# ECA-cover in Germany: Does Foreign Content Policy Need to Be Reconsidered?

Beate Bischoff[1]

*Via* state-backed Export Credit Agencies (ECA) countries promote national exports by providing insurance coverage to companies involved in export transactions and the banks who finance them. ECA-cover is mostly used for capital goods exports to emerging markets with high country risk, where the private market is not able to assume the financing volumes and tenors requested. ECAs are bound to a set of rules established among the OECD countries – hence called the OECD-consensus – in which basic patterns such as maximum financing tenors for export credit insurance are agreed upon in order to avoid undue competition between countries. The overall aim of state-backed export credit insurance is to secure employment in the respective home country by allowing export oriented companies to grow internationally by entering into difficult foreign markets.

For ECAs, the notion of national export used to be synonymous with the national origin of the goods exported. However, as a consequence of the ongoing globalisation of production patterns and trade flows, the need to include certain elements of foreign content in an export project has become evident over time.

Companies are facing increased global competition in pricing, as well as technological know-how. Many companies have shifted production to subsidiaries in foreign countries. Moreover, many importing countries request the inclusion of local content in projects. To offer a competitive contract price, it is often mandatory for an exporter to include deliveries from third countries into a project, be it from its own foreign subsidiary or from foreign suppliers. This is especially the case in the construction of huge industrial plants in the petrochemical sector, for example. Typically, the high-end engineering will be done in Germany, whereas huge parts of the capital goods involved will be sourced at competitive pricing in third countries and the local construction work will be entirely handled by local firms.

Hence the necessity for ECAs to adopt rules that allow for the inclusion of certain foreign and local content in their export cover policies. It is important to note that the OECD rules provide a common framework for local content, whereas for foreign content they do not. It is thus the responsibility of the respective countries to define a foreign content policy for their export credit insurance schemes.

The results vary largely. The approach adopted by countries differs due to their economic size, philosophy or culture. In small countries no project can realistically be sourced from the national industrial base alone. Considerations of organised labour may be dominant in some countries, pointing to the fact that national jobs will be hurt by encouraging production elsewhere. In other countries, the state backs its national champions as a matter of industry policy. Consequently, looking at ECA policies on foreign content in the OECD, there is a wide span from strict definitions of national origin to very liberal interpretations of national interest.

In this context Germany tends to settle at the strict end of the scale. Fundamentally, as far as capital goods exports are concerned, the German ECA Hermes grants export insurance coverage for goods for which a German certificate of origin is issued. In the past, however, Hermes has been prepared to support the exporting industry in its request for greater flexibility in foreign content policy to strengthen the competiveness of German exports. As early as 2008 Hermes modified the rules governing the inclusion of foreign content, and amended these rules again at the end of 2011.[2]

[1] BHF-BANK AG.

[2] In its treatment of foreign content the German ECA distinguishes between short-term trade transactions and the export of capital goods. For short-term trade transactions, it is possible to allow for 100 percent of so-called transit goods. Transit goods usually comprise of raw and basic materials, agricultural produce, fertilizers, commodities and consumer goods. The credit period usually extends to 180 days, and in all events is no longer than 360 days. For the export of capital goods, a much more complicated and restrictive set of rules for foreign content apply – see Hermes Cover Special, March 2012, Inclusion of Foreign Content in Hermes-cover.

A three-tier system exists, which varies in the percentage of foreign content that can be included in insurance coverage and the necessity of providing explanations and justifications. The first tier refers to a foreign content of up to 30 percent, which is accepted automatically. The second tier allows for the inclusion of foreign content of up to 49 percent. If the foreign supplier is a direct subsidiary of the German exporter, approval will be given automatically. If this is not the case, i.e. if foreign content comes from a third-party supplier, the exporter has to provide convincing arguments and approval is then optional. The third tier refers to foreign content above 49 percent. A much more detailed explanation must be given and approval is granted on a case by case basis with the sole involvement of the Hermes Inter Ministerial Committee (IMC).

