Moral Hazard, Juniority, and Sovereign Lending: The Case of the US Exim Bank

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This paper shows that the actions undertaken by the US Exim Bank have encouraged moral hazard and induced risk-taking behaviors. More specifically, the junior status of the Washington-based institution has exacerbated debtor moral hazard. Section 1 investigates how and why the legal and regulatory frameworks of export credit schemes contribute to reinforcing moral hazard. Section 2 explores the practices of the US Exim Bank in the 1970s. In a context of massive lending to developing countries, this institution refrained from using a reliable country risk rating system, 'weaponized' its junior creditor status and prioritized sovereign borrowers with strong geopolitical ties with the United States. It is not surprising that the percentage of non-performing loans soared during 1975–1982. Section 3 analyzes how, after a three-decade decline, the Exim Bank was reinvigorated to counter the Chinese influence. A huge loan to Mozambique in 2019 supports this view. The new role of the Exim Bank may foreshadow an unprecedented 'battle of creditors' where juniority would be contingent on the nationality of creditors. Debtor moral hazard would then materialize to the detriment of specific countries. Section 4 concludes.

The export credit industry developed in the aftermath of World War I. In a context of international monetary turmoil, gloomy economic growth, and an increasing trend towards protectionism, major European governments started subsidizing their exporting firms in order to promote the competitiveness of their national economies. Export credit agencies (ECAs) and export-import banks were established to fulfill this goal.[1] Such measures were supposedly temporary, but they were maintained even after World War II. Export credit schemes contributed to spur international trade in the 1950s and 1960s, but they also burdened developing countries with short- and medium-term debts. In the meantime, only big firms in capital-exporting nations managed to obtain

[1] For example, the Export Credits Guarantee Department (ECGD, United Kingdom), the Nederlandsche Credietverzekering Maatschappij, and the Société française d'assurance-crédit were established in 1919, 1925, and 1927, respectively. The Export-Import Bank of the United States ('Exim Bank' thereafter) was set up in 1934.

guarantees and/or credits for their foreign clients. The growing competition from Japanese and Taiwanese firms in the 1970s exacerbated competition among ECAs and export-import banks, which sacrificed country risk analysis to preserve their core business. The world debt crisis of 1982 jeopardized the future of these institutions. Most of them were subsequently reorganized or privatized. They implemented reliable country risk ratings and revised their insurance, guarantee, and lending policies. Despite that, their role has remained ambiguous since the 1980s: ECAs and export-import banks are still a foreign policy tool and thus do not enjoy a senior creditor status like the International Monetary Fund (IMF) and the World Bank.

This paper examines how the actions undertaken by ECAs and especially the US Exim Bank have not only distorted competition in international trade and finance, but also encouraged moral hazard and excessive sovereign lending. On the one hand, ECAs and export-import banks are *agents*, acting on behalf of their government.[2] On the other hand, especially in their roles as insurers and guarantors, they are expected to monitor the actions of *two* types of insured parties (i.e., the domestic exporters and the foreign importers) in order to eliminate information asymmetry and avert excessive risk taking. In this idiosyncratic environment, the export credit business is likely to face multiple and possibly contradictory objectives and encourage moral hazard.

Section 1. The Export Credit Industry: An Obstacle to Economic Efficiency

The history of the export credit industry can be split in two distinct periods: the era of export subsidies and competitive incentives (1920–1980) and the era of professionalization and multilateralism (1980–2020).

From the 1920s to the early 1980s, the expansion of ECAs' activities consisted of subsidizing the export industry. Concretely, through their insurance and guarantee schemes, ECAs charged premium fees significantly lower than those justified by the actual risk, while export-import banks granted loans at below-market rates. For both types of export promotion programs, subsidization could also involve abnormally long terms as well as guarantee and credit extension.

The first government export credit insurance programs were designed to stimulate exports following the collapse of international trade and alleviate the lack of private credit insurance schemes (Hanna, 1931, p.°541; Dietrich, 1935). In the 1930s, within a context of growing protectionism, the development of the export credit industry accelerated as the exporter that awarded the longest payment term enjoyed a key competitive advantage and was very likely to obtain the deal (Bonin, 2002, p.°345).

In the interwar years, the development of export credit was thought to be a temporary measure leading to trade recovery. Yet, ECAs flourished in most European countries and the subsidization

[2] We assume here that ECAs and export-import banks are de jure or de facto state agencies.

of exporters intensified. In addition, ECAs and export-import banks were instrumentalized to reach foreign policy goals.[3] These policies increased competition between major capital-exporting nations such as the United States, the United Kingdom, and France. They were particularly keen on lending to the clients of their national champions (Bonin, 2002, p.°347), which distorted international trade.

