

Analysis on the Functions of Policy Oriented Export Credit Insurance in China-ASEAN Economic and Trade Cooperation

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Abstract

ASEAN announced to launch economic community in 2015 for the purpose of establishing a unified market with a huge population of 600 million. China should devote greater effort to establishing China-ASEAN Free Trade Area and the Chinese enterprises need to accelerate the in-depth cooperation with ASEAN countries especially. Various problems lie in the economic and trade cooperation of ASEAN and Chinese enterprises, such as political risks, commercial risks, barriers of international market development and financing problems. The functions of export credit insurance as a policy oriented financial instrument in the economic and trade cooperation between Chinese enterprises and ASEAN was analyzed in this paper.

Keywords: Policy oriented export credit insurance; Chinese-ASEAN FTA; policy oriented financial tool

1. Introduction

China-ASEAN Free Trade Area was well-established on January 1st of 2010. At present, ASEAN is the third largest trade partner of China which provides the largest foreign investment market for Chinese enterprises while China is the largest trade partner of ASEAN. ASEAN has announced to launch economic community in 2015, aiming to establish a unified market with a huge population of 600 million. The 10 countries of ASEAN have encountered many problems in economic integration but problem-solving is in progress. China should devote greater effort to establishing China-ASEAN Free Trade Area. Now, more and more Chinese enterprises work with Southeast Asian countries to seek for new development.

In the economic and trade cooperation between Chinese enterprises and ASEAN, there are a lot of problems exist, such as foreign political risks, commercial risks, barriers of international market development and financing problems. Therefore, it is necessary to solve these problems by import and export credit, export credit insurance as well as other

policy oriented financial instruments. The functions of export credit insurance as a policy oriented financial instrument in the economic and trade cooperation between Chinese enterprises and ASEAN were analyzed in this paper.

Policies like import and export credit, export credit insurance and export tax rebate are common public policies that used by countries in the world to promote the development of foreign trade and economic cooperation. Among all, import and export credit and export tax rebate have been used for a long time and extensively recognized; but the policy of export credit insurance has been applied in China just for a short time and its effects have not been fully brought into play, so that it has not been highly recognized by Chinese society.

2. Export Credit Insurance and Company

Export credit insurance (ECI), is a governmental policy oriented support measure which is designed to enhance the international competitiveness of domestic products, promote export trade, ensure the security of exporters' receipts and the banks' credits,

boost the economic development and provide risk-free guarantee for enterprises in economic activities like export trade, investment abroad and overseas project contracting with the financial backing of the government. It is a non-profit insurance business and an indirect measure of the government to control and supplement the market economy. ECI bears a huge risk and it is difficult to use statistical methods to estimate the loss probability. General commercial insurance companies are reluctant to underwrite these risks, thus most of the insurance is undertaken by the government. Since China Export & Credit Insurance Corporation (hereinafter referred to as “Sinosure”) was established, China has a professional agency to underwrite policy oriented export credit insurance. Specifically, this company is also the unique policy oriented insurance company in China.

3. Analysis on the Policy Functions of ECI

As a policy oriented financial instrument, export credit insurance of China has the following main policy functions:¹

3.1 Support Enterprises to Invest Abroad

Compared with the domestic investment project, the overseas investment project is most distinctive in its sufferings from country risks lying in the host countries. As the investing enterprises are often unable to control the country risks and are subject to investment protectionism, international geopolitics and other comprehensive factors beyond Chinese sovereignty, direct threats are posed to enterprises engaged in overseas investment. In order to support Chinese enterprises to engage in overseas investment projects like merging and acquiring the strategic industry, the energy industry and the resource industry in other countries, such as power industry and mine industry, Sinosure was established to

