
Ex-Im, Exports, and Private Capital: Will Financial Markets Squeeze the Bank?

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The Role of Ex-Im Bank

The explicit mandate of the US Export-Import Bank envisions that it “provides or facilitates export financing that otherwise would not be available from private or commercial sources” and, in addition, “counters the export credit subsidies offered by foreign governments” (US Export-Import Bank, *1999 Annual Report*, i). Implicitly, the Bank’s role also has foreign policy and systemic stability dimensions. Even though private financial markets have come to dominate capital flows to emerging markets in the past decade, it is likely that Ex-Im will remain a vital financial vehicle for a long time to come. The United States is entering a period when export growth will be more critical than usual. Although some emerging-market economies will graduate to sole reliance on private markets, many others will follow them on the developmental ladder. Moreover, for at least some time, traditional private bank financing may remain constrained, even as total private capital flows advance. Finally, Ex-Im is one of the few US bilateral instruments available for intervention in times of financial crises or when key partner countries face difficulties. The real question for the future is not whether the private financial markets will squeeze Ex-Im, but whether it will be large enough to do its job.

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Export Support

The classic, and politically most attractive, role of Ex-Im is to be the catalyst for raising US exports. Politically, this appeals because it translates into export jobs, at least in terms of direct effects. In economic terms, however, for some years to come the principal appeal of increased US exports due to Ex-Im will be the likely need for a major adjustment to narrow the US external current account deficit. The deficit is now headed toward more than 4 percent of GDP. This is even higher than at its 1987 peak, which reflected the large overvaluation of the dollar in the mid-1980s and, at the time, posed the risk of a “hard landing” for the US economy.

The essence of the problem is that the boom in US consumption, fueled by the wealth effect from the rise in US stock market valuation (from about 50 percent of GDP in 1991 to about 150 percent in 2000), has caused private saving to fall by more than the reduction in public dissaving. It will be a considerable challenge for the United States to achieve adjustment to a more sustainable external imbalance without entering into a vicious circle of declining dollar, rising interest rates (from the Federal Reserve’s concern about the inflationary impact of higher import prices), declining stock market, declining dollar (as still more foreign capital is discouraged), and so forth. In carrying out an adjustment, US exports will need every bit of help they can get.

But only a little bit of help can be expected from the Ex-Im contribution—at least given its current dimensions. In 1999, Ex-Im provided about \$13 billion in export financing, of which about \$1 billion was direct loans, \$8 billion loan guarantees, and \$4 billion export credit insurance (US Export-Import Bank, *1999 Annual Report*, 15). Even if we assume that none of the exports supported would have taken place in the absence of the financing,¹ this amounted to only about 1.3 percent of actual exports of goods and services. So, although Ex-Im is a relevant instrument for helping to carry out the macroeconomic task of external adjustment, its base is so small that it will be able to make only a modest contribution toward this end.

Meeting the Competition

A dominant feature of Ex-Im export support is to limit the extent to which foreign subsidies displace US firms in global export markets. The Organization for Economic Cooperation and Development (OECD) has been the principal venue to curb competitive spirals in interest-rate and other financial subsidies among the export credit agencies of industrial

1. The “additionality” of Ex-Im’s impact on exports is an issue of long-standing debate.

countries. Nonetheless, it would appear that de facto or perceived subsidies continue to play a substantial role in export competition.

A major consequence of this concern appears to be the surprisingly large concentration of Ex-Im's operations in the aircraft sector. In fiscal year 1999, authorizations for finance to support aircraft exports amounted to \$6.1 billion, or 47 percent of the total. One can presume that subsidized competition from Airbus forced this response. Those who seek a theoretical justification for this approach can find some comfort in the strategic trade literature (Brander and Spencer 1985).² The basic notion is that in the presence of potential monopoly profits, there is a case for ensuring that the home producers secure a strong early position rather than ceding the field to foreign producers. Indeed, doing so by subsidizing the export is more efficient than seeking to do so by protecting against the import, so Ex-Im is on the side of the angels within the confines of strategic trade theory.