In the early years of export credit insurance, the main challenges were scarce information and the lack of reliable credit ratings to set adequate premium rates (Hanna, 1931, p. 548). For example, blindsided with its initial objective of promoting French exports, the Société française d'assurance-crédit (SFAC) encountered financial difficulties as early as 1930 (i.e., three years after its establishment). It appeared that the SFAC had covered risky and insolvent importers because it had failed to assess their creditworthiness efficiently (Bonin, 2002, p. 350).[4] This concern was even more pronounced after WWII. Starting in the 1960s and until 1982, the huge amounts lent by the Exim Bank to foreign firms and governments for the purpose of buying U.S. industrial goods were made possible by a very lax risk assessment policy (see Gaillard, 2020a, p.°50 and Section 2 below).

In the 1960s and 1970s, western ECAs offered a wider array of financial services, including political risk guarantees. These schemes enabled exporters to sell their products in new, risky importing countries without bearing any significant financial consequences. Consider the case of Coface, the French state-owned ECA established in 1946 (for an exhaustive discussion, see Saul, 2002 and 2010). Between 1957 and 1967, the total amount of French exports benefiting from medium-term guarantees against natural disasters, political risk, and transfer risk rose by a factor of 8 (Saul, 2010, p. °172).[5] This boom was driven by the rapid expansion of the insurance coverage. During 1963–1967, Coface announced it insured against corporate default risk, lowered premia, increased the maximum guarantee threshold from 90% to 95% for transactions exceeding 5 years, and covered foreign loans and foreign direct investments provided they were connected to export activities (Saul, 2002, p. ° 364). This system reinforced the ties between major exporters and their governments. The favorable treatment granted to multinational firms resulted in a system of "corporate welfare". As the ECAs located in other countries followed similar strategies, it became obvious that the global outcome of the export credit industry was a zero-sum game.

So, it is not surprising that some rules needed adjustment to bring more discipline to the export credit industry, particularly in light of the growing competition from Hong Kong, Japan, Singapore, South Korea and Taiwan. The members of the Organisation for Economic Co-operation and Development (OECD) expressed their willingness to expand international rules to limit the possibility of governmental subsidization of domestic exporters and mitigate competition (Alvarez

[3] The establishment of the Exim Bank in 1934 was driven by financial as well as diplomatic motives, see Section 2.
[4] It is important to recall that Moody's assigned sovereign ratings since 1918 (see Gaillard, 2011, p.°4).
[5] During the same period, the aggregated inflation rate was around 60% only; see https://france-inflation.com/inflation-depuis-1901.php

and Flores, 2014, p. 129). They ultimately adopted the OECD Arrangement on Guidelines for Officially Supported Export Credits in 1978 (1978 Arrangement). In a context of heightened multilateralism, participating countries agreed to refrain from giving an unfair advantage to their domestic firms.

The 1978 Arrangement contributed to transition into a new era. The default of Mexico in 1982 had repercussions worldwide and affected the export credit industry. In the early 1980s, major exporting countries (except Germany and Japan) had to sustain growing trade deficits attributable to insufficient export credits. More dramatically, some key players such as the Exim Bank and Coface posted structural losses, reflecting the exhaustion of their business model. Inevitably, an era of deregulation was to start where the state would reduce its involvement (see Becker and McClenahan, 2003, pp. 269–279; Saul, 2010, pp. 176–180).

The "professionalization era" starting in the 1980s was driven by three fundamental changes: the privatization of many ECAs, the extensive use of country risk ratings and the ongoing promotion of multilateralism to prevent distortions in the export credit industry.

A major evolution in the last two decades of the 20th century was the wave of privatization of ECAs, largely caused by the losses experienced in the late 1970s and early 1980s. For example, the ECGD, COSEC (the Portuguese export credit agency), Coface, and the Israeli Credit Insurance Company were privatized in 1991, 1992, 1994, and 2002, respectively.[6] Traditional ECAs also gained autonomy and were allowed to acquire foreign competitors. However, regardless of their status, ECAs have kept strong ties to their governments. In the meantime, private insurance companies entered the political risk insurance business.

Country risk methodologies and ratings have developed and refined remarkably since the 1980s.[7] ECAs have become reliable country risk experts whose ratings are extensively used by exporters as well as international investors. In 2020, Credendo (the Belgian export credit agency) published several types of ratings assessing short-term political risk, medium/long-term political risk, political violence risk, expropriation and government action risk, currency inconvertibility and transfer restriction risk. Other ECAs, such as Atradius, Coface and Euler Hermes, have set up quite similar country risk ratings.[8] These additional indicators enable investment decisions to be made much more confidently than several decades ago.

The 1980s heralded an era of multilateralism with the increasing importance of OECD legal instruments. An agreement on premium for export credits (the so-called Knaepen Package) was reached and incorporated in the OECD Arrangement in 1997 (OECD, 2008). A classification was

[6] See https://www.icisa.org/members-public.
[7] For an analysis of the accuracy of such indicators, see Gaillard, 2020a, pp. 191–256.
[8] Atradius and Euler Hermes are Dutch and French-German ECAs, respectively.

established for the purpose of setting minimum risk premium rates: countries are rated on a scale of 0 to 7, where 0 represents the least risky countries and 7 the riskiest (Gaillard, 2020a, p. 199). The OECD country risk classification results from a consensual decision from an expert group composed of ECA representatives.[9] The OECD norms have also aimed to promote responsible lending practices, including human rights and environmental issues (Darbellay, 2021).[10] Most notably, in 1998, the OECD developed the Recommendation on Common Approaches for officially supported export credits, which were approved in 2003 and have been revised several times since then.