underwrite overseas investment insurance under the approval of the State Council. The main risk responsibilities of policy oriented overseas investment insurance are: collection (refers to the host government completely or partly deprives the investors or the investing enterprises of the ownership and management rights of the project as well as completely or partly deprives the investors or the investing enterprises of the rights of using and controlling the project fund or assets through nationalization, expropriation, confiscation as well as other means), default (refers to the act that the host government or other main bodies admitted by the insurer violate or default the relevant agreements of the investment projects reached with the investor and refuse to compensate the investors the amount of money stated in arbitration award), business interruption (refers to the temporary, complete interruption of the construction or operation of an investment project under equity investment insurance resulted from the damage or loss of project assets or evacuation which are fundamentally caused by wars and political rebellion), wars and political rebellion (refers to the behaviors like wars occur in the host countries, such as revolution, riot, coup, civil war, rebellion and terrorist activities, which lead to the investment loss of the investors caused by the damage or loss of the tangible property or the management failure of the project) and exchange restriction (refers to the measures taken by the host country which are designed to impede and restrict the investors from converting local currency into the stated investment currency in the insurance policy or other convertible currencies, or to prevent the investor from withdrawing the investment currency or earnings from the host country).

General speaking, the policy functions of investment insurance are mainly reflected in three aspects: firstly, share risk with enterprises; secondly, promote project financing; thirdly, expand overseas investment market.

As far as the application of the underwriting policies of “collection”, “default”, “business interruption” and “war and political violence”, here is a case about how the overseas investment interest of the enterprise is insured. A Chinese enterprise invested in Burma Taiping River Power Station Project had been insured by Sinasure. In the June of 2011, due to the military conflict occurred between the governmental military of Burma and the local armed forces of the second special zone of Kachin in the perimeter zone of the project, the Chinese production personnel are forced to evacuate and the machine set has to be shut off. According to the insurance policy, as the project enterprise ceased operation because of risks brought in by the war or political violence in Burma which made the enterprise unable to repay the bank loans, Sinasure will compensate the company 156 million yuan after exploration and assessment. On one hand, this practice liberated the enterprise from the financial dilemma; on the other hand, it ensured the capital security of the bank.

3.2 Assist Export Enterprises in Market Expanding

Export trade involves the development of international market, sales mode, sales strategy (payment on delivery or payment before delivery) and operating safety as well as other aspects. In order to cooperate with the enterprises to solve the problems above, export credit insurance supports the enterprises from the following aspects.

3.2.1, Sinasure ensures the security of accounts receivables of the enterprise and implements the

asset security measures. In the export trade, export credit insurance assumes the following business risks: buyer's payment in arrears; insolvency; buyer's rejection of goods; buyer's bankruptcy; the bankruptcy, close down and taken-over of buyer's issuing bank; under the conditions of documents complying with credit terms and all export documents conforming with one another, the issuing bank defaults or dishonors under the usance letter of credit. Political risks are: the state or the region of the buyer or the issuing bank prohibits or restrains the buyer or the issuing bank from paying the price of goods or the money listed on the letter of credit for the insurant; the buyer's imports are prohibited or the import license issued to the buyer is revoked; the war, civil war or riot is occurred, making the buyer unable to perform the contract or the issuing bank fail to fulfill the payment obligations stated in the letter of credit; the third-party country controlling the payment of the buyer or the issuing bank issues the deferred payment command. When the enterprise encounters these risks in the sales of goods, it will obtain loss compensation under the policy of credit insurance so that the security of enterprise collection can be guaranteed.

3.2.2, Sinasure changes the sales model and sales strategy through underwriting policy under the condition of the security of receivables.

In practice, the enterprise may be exposed to the following situations: firstly, as the enterprise marketing new products domestically and internationally to expand market, the buyers often require payment on delivery; secondly, if the goods pile up in excess of requirement, the enterprise has to do marketing in buyer's market; thirdly, credit (sell on credits) transactions cost less than L/C transactions; fourthly, since the international

financial crisis, some foreign countries have been suffering from financing difficulties with high operating costs, so that importers tend to require payment on delivery; fifthly, the cooperation between strategic partners often requires a simplified mode of trade and a lower transaction cost, therefore, payment on delivery has become the basic entry criteria of big buyers for their partners, so that enterprises have to give up the business opportunity if they are reluctant to accept credit trading.