Countering Systemic Instability

In addition to its traditional mandates, a potential role of Ex-Im would be to provide a supplementary vehicle for US support when financial crises erupt in emerging markets. At a global level, the principal institution for this purpose is the International Monetary Fund. Within the United States, the Treasury Department's Exchange Stabilization Fund has been used to assist emerging-market nations in times of financial distress, along with Federal Reserve swap arrangements in the case of Mexico. However, bilateral export finance has sometimes been used to encourage private-sector confidence by showing that there is a "second line of defense."

Ex-Im Bank played a significant role in helping to resolve the 1997-98 Asian crisis by providing *short-term* trade credit insurance lines. Shipments to South Korea, supported by these new short-term lines, rose from practically zero in 1997 to \$920 million in 1998, before declining to \$324 million in 1999, as private lending began to return to the market. But in Indonesia and Thailand, Ex-Im's lines primarily had an announcement effect, because it took a long time to put the lines into place. Ultimately, the lines were not implemented in Thailand and only generated a few export transactions in Indonesia.

Whereas Ex-Im's special short-term lending played at least a catalytic role in helping to build confidence during the East Asian crises, its longer-term lending failed to do so. For the fiscal year (FY) ending 30 September, Ex-Im's *medium* and *long-term* credit authorizations for Korea fell

2. The comfort should be scant, however, because this literature is highly sensitive to assumptions, e.g., about the particular type of oligopolistic behavior. See Cline (1994, 60-62).

from \$755 million in FY1997 to zero in FY1998; but rebounded to \$882 million in FY1999. Authorizations for Indonesia fell from \$626 million in FY1997 to \$4.3 million in FY1998; and rebounded to \$301 million in FY1999. Authorizations for Russia fell from \$637 million in FY1998 to zero in FY1999. These patterns all amounted to a cessation of medium- and long-term credit support at the height of the respective crisis periods. Only in Brazil, where authorizations rose from \$353 million in FY1998 to \$514 million in FY1999, was there an increase in the period of most intense crisis (US Export-Import Bank, 1997, 1998, and 1999 *Annual Reports*).

It appears, then, that Ex-Im's longer-term operations have not been used much for systemic stability purposes and, arguably, have been procyclical rather than countercyclical. Operationally, it may well be difficult for Ex-Im to extend new credits when it has just downgraded a country's credit rating as a consequence of the financial emergency. Caution in crises is understandable, given Ex-Im's past experience with reschedulings in Paris Club arrangements. Nonetheless, it is somewhat surprising that Ex-Im did not seem to help more in confronting the major financial crises of the late 1990s. In contrast, Japan used the Japan Export-Import Bank (now the Japan Bank for International Cooperation) as its chief vehicle for doing so, and in large volumes. Much of this support was not directly tied to Japanese exports.

One reason for the apparent procyclicality of Ex-Im lending in these cases may well be that the motive of meeting the competition dominated any systemic-stability motive. Thus, the entirety of the \$755 million authorized for Korea in FY1997 went to the aircraft sector. It is not surprising that a country's demand for big-ticket capital equipment imports, such as aircraft, would collapse in a financial crisis—and hence so would Ex-Im financing for such items. The shift to a large volume of short-term credit in Korea was thus an appropriate adaptation, albeit ad hoc and apparently not very successful elsewhere in that region.

This credit pattern during financial crises suggests that Ex-Im might wish to explore a more permanent facility that provides greater scope for general export finance in periods of increased uncertainty—at least for the key borrowing countries. After all, this is precisely when “export financing . . . otherwise would not be available from private or commercial sources.” Such a facility would admittedly need to be used with prudence. It would require distinguishing between those countries where medium-term prospects are strong and private markets are temporarily in an unduly pessimistic mode, and those where the difficulties are likely to be much more protracted.³

3. The difference between the lending to Brazil and Russia cited here suggests that Ex-Im made just such a prudent distinction in these two recent cases.

Development Finance

Finally, Ex-Im plays a role as one of the few vehicles for US bilateral finance to developing countries at market-related interest rates. Examples in FY1999 include credits to such sectors as power, construction, and farm equipment in countries such as Angola, Colombia, Ghana, Romania, Turkey, Uzbekistan, and Venezuela.

Private versus Public Capital Flows to Emerging Markets

A central question for the US Export-Import Bank, and its counterparts in other industrial countries, is whether the day of official bilateral export finance has passed because of the shift to global private capital markets. If the rationale for Ex-Im Bank is to provide credit otherwise unavailable from the private sector, and if private credit is much more available and dominant than before, then Ex-Im's role arguably might have been superseded. The analysis in this section and the next will argue, in contrast, that key features of the global private capital market mean that an important role for Ex-Im is likely to continue—despite the growth of private capital markets during the past decade and their likely expansion in the next.