It is crucial to understand that *debtor* moral hazard has been a persistent outcome of export credit schemes. Concretely, ECAs and export-import banks provide massive guarantees and/or loans at subsidized rates to borrowing firms and states. In engaging in permissive lending practices without conditionality, they implicitly allow that part of the debt burden will be eventually restructured or will lead to additional loans. Seck and Chimisso dos Santos (2018, pp. 97–99) show how ECA-supported activities are likely to burden debt service payments. The export credits granted in the 1960s and 1970s are striking illustrations (see Gaillard, 2020a, p. 46). More recently, Coface faced criticism owing to its lax practices in the 2000s. From 2002 to 2006, the write-off of Coface claims increased by 395% to reach EUR 2.05 billion (Fourcade et al., 2008, p. 96). Concerns were raised about reclassifying, ex post, Coface's distressed commercial loans into official development aid (Fourcade et al., 2008). Such deplorable policies, disconnected from any commonsense country risk analysis, support the view that (i) some loans were granted for diplomatic or political purpose and (ii) their *full* repayment was never expected. It is noteworthy that these practices occurred several years after Coface was privatized. The strategy of the Exim Bank in the 1970s also illustrates this type of moral hazard.

Section 2. The Failure of the Exim Bank as Sovereign Lender

The utter failure of the Exim Bank observed in 1982–1983 occurred in the context of the economic recession and the less developed countries' (LDC) debt crisis. The Washington-based institution had not only failed to cut the U.S. trade deficit,[11] but it had also posted a record high percentage of delinquent loans, which jeopardized its existence. Several factors combined to undermine its credibility: its junior creditor status, its permissive lending practices, and its poor credit rating system.

[9] The lowest possible fees for a transaction are determined by the OECD country risk classification (Gonter, 2011, p. 223). This mechanism prevents ECAs from charging excessively low premium fees to risky borrowers.
[10] For an analysis of the societal responsibility of multinational firms (especially regarding human rights), see Bernaz (2017).
[11] Recall that, in 1970, Henry Kearns – then Chairman of the Exim Bank – believed that the institution could generate enough exports sales to erase the U.S. balance-of-payments deficit. See P. Shabecoff, "Ex-Im Bank Adopts Hard Sell," *New York Times*, 13 December 1970.

Here, we argue that debtor moral hazard did play a key role in the failure of the Exim Bank. Why? Because the bank's strategy and its junior status encouraged moral hazard among foreign buyers.

2.1 Establishment and Development of the Exim Bank

The *First* Export-Import Bank was established in Washington in February 1934 to facilitate trade with the Soviet Union. A few weeks later, the *Second* Exim Bank was created to assist economic relations with Cuba, but its activities were soon extended to all countries, except Russia. Following the breakdown of debt negotiations between Russia and the United States, the Second Bank was liquidated, and the First Bank was allowed to take over its activities. Since 1936, there has been a single Exim Bank: it is the United States' official ECA (Patterson, 1943). Over the past 85 years, the institution was reauthorized with bipartisan support in Congress 17 times, despite several fierce controversies, especially in the 1980s and in the mid-2010s (see below).

Although the agency was designed to create jobs in the United States by promoting the exports of US firms, it has fulfilled other missions. For example, it was urged to counter the subsidized financing of other ECAs. The Exim Bank also played a prominent role to support U.S. foreign policy. The various tasks assigned to the agency have made it difficult for policy makers and scholars to assess its efficiency.

The Exim Bank offers three major types of financial services: direct loans, loan guarantees, and export credit insurance. After granting loans exclusively until the mid-1950s, the agency increasingly used guarantees and insurance to meet the needs of its customers. The share of these two services combined rose from less than 1% in 1955 to 54% in 1975, 87% in 1995, and more than 99% in 2015.[12]

The main recipient countries have been major developing and emerging economies, such as Argentina, Brazil, India, Indonesia, Mexico, the Philippines, South Korea, and Turkey. China and Russia joined this list in the 1990s.[13] The top beneficiaries of Exim Bank operations have long been the aircraft, oil and gas, and manufacturing sectors (see Feinberg, 1982, pp. 34–35 and Kidwell, 2015, pp. 10–12). The U.S. Exim Bank served as model for several governments eager to develop their own export credit schemes, including the export-import banks of South Korea, India, and China, established in 1976, 1982, and 1994, respectively.

[12] Authors calculations based on Becker and McClenahan (2003) and Exim Bank (2015).
[13] It is important to recall that, along with the Marshall Plan, Exim Bank's loans enabled Western Europe to recover from World War II.