In the three-tier system favourable treatment has been granted to supplies from direct foreign subsidiaries of German companies, acknowledging the shift in global production patterns. Supplies from the EU countries also benefit from a positive bias in the calculation of foreign content. The three-tier system has been welcomed by the export industry as an important move towards making export insurance more flexible in terms of the global sourcing of equipment. It is considered to have a rather technical imprint, however, which is reflected in a nine-page foreign content programme flyer. It certainly lacks the much desired automatism of the inclusion of higher proportions of foreign content. There is no guideline as to exactly what types of 'explanation' should be submitted, leaving approval optional at best for second tier projects; and on an even stricter case-by-case basis for third-tier projects. From an industry point of view, it could be argued that one cannot properly rely on obtaining approval for projects with high foreign content, thus making sound and competitive project planning difficult.

Important parts of German industry advocate opening up foreign content policy in a more general manner. Whereas it could be argued that the present definition of German origin considers the inclusion of foreign content to be rather an exception to the rule, a more general approach would be to consider the fulfilment of German interest in making a project eligible for Hermes-cover. A similar approach has been adopted by a number of other ECAs, although structures vary from country to country. It has been put forward that these countries' more liberal policies on foreign content provide a competitive edge for the respective national exporting industry and put German companies at a comparative disadvantage. Thus, losing out export projects to neighbouring competitors will ultimately put German jobs in danger.

Merely adapting another country's ECA scheme on foreign content to Germany seems difficult, however, because countries differ widely in industrial patterns and policy rationale. In countries with a small or less diversified industrial landscape, ECAs may want to diversify the risk they insure. By building up a portfolio, concentration risk on certain industrial segments and countries covered can be avoided. Generous ECA principles on foreign content may attract exporting business by incentivising foreign companies to shift their sourcing, at least partially, to a country, making the project in total eligible for ECA cover. Asian countries notably have sound industrial policy motives and strongly back their national industry champions, often linking export insurance coverage with a wider political motive such as the securing imports of natural resources. The United States, at the opposite end of the scale, has the strictest interpretation of all countries on the question of national origin. However, American industry in general is less dependent on exports of capital goods than, for instance, Germany.

Germany has a large and very heterogeneous industrial and exporting basis, ranging from SMEs to large DAX corporates. Its exports come from all sectors: commerce and trade, ship building and aircraft, energy, construction, capital good manufacturing and large plant engineering. Export destinations are worldwide, which Hermes-insurance reflects by covering over 150 countries. Clearly, German ECA policy in general and foreign content policy in particular, has to consider the manifold interests and needs of the German corporate and industrial landscape. Taking into account this plurality, Hermes will be cautiously considering each move for its viability for a large group of industrial players. Moreover, for Germany as a matter of policy, it is very important to ensure that any Hermes-cover principle supports employment and, moreover, that particular attention is paid to the SME sector.

The German ECA cover instrument is based on the notion of German origin of goods, to be evidenced by a German certificate of origin. It could, however, be argued that this scheme provides less and less informational value in a globalised world. In fact, research on input-output data suggests that of every euro exported from Germany, only 60–70 cents are of true German origin. This figure surely varies across sectors, but the underlying pattern is clear. What exactly is of German origin, then, and what is the true value added to an export project in Germany? From this perspective, the issuance of a German certificate of origin for an individual export project may be an indication of the national value added and a feasible way of demonstrating eligibility for support under the export credit scheme. However, it is no longer the only indicator for the much sought-after impact on employment that ECA-cover for a project targets.

Without necessarily abandoning the current system that relies on the examination of a single project's national and foreign content, it could be worthwhile discussing an add-on approach that takes a wider perspective. In the ECA-cover context, the overall aim of national job securement will, in most cases, not be directly related to one individual export project, but rather to the successful export performance of a company over time. The proportion of foreign content is very likely to vary from project to project. The aggregate of foreign content in companies' projects over one year, for instance, might well be below a level considered critical by the German ECA.

## Conclusion

Not regulated by the OECD consensus, foreign content policy is defined by each national ECA. In recent decades almost all ECAs in OECD countries have substantially enlarged foreign content acceptance, including the German ECA Hermes. With ongoing and deepening globalisation in production and trade, it has become more difficult to quantify the true national value added in an export project. Both from a practical, competitive and an academic point of view, there is a need to reconsider the viability of German foreign content policy in its current imprint.

To date trade finance in general and ECA-cover policies in particular have been subject to little academic research, although they are vital activities for export-oriented nations. Empirical data and quantitative evidence is relatively scarce. Interest in research on trade and export related matters seems to be growing, however, and its methodological competence can add much value to the discussion of ECA-cover fundamentals.