Export Credit Guarantees, Moral Hazard and Exports Quality

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November 20, 2002

Abstract

We analyze the role played by Export Credit Guarantees (ECGs) to encourage exports to developing countries. The existence of moral hazard on the side of the firm is introduced. Whereas it is claimed that ECGs provide a signal of good quality, we show the possibility that excessive insurance coverage may have the opposite effect. In our setup, firms can actually influence the probability of payment default by cheating on the quality when an experience good is involved. Then the inability of the exporter's government to verify the actual quality of the product will limit its ability to encourage trade through ECGs, once the coverage provided goes beyond a certain threshold. This result provide a rationale behind the limited coverage on ECGs.

JEL: F12, H56, L10

Keywords: export credit guarantees, offsets, moral hazard.

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*We are grateful to the ESRC for support under grant R00239388. Correspondence to M.C.Garcia-Alonso@ukc.ac.uk. Department of Economics, University of Kent, Canterbury, Kent CT2 7NP, UK.