Table 7.1 reports the magnitudes and composition of private and public capital flows to 29 major emerging-market economies during the past decade and provides a forecast for 2000 (see Institute of International Finance 2000). Seven patterns stand out.

First, there has indeed been a major shift in net capital flows to emerging markets toward a more complete dominance by private rather than public sources. Thus, in 1991, the private sector accounted for 66.3 percent of net flows. By 1999, 97 percent of net flows were from the private sector. Even in the crisis period of 1997-98, when the public sector stepped in with large emergency financing packages (and some private flows to some countries were negative in large magnitudes), the private sector accounted for 81 percent of net flows.

Second, private capital flows peaked at about \$330 billion in 1996, the year before the East Asian crisis. They then fell to a low of \$137 billion in 1998, before edging up to \$150 billion in 1999. They are projected to rebound more significantly to nearly \$200 billion in 2000.

Third, there has been a persistent rise in the share of direct investment in the total for private flows. Whereas direct investment accounted for only 32 percent of net private flows in 1991, by 1998-99 its share had risen to 90 percent (or 67 percent of the total for *positive* private flow categories).

Table 7.1 Net capital flows to emerging market economies (billions of dollars)

Capital flows	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000 ^a
Total private flows	72.9	121.6	185.2	164.5	231.1	329.8	266.4	137.4	150.5	198.7
Direct investment	23.4	31.1	44.3	65.2	76.8	91.7	115.9	118.8	141.4	130.0
Portfolio equity	5.0	14.4	45.5	32.8	27.7	33.7	25.9	14.1	21.0	42.4
Banks	17.7	33.7	22.7	40.3	100.9	116.4	35.6	-58.8	-40.5	-11.1
Other creditors	26.8	42.4	72.7	26.3	25.6	88.1	89.0	63.4	28.6	37.4
Total public flows	37.0	36.8	27.1	28.8	37.9	7.3	44.8	48.1	5.0	-0.8
Multilateral	12.8	7.9	9.7	5.3	20.4	6.7	29.6	37.7	2.6	1.3
Bilateral	24.1	28.9	17.4	23.5	17.4	0.6	15.3	10.4	2.4	-2.1
Total flows	109.9	158.3	212.3	193.3	269.0	337.1	311.2	185.5	155.5	198.0

a. Forecast.

Note: Countries included among emerging markets (by region): China, India, Indonesia, Malaysia, Philippines, South Korea, Thailand; Argentina, Brazil, Chile, Colombia, Ecuador, Mexico, Peru, Uruguay, Venezuela; Bulgaria, Czech Republic, Hungary, Poland, Romania, Russia, Slovakia, Turkey; Algeria, Egypt, Morocco, South Africa, Tunisia.

Source: Institute of International Finance data.

Fourth, and a key point to be examined further below, net lending from commercial banks to emerging-market economies has undergone a sharp upswing and then downswing during the decade. It rose from less than \$20 billion in 1991 to a peak of \$116 billion in 1996, but then plunged to a negative \$59 billion in 1998. Net bank flows remained negative at \$40 billion in 1999 and are projected to remain negative, albeit at only about \$10 billion, in 2000.

Fifth, net lending by “other creditors,” largely bonds, expanded dramatically in the 1990s. This lending went from under \$30 billion in 1991 to about \$90 billion annually in 1996-97, before contracting to less than \$30 billion in 1999 on the heels of the East Asian, Russian, and Brazilian crises. Projected levels for 2000 are considerably stronger again, at almost \$40 billion.

Sixth, private capital flows in the form of portfolio equity (stock) purchases surged in the 1993-94 period, continued through much of the decade in the range of \$20-\$30 billion annually, and are likely to reach about \$40 billion in 2000.

Seventh, private flows going through capital markets—through purchases of stocks and bonds by myriad and dispersed investors—will reach about \$80 billion in 2000, or 38 percent of the total for positive private flow categories. By contrast, transactions involving large-firm investors (banks and multinational firms) are bifurcated. The bank part is still negative, but that of the multinationals (direct investment) is large and positive.