2.2 The Exim Bank and its Foreign Debtors

The presumption of morally hazardous behaviors between the Exim Bank and its debtors must be examined very carefully because of the nature of the bank's activity. In fact, the Exim Bank provides *project* loans, guarantees, and insurance to private and public entities. Considering that there is seldom a unique borrower or insured entity within a given country, one could conclude that the "too-big-to-fail" (TBTF) problem does not arise as when investors lend massively to the same borrower (typically a government) for general purpose. Despite that, systemic risk does exist for two reasons. In autocratic and socialist countries, the state is often the guarantor of all deals signed by private firms. Besides, inconvertibility risk remains a serious impediment to *all* transactions in a foreign country. This is because, in some countries, the credit position of private and public debtors and insured entities is largely contingent on the capacity and willingness of the government to preserve its own credit position and maintain capital mobility.

The next (perhaps utmost) challenge consists of substantiating possible debtor morally hazardous strategies. Such evidence can be provided in few cases. As a result, we analyze primarily the actions performed by the Exim Bank and the elements of the environment from the 1960s through the 1980s that were *likely* to encourage debtor moral hazard.

The first factor was undoubtedly the *junior* creditor status of the Exim Bank. The wave of sovereign debt restructurings announced in the 1960s shows that the type of external debt most frequently subject to consolidation involved suppliers' credits, such as those granted by ECAs (World Bank, 1969). The reason was that their higher interest rates and shorter maturities increased debt service payments. This junior status meant that the dubious debtors had an incentive to borrow from the Exim Bank rather than from the World Bank, which enjoyed a *senior* status. Thus, it is hardly surprising that the number of Exim Bank loans classified as delinquent rose from 15 in 1960 to 32 in 1967 and 54 in 1972. More importantly, the ratio of delinquent loans to total loans (in volume) soared in the second part of the 1970s and in the early 1980s (see Chart 4.1 below). Two explanations can be advanced. First, Bohn (1986) contends that, like other ECAs, the Exim Bank seems to have vacillated between its export-promoting function and its role as a potential source of development assistance support. Second, Alvarez and Flores (2014) find that export credit schemes were used as leverage to lead LDCs to sign stand-by agreements with the IMF.

Turn now to another issue. The Congress has long used the Exim Bank as an instrument to pursue the U.S. foreign policy. For example, the Foreign Assistance and Related Agencies Appropriations Act of 1964 prohibited the Exim Bank from lending to any communist country, except Yugoslavia. In 1971, the Export Expansion Finance Act removed this prohibition to stimulate East-West trade. However, if one wants to find some elements of debtor moral hazard, it is necessary to examine the Exim Bank policy regarding U.S. allies.

The Western economies do not seem to have raised any concern. After getting massive loans in 1945–1948 for their reconstruction, these countries joined NATO and thrived on their own.[14] For example, the Exim Bank's exposure to Belgium, France, Germany, Italy, Netherlands, and the United Kingdom declined from 28% in 1959 to 10% in 1967, and 7% in 1982.[15] None of these governments defaulted on their loans to the agency.

In fact, some forms of debtor moral hazard may be identified among what Pipes and Garfinkle (1991) call "friendly tyrants." Several of these allies had significant bargaining power with Washington and managed to obtain fresh loans from the Exim Bank amid a complex geopolitical context and opaque business conditions. Different strategies were implemented to do so; two deserve examination here.

In a certain number of deals, the LDC government claimed cost overruns to get additional financing and guarantees. This strategy enabled the Philippines and Zaire to finance expensive projects: a nuclear plant and a hydroelectric plant, respectively.[16] In other cases, Exim Bank's loans served as a sweetener in negotiations over renewal of American military bases, as happened in Spain and Turkey in 1976.[17]

The outcomes of these massive capital flows were incredibly diverging. On the one hand, Spain and the Philippines piled up debt, guarantees, and insurance which accounted for more than 8% of the Exim Bank exposure in 1982.[18] Both governments were solvent when the world debt crisis erupted that year. On the other hand, the Exim Bank rescheduled certain loans to Zaire and Turkey as early as 1977–1978. What is remarkable is that the two countries got additional loans shortly after their default! This "policy" undoubtedly encouraged debtor moral hazard; it also reflected poor monitoring efforts.

Here is the third factor that distorted the relations between the Exim Bank and its debtors: namely, the weak country risk assessment performed by the institution.

The Exim Bank's lending policy was based on several criteria but the top one was certainly the borrower's status and its capacity to obtain preferential treatment, such as a state guarantee, a complementary state loan, tax concessions, and/or subsidies. The agency's country risk rating system was rudimentary: the key determinants were the risk of balance-of-payments problems, the level of indebtedness, and the repayment performance of previous loans, especially Exim Bank

[14] The North Atlantic Treaty Organization (NATO) was established in 1949.
[15] Authors' calculations based on Exim Bank's annual and semiannual reports (various years).
[16] See "Ex-Im Bank Sets Loan, Guarantees Credits For Zaire Power Line," *Wall Street Journal*, 11 June 1979; "Ex-Im Bank to Back Loans to Philippines For Nuclear Facility," *Wall Street Journal*, 25 March 1981; "Ex-Im Bank to Back $204.5 Million Loan For Philippines Plant," *Wall Street Journal*, 15 September 1982.
[17] See M. Acoca, "U.S., Spain Sign Pact on Defense: Accord on Bases Sets $1.3 Billion," *Washington Post*, 25 January 1976; Howard (1976, p. 309); Exim Bank (various years).
[18] Authors' calculations based on Exim Bank (1982, pp. 34–35).

loans[19] (see Gaillard, 2020a, pp. 49–52, for an analysis of country risk rating methodologies used in the 1970s).