The underwriting of Sinosure can guarantee the security of enterprise's credit trading. Through supporting enterprise to defer the payment days, it provides the buyer with more credit support which in return improves the export competitiveness of the enterprises and won more orders from the buyers. The large enterprises with abundant funds can convert its advantage of effortless financing into the financing support for foreign buyers. The deferred payment is a kind of financing support for the payer, which can make the trading parties realize mutual cooperation and win-win situation, so that the price of exports and the bargaining power of the exporters can be enhanced, thereby the objectives of increasing profits and stabilizing strategic partnership can be attained.

3.2.3, Sinosure supports the enterprises to actively explore the international market. Under the support of the state, Sinosure has established credit channels in 191 countries and regions. Especially, it has assisted enterprises to understand the overseas buyers and screen clients, providing effective support for large enterprises in market reinforcement and customer management. In addition, Sinosure actively cooperates with the enterprises to explore the international market and strengthen the business risk management.

3.3 Support Enterprises to Set up Overseas Companies to Carry out Global Procurement, Global Sales and Multinational Operation in Various Forms

Sinosure actively supports enterprises to set up affiliated companies in foreign countries to carry out foreign sales. The establishment of foreign companies can facilitate the enterprise to make full use of the international and domestic markets, the resources of the two countries, two financing platforms and various policy measures, so as to carry out transnational operation on a larger scale which conduces to maximize the business interests.

3.4 Support Enterprises to Carry out Import Trade

Priority has been given to support and promote the import of important energies, rare resources, high-tech products, key mechanical equipment and spare parts as well as other goods based on the import encouragement policy of China. Through the advance payment insurance business, Sinosure protects the insured company from foreign suppliers' postponement and rejection of delivery and the discrepant product quality with the provisions of the contract after the advance payment is made, so as to ensure the fund security in import trade and promote the long-term stability of importing channels.

3.5 Support Overseas Project Contracting and Equipment Exportation and Guarantee the Security of Receivables at Certain Stage of a Project

Specific contract insurance is designed to support the equipment exportation or project contracting of China export enterprises. Sinosure underwrites the foreign exchange risk of a specific contract for the enterprise which is applicable for the export of mechanical and electrical products and complete sets of equipment as well as foreign project contracting and labor service cooperation. Sinosure permits all kinds of modes of

payment (non-L/C included) and the credit period is within 360 days. It is applicable to the EPC-based export turnkey contract (design-procurement-construction) and it supports the non-L/C mode of payment. The main risk is: when the construction enterprise has completed some workload, as agreed upon in the contract, the proprietor should pay the project cost in time and any arrear incurred should be covered by Sinasure.

3.6 Support the Enterprise to Carry out Overseas Leasing

Specific to the transnational leasing transactions made by enterprises and financing institutions that are qualified to engage in leasing, Sinasure underwrites the political risks of the host country of the lease project and the credits risks of the lessee for the leaser. Political risks refers to the loss of the insured from the rent receivables or the termination of the lease contract caused by the war, the collection, exchange limitations in the country of the lease or the host country of the project. The default of the lessee refers to the act that the lessee fails to pay the rent as stated in the contract on time due to the reasons other than force majeure. This insurance policy is designed to promote enterprises to sell equipment and goods through leasing.

4. Conclusion

Based on the analysis above, we can get that the export credit insurance, as a policy oriented financial tool designed to promote the foreign trade of Chinese enterprises, has developed complete policy measures, which provides the essential policy support for the economic cooperation of China and ASEAN. In the future, these policy measures should be further promoted and implemented. For example, the total export of China to the ten countries of ASEAN

amounted to 243.78 billion dollars, among which the export underwritten by export credit insurance amounted to 22.877 billion dollars, accounting for 9.38% of the total. ² This fully shows that the coverage and support of this policy need further expanding. In addition, by the end of 2012, Chinese enterprises have invested 23.6 billion dollars³ in ASEAN. 6.602 billion dollars of Chinese investment in ASEAN has been supported by the policy oriented export credit insurance, indicating that the supportive force should also be further strengthened.

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