial adventures, or by money lenders who were merely hoping to earn interest on the money they lent. The manufacturer of equipment – the supplier – did not have to worry about financing his sales since these were paid for in cash by means of the investor's own funds and the long-term loans he had taken out on the financial market.

This market's death throes, it can be said, began from the end of World War I, and the market more or less completely gave up the ghost with World War II. Thus, there were no more investors with their own funds, no more people of private means with money to invest, and in particular, no more confidence. On the other hand, the size of "investments" developed more and more, as did international trade and the need for capital. The supplier thus had to take out credit. He was not able to do this alone since his capital was being used for his own operations, and, in any case, the risk was frequently out of proportion to his means. Any credit he managed to obtain had to come from banks and the banks were not content with the signatures of suppliers. So this gave rise to what we now know as the system for financing by means of export credit guarantees from national credit insurance schemes.

The arrival on the market of developing countries with high hopes and little capital – whereas the hopes were frequently of a long-term nature – has obliged developed countries to give credit over longer and longer periods. For a very long time (up to 1965) the 5-year limit was more or less sacrosanct; the supplier countries, grouped through their credit insurance bodies in an association called the "Berne Union", had stipulated a number of rules intended to limit, if not to prevent completely, what is known as the "credit race". The 5-year limit became 7, 8 and 10 years and a duration of 15 years has now been officially accepted for the very large investments needed for nuclear power stations.

Thus, for a very long time international regulations related mainly to the duration of credit. Interest rate problems were left to the judgement of those involved. In the past they were of only minor importance, since export interest rates frequently differed little from domestic rates and in many countries they were both regulated.

Now, however, for about 10 years there has been a tendency within both the European Economic Community (EEC) and more widely, within the Organisation for Economic Co-operation and Development (OECD), to limit State intervention which would aim to artificially lower export interest rates. In other words, countries – either because their domestic interest rates are low or because they have large amounts of long-term capital available – wish market forces to assert themselves.

The managers of public funds see in this trend the work of proponents of the "market rate". In fact, the budgetary weight of public assistance to export financing becomes extremely heavy, if not insupportable, when the volume of exports backed by credit increases and interest rates rise dramatically. Any measure, any discipline aimed at reducing this weight will therefore be welcome. Additionally in France, irrespective of these international agreements, monetary erosion inadequately compensated by interest rates of the national currency, together with the inflationary effect of the creation of French francs without immediate backing, has justified a foreign-currency export financing policy.

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Design: W. Kalabis

Thus, in 1985, exports of capital goods are financed in a much more regimented and disciplined context than before, which is in the final analysis less favourable to purchasers.

The regulation of credit: The "Consensus"

International regulations are governed by a document currently known under the name of the "Consensus" and adopted by the member countries of the OECD. This document does not have the status of a treaty but only of a "gentleman's agreement", at least for signatory countries. France, like the other EEC countries, does not participate as a State but through the intermediary of the EEC. Within the EEC, the mandate for negotiations is the object of a decision by the Council and is thus binding on Member States. The conclusion is thus reached that Japan and the United States, for example, are committed only by goodwill, whereas the Federal Republic of Germany and France are legally committed.

This Consensus contains regulations establishing the most favourable credit conditions, duration, and interest rates which may be granted by an exporting country to its clients for paying its own exports when public assistance is provided. Specific regulations apply to certain sectors: ships, aircraft and, in particular, the nuclear industry.

If the various stages in export financing were to be examined in chronological order it would be necessary, first, to discuss "prefinancing", i.e., the satisfaction of the cash-flow needs of the company during the period in which products are manufactured (this is the period before the delivery of the object sold). Only then would we discuss the different methods of financing the credit granted to the client.

Nevertheless, prefinancing requirements depend largely on payment conditions and on the type of credit. In the interest of clarity, the order which at first glance appears to be the logical one for this discussion will be reversed.

The Consensus

	Maximum duration of the credit (years)		
Category of country	2-to-5	5-to-8.5	8.5-to-10
Relatively rich	12%	12.25%	Not applicable
Intermediate	10.7%	11.20%	Not applicable
Relatively poor	9.85%	9.85%	9.85%

The rates of the Consensus are the subject of a movable scale with reference to the weighted average of rates of the five currencies selected for Special Drawing Rights of the International Monetary Fund (IMF). Every six months, on 15 January and 15 July, the rates of the Consensus are reviewed as a function of variations in the index numbers selected, as long as these index numbers have varied by at least 0.5 of a point. Shown here are the rates applicable as of 15 January 1985 for credits supported by public funds. The sectorial agreement relating to the nuclear industry provides for a credit duration which may be as much as 15 years and an interest rate which is one point higher than the Consensus.

The mechanisms

It goes without saying that for a businessman the ideal is to be paid strictly in cash with an advance, and an instalment as soon as the contract has been signed, even before he has incurred any expenditure in its fulfilment. Conversely the client, who will not benefit from this investment until it has been realized, will of course attempt to postpone payments until the benefits have balanced them out.

The usual solution is a compromise giving the client, after payment of an advance with the order, time to pay. A second instalment is paid on delivery and then the proper credit is repaid, spread out over a period which is a function of the nature of the activity, the amount of the contract, and the country of destination. If this credit is granted by suppliers, they will have to obtain the necessary funds from the bank.