The Washington-based institution used to rate countries on a 4-notch scale but this rating system was discontinued in 1977 (Feinberg, 1982, p. 46). Its risk assessment policy was very lax. In several annual reports, the agency stated that the risk of loss on loans, guarantees, and insurance was not susceptible to accurate measurement because of the unpredictable nature of future economic and political conditions throughout the world (Exim Bank, 1969, p. 21; 1979, p. 28). It is therefore not surprising that the share of loans classified as delinquent increased inexorably in the second half of the 1970s and in the early 1980s (see Figure 1).

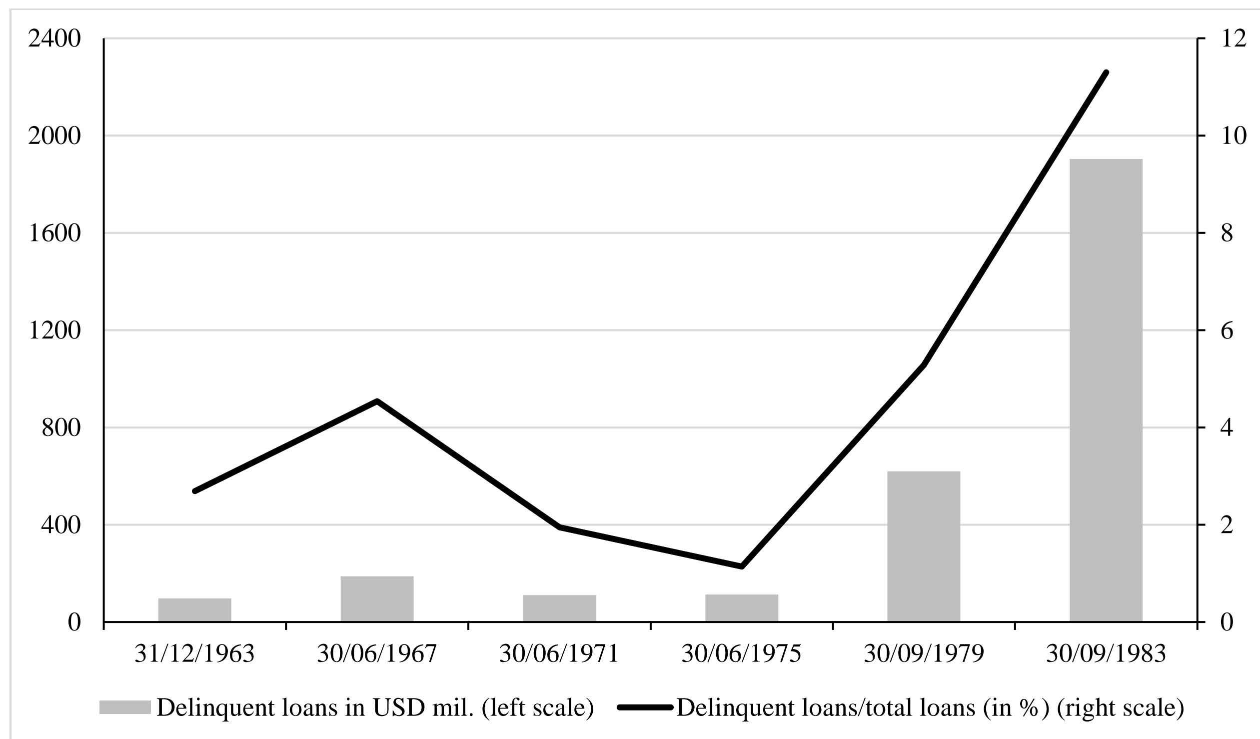

Figure 1: Exim Bank's Delinquent Loans, 1963–1983

Sources: authors calculations based on Exim Bank's annual and semiannual reports (various years).

The junior status of the Exim Bank, its opaque role in the U.S. foreign policy, and its poor country risk rating system combined to undermine the credibility of the agency. The 1982–1983 debt crisis only hastened its decline. It is obvious that the policy followed by the financial institution in the 1970s paved the way to some forms of debtor moral hazard. The agency lent massively to countries like Turkey and Zaire. Despite their default, those countries bargained their "geostrategic" position and managed to get fresh loans from the Exim Bank. Here is what can surely be considered "creeping bailouts" driven by debtor moral hazard.

[19] This criterion is hardly credible in light of what we have just described.

Section 3. The Evolving Role of the Exim Bank

3.1 A Minor Role until the Late 2010s

The 1980s marked the inescapable decline of the Exim Bank. Two key factors combined to weaken the institution.