In sum, global private capital markets facing the emerging-market economies have undergone enormous changes in composition and have experienced very large cyclical fluctuations. This structural change is important to evaluating the role of Ex-Im in the coming decade, as discussed below.

For their part, public-sector capital flows to emerging markets have shown a declining trend—even in absolute nominal magnitudes—during the past decade, with the temporary exception of crisis years 1995 (Mexico) and 1997-98 (East Asia, Brazil). Critics of the international financial rescue programs see these patterns as evidence that the public sector “bailed out” private creditors. Those—including many in the public sector—who see the late 1990s as a period of successful public-sector response to systemic crisis instead see the same pattern as reflecting an appropriate “balance wheel” role for the public sector. When it is recognized that the “moral hazard” problem resulting from the rescue packages has been seriously exaggerated (because of the sizable private-sector losses and the persistence of higher, rather than lower, risk perception after these episodes), the second view seems more valid.⁴

Within public-sector flows, there has been a declining trend for both bilateral and multilateral net lending. Net bilateral flows averaged \$23

4. See Institute of International Finance (1999); Zhang (1999).

billion annually in 1991-94, falling to an average of \$6.5 billion annually in 1997-2000. The bilateral flows include both concessional flows (in the case of the United States, through the Agency for International Development) and market-related flows through the export credit and investment financing agencies (including Ex-Im and the Overseas Private Investment Corporation in the United States). (Because the focus of the analysis here is on the middle-income emerging-market economies, the relative size of public-sector flows is somewhat understated, because assistance to low-income countries is not included.)

Annual net flows for Ex-Im itself are somewhat ambiguous. The bulk of Ex-Im's financing support takes the form of loan guarantees, so the more typical comparison of new disbursements against amortization is difficult to obtain. However, a useful proxy for annual net flows would seem to be the average annual increment in authorizations of all types (loans, guarantees, and export credit insurance). Total Ex-Im authorizations amounted to \$11.5 billion, \$12.2 billion, \$10.5 billion, and \$13.1 billion in fiscal years 1996 through 1999, respectively. Thus, on average, authorizations rose at a rate of about \$500 million annually for those years. This is the broad range of Ex-Im's annual contribution to net capital flows to emerging markets, and represents less than a tenth of bilateral flows in this period.⁵ This once again reinforces the earlier observation that, in terms of pure volume, Ex-Im's role is modest.

Changes in the Structure of Private Lending

A key feature of the changing structure of private capital flows is the shift in recent years from net bank lending to lending through bonds and other nonbank sources. A central question is whether this has been solely due to the outflows from crisis countries associated with their repayments to banks in the OECD countries. A closer examination of the data suggests that the phenomenon is broader.

Table 7.2 disaggregates net bank lending in 1996-2000 into specific destinations: the five East Asian economies most affected by that region's crisis (Indonesia, South Korea, Malaysia, Philippines, and Thailand), Russia, Brazil, and all other emerging-market economies. Not surprisingly, negative net bank flows in 1998-99 were concentrated in the crisis economies themselves. For the East Asian five, Russia, and Brazil, net outflows to banks were about \$60 billion in 1998, and will likely still be about \$17 billion in 2000 (as highly leveraged private borrowers in, e.g., Korea and Thailand reduce their debt to more sustainable levels). What is more

5. And this comparison is somewhat overstated, because the Ex-Im total includes many countries, primarily lower-income ones, that are not included in the 29-country emerging-market group considered in table 7.1.

Table 7.2 Net capital flows from commercial banks to emerging markets (billions of dollars)

Region or country	1996	1997	1998	1999	2000 ^b
Africa and the Middle East	0.5	5.2	0.8	-1.4	-0.3
Asia	80.1	-14.5	-59.6	-31.8	-17.6
East Asian five ^a	64.1	-19.8	-50.8	-26.9	-18.1
Europe	19.3	22.4	5.3	3.7	5.6
Russia	7.1	9.9	-2.1	-1.0	-0.5
Latin America	16.5	22.6	-5.4	-10.9	1.3
Brazil	13.5	11.9	-8.7	-7.2	2.0
Total	116.4	35.6	-58.8	-40.5	-11.1
East Asian five, Russia, and Brazil	84.7	2.0	-61.6	-35.1	-16.6
Others	31.7	33.6	2.8	-5.4	5.5

a. East Asian five: Indonesia, South Korea, Malaysia, Philippines, Thailand.

b. Forecast.