To be able to benefit from advantages associated with "export credits", the credit is subject to a number of conditions. In France, for any credit over more than 3 years the letter of credit first must be the subject of a guarantee from the French Insurance Company for Foreign Trade (COFACE). Secondly, it cannot be used until the debt has been incurred, i.e., when it corresponds to a service that has actually been provided or to an actual delivery of equipment and the client has thus recognized his debt. This regulation has been relaxed in recent years in respect of the actual nature of deliveries by the introduction of the "progressively paid supplier credit".

Even when the debt has been incurred the exporter will continue, until the credit has been completely paid off, to bear the risk of non-payment as a result of his performance being deemed to be substandard. In any case, he must make provision for the part of the credit which is left to his own risk by COFACE insurance, i.e., 10-to-15% as a rule.

Buyer credit

The lengthening of the duration of credits and the enormous size of modern industrial investment make this weight and these risks excessively large for companies. Solutions have therefore been sought with a view to the following:

- Granting the client attractive conditions of payment, that is, not requiring payments until the investment is working for him and can be assumed to be generating products.
- Not making the industrialist play the role – which is not his – of banker by putting him in a situation which is as similar as possible to that discussed above in which he is paid in cash.

This has resulted in the introduction of the progressively paid buyer credit, whereby the company's cash flow situation is not excessively disturbed while at the same time the debt is paid off gradually as the loan is taken up. In fact, in the purchaser credit system, the principle is that the agreement on the opening of the credit is entirely separate from the commercial contract, although of course the latter "causes" the former.

By means of the agreement on the opening of the credit, the French banker puts directly at the disposal of the purchaser the funds which will be used for paying the supplier. This is done in accordance with a schedule specified in the commercial contract and which is as similar as possible to the schedule of a contract payable in cash.

Prefinancing requirements

It will thus be seen immediately that prefinancing requirements are very different depending on when one or the other hypothesis is being followed.

In the first case – that of the supplier credit – the debt is incurred only at the time when the finished product is delivered. This is so that the exporting industrialist will not have been able to realize his claims and will have to have recourse to a bank loan. In respect of this he will have to bear the costs and risks and he will be indebted to his bankers.

Prefinancing export credits can, however, be obtained. In France, these are "overdraft" credits which can be provided by the Bank of France. These specialized prefinancing credits can be granted at a fixed rate which does not vary while the operation is being set up. In this case they are called "stabilized-rate prefinancing credits" (PFTS).

In the other extreme hypothesis – that of the progressively paid buyer credit with the drawing of credit exactly matching the exporter's cash flow requirements – the exporter is entirely at his ease and does not have recourse to his banker. The credit drawn must not exceed the exporter's expenses, since any over-financing is strictly monitored by the Bank of France and funds will be blocked. In fact, any drawing of funds in excess of requirements generated by actual expenses would mean that the company was benefitting unjustifiably from subsidization of its liquidity position.

This "perfect" progressive payment system assumes a contract drawn up in an extremely rigorous fashion and considerable supporting capital on the part of the client. On the other hand, the client mostly requires a bond to be issued for the repayment of payments made in this way. This means that it becomes necessary for these guarantees to be assigned to creditors (since the payments have been made on the basis of funds lent and, if they were not assigned, these bonds would double the risk incurred by the client). The rate of interest is that of the credit. This rate is below the PFTS for credits granted to purchasers belonging to poor and intermediate countries and higher only for rich countries. Moreover, interest rates may be aggregated when the client requests their refinancing for the period between delivery and the commencement of the credit that becomes payable during the manufacturing period. Most often, progressive payments do not cover expenses exactly, thereby making it necessary to have additional recourse to standard prefinancing.

Pros and cons

Both types of credit granted to the client – buyer credit or supplier credit – have their own advantages and disadvantages.

The advantage of the supplier credit is that all aspects of negotiations are in the hands of the exporter. But they are also at his own risk. He may therefore establish a system of "communicating vessels" between the industrial constituents of his price and financing costs. This gives rise to the possibility, on the one hand, that the level set for the credit will be raised and, on the other hand, that the interest rate actually shown will be lower, which will obviously be at the expense of the price (this technique is charmingly called "cosmetic"). We have already seen that, as against these advantages, the exporter will have to bear a residual risk throughout the duration of the loan, which will have a paralysing effect on his financial position when contracts are of the dimension of nuclear contracts.

The buyer credit does not have this disadvantage but does leave a large part of financial negotiations up to bankers. The level set for the credit is by no means flexible and, if one wishes to offset through the industrial price the financing of certain financial costs, this can be done only with the full knowledge of all concerned; "cosmetic" changes become much more complex.

In France these prefinancing and financing arrangements are the responsibility of two institutions: Credit Insurance, i.e., COFACE, and Export Credit, which is mainly covered by the French Foreign Trade Bank (BFCE). COFACE and BFCE are the secular arms of the Government for this purpose. This mandatory intervention by the governmental authorities characterizes the French export credit system and makes it more concerned – than it would be under certain systems applied in other countries – with the regulations and limitations imposed by the EEC and the OECD.