First, the Reagan administration, which came into power in January 1981, was eager to impose a neoliberal agenda. David Stockman, the Director of the Office of Management and Budget, targeted the bank's direct lending program and proposed cutting back its operations by 20% for the current FY1981 and another 20% for FY1982. He argued that the agency was too costly in the then context of massive fiscal deficit. He also complained that two-thirds of the loans granted in 1980 went to seven companies: Boeing, Combustion Engineering, General Electric, Lockheed, McDonnell Douglas, Western Electric, and Westinghouse. Despite the resistance by some in the Congress and big exporters, the Exim Bank had lost its momentum by 1985.[20]

Second, the LDC crisis tarnished the reputation of the bank, whose cumulative losses reached $1.1 billion during FY1982 through FY1985.[21] The worrisome reports published by the GAO in the preceding years were well founded. The problem was that the world economic recovery was slow. The austerity measures imposed on developing and emerging countries by the IMF and major creditor governments depressed international demand and prevented the bank from resuming its full activities. For example, during FY1983–FY1986, the credits authorized by the agency were around 30% of the levels budgeted.[22] Exim Bank President William Draper reacted by promoting in 1985 a new program called "I-Match." Under this program, the institution would make up the difference between the subsidized loan rates offered by competing ECAs and higher market rates. This initiative was opposed by major exporters and traditional Exim Bank supporters because subsidies could be easily identified and estimated. A watered-down program was eventually adopted because there was nothing better to expect from the Reagan administration (Becker and McClenahan, 2003, pp. 210–211). The golden age of the Exim Bank was over.

Starting in the 1980s, the Exim Bank played the traditional role of an ECA by offering mainly guarantees and insurance schemes. It is interesting that, in 2007, the Congress enacted legislation that made the Exim Bank a self-sustaining entity no longer requiring a direct appropriation to fund its operations (Exim Bank, 2008, p. 3). Despite this historic move, the controversy about the efficiency of the institution did not diminish. In 2012, the Exim Bank's charter reauthorization was

[20] C. H. Farnsworth, "Ex-Im Bank vs. Budget Cutters," *New York Times*, 13 February 1981; G. Lardner Jr., "House Stuns Administration by Defeating Ex-Im Bank Fund Cuts," *Washington Post*, 19 May 1981; and Becker and McClenahan (2003), pp. 210–211.
[21] Authors' calculations based on Exim Bank's annual reports.
[22] Authors' calculations based on Becker and McClenahan (2003), p. 223.

reduced from five years to two years and, in 2014, its authority was extended for only nine months, through June 30, 2015. On July 1, 2015, its full authority lapsed, which meant that the agency was prohibited from engaging in any business activities. A few months later, the Export-Import Bank Reform and Reauthorization Act of 2015 reauthorized the bank through September 30, 2019. However, due to a lack of quorum for the transaction of business by its Board of Directors, the institution was unable to authorize any long-term transactions. As a result, the total amount of authorizations (including loans, guarantees, and export credit insurance) declined from $20.5 billion in 2014 to $5 billion in 2016 and $3.3 billion in 2018 (Exim Bank, various years).

3.2 The Exim Bank and The Coming Battle of Creditors

2019 marks a transition to a new phase. In May 2019, the quorum of the board was restored and allowed the bank to again offer its full range of financing. Shortly later, the Trump administration granted the Exim Bank a seven-year reauthorization. Kimberly Reed, the Exim President, recently explained that her institution had the mandate to take on Chinese exporters on behalf of U.S. businesses.[23] In a brief, the Exim Bank went even further, stating that "China challenges American power, influence, and interests, attempting to erode American security and prosperity."[24] The Exim initiative called "Program on China and Transformational Exports" is designed to (i) neutralize China's export subsidies for competing goods and services financed by official export credit or tied to aid and (ii) support American innovation and technological standards, through direct exports in key industries (e.g., artificial intelligence, biotechnology, biomedical sciences, wireless communications equipment, quantum computing, renewable energy, energy efficiency, and energy storage, semiconductor and semiconductor machinery manufacturing, emerging financial technologies, water treatment and sanitation, and high-performance computing).

In this exacerbated context, it is not surprising that the bank might support risky projects. In September 2019, it approved a $5 billion loan for Mozambique, the largest direct loan in the history of the bank. Its purpose is to provide equipment and services for the development and construction of an integrated liquefied natural gas (LNG) project. The principal supplier was Anadarko Petroleum Corp., a Texas firm which was acquired by Occidental Petroleum Corp. during the summer of 2019.[25]

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[23] See https://www.theafricareport.com/29796/us-exim-we-have-a-new-mandate-to-take-china-on-around-the-world.

[24] See https://www.exim.gov/who-we-serve/external-engagement/china-and-transformational-exports-program/fact-sheet.

[25] In September 2019, Anadarko sold its 26.5% operated interest in the Mozambique LNG project to Total. The other operators were ENH Rovuma Área Um, S.A. (15%), Mitsui E&P Mozambique Area1 Ltd. (20%), ONGC Videsh Ltd. (10%), Beas Rovuma Energy Mozambique Limited (10%), BPRL Ventures Mozambique B.V. (10%), and PTTEP Mozambique Area 1 Limited (8.5%). See https://www.total.com/media/news/press-releases/total-closes-acquisition-anadarkos-shareholding-mozambique-lng.