Note: Countries included among emerging markets: China, India, Indonesia, Malaysia, Philippines, South Korea, Thailand; Argentina, Brazil, Chile, Colombia, Ecuador, Mexico, Peru, Uruguay, Venezuela; Bulgaria, Czech Republic, Hungary, Poland, Romania, Russia, Slovakia, Turkey; Algeria, Egypt, Morocco, South Africa, Tunisia.

Source: Institute of International Finance data.

surprising is that net bank lending to all other emerging markets also collapsed, from a range of about \$30 billion annually in 1996-97 to near zero in 1998-2000.

Table 7.3 presents the same geographical disaggregation for net lending through bonds and other nonbank sources (supplier credits, nonresident purchases of domestic treasury bills, etc.). Whereas nonbank net lending to the crisis countries themselves collapsed to about zero, net lending from these sources to other emerging markets not directly swept up in the crises held up quite well. Nonbank net lending to these countries stayed at a plateau of about \$35 billion annually in 1998-2000, down moderately from a peak of \$49 billion in 1997.

One possible explanation for why bond and other nonbank lending held up better than bank lending during the crises of the late 1990s might be that bonds were not rescheduled in the 1980s debt crises, whereas bank claims were—and typically lost about 35 percent of their value in the Brady Plan workouts. However, the share of bonds in the total outstanding external debt of emerging-market economies has grown from a small fraction of bank debt in the 1980s to rough parity by now. Bond investors have probably figured out that, with their growing importance, they are no longer excluded from rescheduling, as they were when bonds were only a small part of total debt. Indeed, the defaults on Brady bonds by Ecuador in 2000, and the restructuring of Eurobonds owed by Pakistan

Table 7.3 Net capital flows from nonbank creditors to emerging markets (billions of dollars)

Region or country	1996	1997	1998	1999	2000 ^b
Africa and the Middle East	0.2	3.3	2.8	3.8	4.4
Asia	33.6	23.5	3.5	-0.8	-0.5
East Asian five ^a	27.3	13.3	-3.4	-3.4	-2.6
Europe	18.5	39.2	15.3	11.2	9.3
Russia	9.6	23.5	8.6	1.5	-1.2
Latin America	35.7	23.0	41.9	14.3	24.2
Brazil	14.0	3.4	20.9	1.9	7.3
Total	88.1	89.0	63.4	28.6	37.4
East Asian five, Russia, and Brazil	50.9	40.2	26.1	-3.8	3.5
Others	37.2	48.8	37.3	32.4	33.9

a. East Asian five: Indonesia, South Korea, Malaysia, The Philippines, and Thailand.

b. Forecast.

Notes: Countries included among emerging markets (by region): China, India, Indonesia, Malaysia, Philippines, South Korea, Thailand; Argentina, Brazil, Chile, Colombia, Ecuador, Mexico, Peru, Uruguay, Venezuela; Bulgaria, Czech Republic, Hungary, Poland, Romania, Russia, Slovakia, Turkey; Algeria, Egypt, Morocco, South Africa, Tunisia.

Source: Institute of International Finance data.

in 1999, sent a clear signal that bonds are not exempt from debt restructuring. Even so, the amount of new bonds issued by emerging markets in the first quarter of 2000 considerably exceeded the annual rate last year. This suggests that investors had not previously assumed that bonds would be excluded from rescheduling, and hence were not frightened away from bond markets when the first significant defaults and reschedulings did occur.

Instead, a more fundamental economic reason why lending may be shifting from banks to bonds may be the interaction between leverage and risk. Banks are leveraged institutions. The Basel capital requirement of 8 percent implies leverage of 12-to-1. And as only half of capital is tier-1 equity, leverage may be seen as potentially 25-to-1. In contrast, bond investors are likely to be less leveraged; they include wealthy individuals (those with more than \$30 million financial net worth number 55,000 worldwide, and have \$8 trillion to invest, according to a recent study),⁶ mutual funds, and (for the higher grades) pension funds and insurance companies.

Risk management pays close attention to the probability of loss, and in particular tends to limit leveraged institutions' investment exposure

6. Merrill Lynch/German Consulting, *World Wealth Report*, as reported by Canada Newswire, 2 May 2000.

to amounts that, if lost in “extreme events,” would not wipe out the institution’s capital and turn it insolvent. In this kind of portfolio management, if the perceived risk curve (or probability distribution of losses) is seen as shifting outward to the right—so that there is a “fatter tail” over the range of extremely large losses—then the firm will react by reducing its exposure back to the point where once again capital will not be wiped out (up to some probability of assurance, such as 99 percent).

If we compare two investors, one highly leveraged and the other not, then the latter is the more likely one to continue lending in a situation where the perceived risk curve has shifted outward in the way just described, because its capital stock will be much larger relative to the exposure. The observation that bond and other nonbank lending to non-crisis emerging-market economies held up favorably in the late 1990s, while net bank lending did not, is consistent with what one would expect if the series of crises cast a shadow of heightened risk across all emerging-market economies, not just those directly in crisis.

Following the East Asian crisis, moreover, many banks intensified attention to their systems for managing risk in emerging-market lending, including more sophisticated modeling techniques. This has likely heightened the sensitivity of bank lending to risk in emerging markets, thereby amplifying the leverage-risk nexus and further compressing bank lending to these markets in recent years. In addition, a number of large international banks appear to be moving in the direction of investment banking activity, seeking higher risk-adjusted return on shareholder equity by arranging bond flotations for emerging-market borrowers, rather than extending direct loans and holding the loans on the bank’s own balance sheet.

These considerations suggest that the recent decline of net bank lending to emerging markets, relative to capital raised through bonds and other nonbank sources, may be a more persistent phenomenon than merely a short-term reaction to the crises of the late 1990s. Presumably, the perception of heightened risk will ease over time if key economies pursue sound policies. Already there has been considerable recovery of confidence in emerging markets and moderation in the extremely high lending “spreads” of interest rates over US Treasury rates that characterized late 1998 and much of 1999. In principle, this could mobilize the leverage-risk nexus in the opposite direction from that of the past 3 years.

Nonetheless, the residual heightened risk perception of emerging-market debt as a class (following the crises of the late 1990s) together with intensified attention to risk management systems and other institutional changes in banking, seem likely to limit net bank flows to emerging markets to levels far below those of the mid-1990s for a long time to come.

Trade credit, as a specific component of bank flows, might fare somewhat better, because traditionally it has been seen as less risky than medium-term lending. However, after the recent crises, short-term trade

credit may well be perceived as having somewhat higher risk than previously thought—in view of the concerted conversion of about \$20 billion in short-term loans to South Korea into 1-year to 3-year bonds, and considering the gentlemen’s agreement among banks to maintain trade lines to Brazil in the second quarter of 1999.

Implications for Ex-Im

This analysis suggests that private markets will not “squeeze,” and certainly not “squeeze out,” lending by official export credit agencies any time soon. The evolution in the structure of private capital flows leaves ample space for official export credits. The volume of lending through the private market vehicle most relevant to export credit—commercial banks—has been falling, not rising. This trend seems likely to continue. The persistent strong rise in direct investment is beneficial for emerging-market economies, but does not directly contribute to general export finance (although it supports exports of capital goods associated with a project). Nor are portfolio equity flows of a nature that links them to export credit.

Within the flows of private lending, the shift toward bonds and away from banks also structurally constrains the likely availability of private export credit. Whereas it is natural for a bank to extend a loan to a private firm to purchase an import, bond finance typically goes to the sovereign or, increasingly, to one of the strongest local corporations; and foreign exchange becomes available only indirectly for import purchases.

In sum, whereas there might have been a case in 1995-96 that ample availability of private bank lending to emerging markets meant that bilateral export credit agency lending had become outmoded, it is much more difficult to make that case today. Moreover, Ex-Im is in a position to make loans and guarantees to the less-developed economies as they move up the developmental scale but still have very limited access to private capital markets. The Ex-Im mandate of countering subsidized competition will persist as long as foreign subsidies do, and these seem unlikely to disappear any time soon. Finally, if the analysis focusing on the interaction between leverage and risk is accurate, Ex-Im loan guarantees and export credit insurance should be particularly effective in mobilizing bank lending, by directly lowering its risk.

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