The loan to Mozambique increased markedly the weighted-average risk rating for export credit authorizations for FY2019 to 6.9, compared to 5.5 in FY2018 (Exim Bank, 2019, p. 41).[26] The agency indicates that it generally does not authorize new credits that would be rated worse than '8', which is equivalent to B– on Standard & Poor's (S&P) rating scale. Yet, the FC rating assigned to Mozambique by S&P was in the "selective default" category when the loan was approved. Consequently, it seems clear that the $5 billion loan was granted regardless of Mozambique's credit position mainly because it thwarted China's ambitions. President K. Reed stated that the bank was told that "China and Russia were slated to finance this deal before our Exim board quorum was restored by the U.S. Senate. The project now will be completed without their involvement and instead with 'Made in the USA' products and services. This is a win for our nation."[27]

The heightened rivalry between the United States and China is likely to encourage moral hazard, quite similar to what was observed in the second half of the 1970s. The Exim Bank has much more leeway than five or ten years ago and its new mission allows it to take more risks. American manufacturers as well as developing economies are aware of this changing environment. The former could be tempted to convince the agency to cover exports to risky foreign countries. The latter might threaten the bank with a shift to China if they do not get additional financing and/or debt rescheduling. It is too early to check whether moral hazard has materialized but the present context should raise concern.

We argue that the main concerns relating to public debt may shift from the legal priority of sovereign debt to geopolitical aspects. Prior to this change of paradigm, the legal priority was a key concern alongside capital market forces. This generally involved constitutional, legal and contractual issues (Gousgounis, Gulati and Buchheit, 2021, p. 476). Contractual aspects involve commitments made by sovereign borrowers to Debt Service *Über Alles*. Nevertheless, it is worthwhile mentioning that Gousgounis, Gulati and Buchheit (2021, p. 481) have concluded that there is little justification for the enthusiasm for Debt Service *Über Alles* assurances.

Legal limitations relating to the promise to pay back public debt may also arise. For instance, the odious debt doctrine may be invoked by sovereign debtors. More specifically, in the case of hidden debt, the existence or the terms of a sovereign debt transaction have not been disclosed in violation of domestic law (Lupo-Pasini, 2021, p. 166). Legal consequences such as the lack of enforceability of a contract that may be void or voidable, leading to invalidating a hidden debt transaction.

Nevertheless, a caveat needs to be made as sovereign debtors also respond to capital market constraints. Typically, debtors accept responsibility for their debt even if it is odious or contracts may be invalidated owing to other legal concerns. Indeed, sovereign debtors do not want to be deprived from accessing international capital markets. For instance, in post-apartheid South Africa, Nelson Mandela's government continued to pay the debt generated during apartheid era because it

[26] The Exim Bank classifies credits into 11 risk categories, with '1' being the lowest risk and '11' the highest.
[27] See https://www.exim.gov/news/exim-approves-5-billion-finance-exports-mozambique-lng-project.

seemed to fear that defaulting would result in losing access to the international capital markets (Kremer and Jayachandran, 2002). In this regard, market forces tend to sometime play an even more disciplining role than legal tools would do.

Apart from that, the status of the creditors typically plays a key role in terms of their priority. Indeed, the seniority versus juniority largely depends on whether the creditor is an export credit agency, a commercial bank or an international institution such as the IMF. In the same vein, agreements among major creditors who are members of the Paris Club may facilitate debt restructurings, thereby leading to dialogues between creditors rather than confrontations.

Under the new paradigm, the rules relating to priority have been disregarded and overhauled by emerging control mechanisms. Above all, the seniority versus juniority debate may increasingly depend on the nationality of the creditor. This is likely to exacerbate the risk of debtor moral hazard. This phenomenon is best illustrated in the light of the Mozambique debt issues, which have been an issue for international creditors for several years. Mozambique has become the subject of a power struggle between major creditors, in particular the US Exim Bank and the Export-Import Bank of China (China Exim Bank). Private entities have also been involved such as the French company Total and banks such as the French bank Société Générale and the Swiss bank Credit Suisse. Broadly speaking, international creditors seek to expand their influence by attempting to ensure that they are awarded preferential treatment. Within this context, ex post debtor moral hazard has emerged as Mozambique has debt obligations to several creditors and is able to decide which creditors to pay back first and which ones to disadvantage or to disregard.

A key aspect that has changed the landscape is the increasing involvement of China Exim Bank and other Chinese lenders as major creditors of the international scene. Chinese lenders contractually secure repayment priority over other creditors as well as contain far-reaching confidentiality clauses (Gelpern et al., 2021, p. 6). "Borrower confidentiality obligations outside the Chinese sample are rare and narrowly drawn. Broad borrower confidentiality undertakings make it hard for all stakeholders, including other creditors, to ascertain the true financial position of the sovereign borrower, to detect preferential payments, and to design crisis response policies. Most importantly, citizens in lending and borrowing countries alike cannot hold their governments accountable for secret debts" (Gelpern et al., 2021, p. 6). "China's contracts also contain unique provisions, such as broad borrower confidentiality undertakings, the promise to exclude Chinese lenders from Paris Club and other collective restructuring initiatives, and expansive cross-defaults designed to bolster China's position in the borrowing country" (Gelpern et al., 2021, p. 8). In sum, Chinese creditors have extensively drafted contracts to maximize their repayment prospects (Gelpern et al., 2021, p. 45).

In Mozambique, the Tuna Debt scandal ended up in Mozambique defaulting on its public debt. "It was revealed in 2016 that semi-public entities in Mozambique had taken on over USD 1 billion of debts backed by government guarantees without submitting them to the Assembly of the Republic

as the Mozambican constitution requires" (Williams and Isaksen, 2016, p. 7; Williams, 2018, p. 1). The discovery of the hidden debt transaction plunged Mozambique into default as the country was denied access to international capital markets and could not obtain additional finance from the IMF (Lupo-Pasini, 2021, p. 168).

The US Exim Bank can afford a haircut as long as the claims of other creditors do not enjoy seniority over its claim or as long as giving the loan excluded other potential creditors. A key motivation behind the US Exim Bank's investment in Mozambique consists of dwarfing China's investment. As a result of the reauthorization of the US Exim Bank, borrowers relating to the Mozambique LNG project dropped Chinese and Russian entities as senior lenders (Exim Bank, Annual Report 2020, p. 28). By the same token, by providing a $91.5 million in loan guarantee financing for US exports to Senegal, the US Exim Bank's involvement also stopped an investment from China (Exim Bank, Annual Report 2020, p. 28).
As a consequence, the geopolitical tensions have been leading to a battle of the creditors. International creditors attempt to enhance their prospects of repayment by any means, including seeking a measure of influence over the sovereign debtors and its other creditors. In so doing, the juniority of the creditors increasingly depends on the nationality of the creditors rather than legal aspects. Sovereign debtors may under some circumstances refuse to pay back supposedly illegitimate debt under the umbrella of the US or China. This may exacerbate ex-post debtor moral hazard. The positive side is that sovereign debtors that would like to refuse to repay illegitimate debt such as odious debt or hidden debt receive support when doing so, which gives them leverage. However, debtor states may experience drawbacks of such a risky approach. Such endeavor may create dependence on certain creditors, paving the way to some form of imperialism. More fundamentally, this drift could threaten the legal architecture of sovereign debt contracts.

Section 4. Conclusion

This paper explores how the export credit industry has distorted international trade and, more dramatically, encouraged moral hazard. The noxiousness of export credit programs is encapsulated in the policy followed by the Exim Bank, especially in the 1970s and early 1980s.

Since the deregulation of the 1980s and 1990s, moral hazard issues have been partly addressed by new domestic and multilateral paradigms. Export-import banks and ECAs are more efficient but some flaws persist. Political interference has been observed in European countries as well as in the United States, especially to support big domestic industrialists and preserve diplomatic influence.

In fact, additional remedies can be advanced to fight moral hazard. The top priority consists of reducing information asymmetry. Export credit firms should be as transparent as possible regarding their exposure and the beneficiaries of their programs (sectors, firms, countries). Next, they must monitor carefully the credit position of domestic exporters as well as foreign importers. This entails robust corporate and country risk methodologies and ratings, which should be used to discriminate

among applicants and set premium rates and/or interest rates. Lastly, governments and parliaments must increase supervision of ECAs and export-import banks, transform them into self-sustaining agencies, or, more radically, privatize them and ensure that the entity will not be bailed out in case of financial distress.

Other issues deserve examination. It is illusory to believe that ECAs and export-import banks successfully reduce trade deficit or improve the competitive position of a country. Competitiveness is fundamentally based on relevant research and development, efficient outsourcing, and reasonable debt strategy. A firm benefitting frequently from export credit subsidies should be considered highly politically connected but, at the same time, vulnerable in the medium/long term. Boeing and General Electric are two striking illustrations. These two major multinational companies have obtained massive Exim Bank loan guarantees for decades (Feinberg, 1982, p. 35; Kidwell, 2015, p. 12) but they have been unable to preserve their international market share and saw their credit position weaken significantly.[28] Why? Because in a globalized world economy, subsidies are short-term, second-best options that not only disincentivize the beneficiary from enhancing its competitiveness but also encourage excessive risk-taking.

Since the 2000s, moral hazard incentives in the credit export industry have waned. However, the last few years have showed that multilateralism is increasingly questioned by populist movements, protectionism is spreading, and many countries may be tempted to subsidize massively their exporting firms to fight against foreign competitors (i.e., industrial suppliers as well as lenders). In the nascent *post-globalization* era (Gaillard, 2020b), a resurgence of moral hazard in the export credit industry is probable and could degenerate in an unprecedented battle of creditors.

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