1

Ex-Im Bank: Overview, Challenges, and Policy Options

RITA M. RODRIGUEZ

Birthdays offer a good opportunity to reflect on the past and contemplate the future. The papers presented at the conference sponsored by the Institute for International Economics in honor of the US Export-Import Bank's 65th anniversary, now published in this volume, describe Ex-Im's environment and identify challenges. Along with providing an overview, this chapter reviews a range of challenges facing Ex-Im and the policy options for addressing them.

The Bank's Mandates

Since its inception, Ex-Im Bank has supported US exports in the presence of either perceived private financial market failure or competition supported by foreign governments. The spirit guiding Ex-Im rarely has promoted exports for the sake of exports; nor has foreign aid been part of its mission.

Supplement Private Financing

The mandate to supplement and not compete with private financing appeared in US President Franklin D. Roosevelt's decree establishing Ex-Im

Rita M. Rodriguez is a former director of the Export-Import Bank of the United States.

Bank in 1934. Some 65 years later, US Secretary of the Treasury Lawrence H. Summers, in his essay, still foresees a continued role for Ex-Im Bank when capital markets fail to provide financing for creditworthy export transactions (see chapter 20). And Congressman James A. Leach, in his essay, attributes part of the congressional support for rechartering Ex-Im Bank in 1997—in the midst of allegations of "corporate welfare"—to the fact that Ex-Im is a "lender of last resort," in the sense that it lends only when private finance is not available[1] (see chapter 19).

Simply put, under congressional legislation, Ex-Im does not compete with private financial markets. Ex-Im's mandate is to support "additional" US exports—beyond those that might have been supported by private financial markets. Consistent with this mandate, over the last 30 years or so, Ex-Im's credit operations abroad have focused on developing countries, and its "marketing" efforts at home have concentrated on small US exporters, which traditionally have been unable to access commercial sources of financing.

As Leach notes, Ex-Im's philosophy of not competing with private financial markets is not shared by all export credit agencies (ECAs). Thus, A. Ian Gillespie, in his essay, considers it impossible to be a lender of last resort and run a "commercial ECA"—arguing that this approach would leave only risky business for the ECA (see chapter 16). Even Lorenz Schomerus, a believer that official export credits should complement the private financial markets, insists in his essay that ECAs need to operate in the black, sometimes doing commercial deals (see chapter 4). The differences in philosophy toward ECA competition with private markets become particularly acute in the case of "market windows," as Allan I. Mendelowitz points out in his essay (see chapter 9). ("Market windows" are officially sponsored agencies that claim to observe the norms of private financial markets.)

The rationale that Ex-Im is a continuing solution for imperfections in US financial markets is somewhat controversial. In this volume, that controversy is best represented in the positions taken by J. David Richardson and by Renato J. Sucupira and Mauricio Mesquita Moreira on one side, and William Niskanen on the other (see chapters 5, 6, and 10, respectively). Richardson's essay reflects the views of those who support Ex-Im Bank and consider that there is a special role for exports and international trade in the US economy. Sucupira and Moreira make analogous arguments, but in the context of a developing country, Brazil. Richardson's first answer to why exports are important is politically the most popular answer: jobs in the exporting sector. However, he goes beyond the employment benefits derived from exports to stress 11 other reasons why exports are important. He shows that exporting firms are "better" firms, exporting

1. See Section 2(b)(1)(B) of the Export-Import Bank Act of 1945, as amended through P.L. 106-274, September 22, 2000, 12 U.S.C. 635 (2000).

jobs are "better" jobs, and exporting sectors are "better" sectors. (But mercantilists beware! Richardson presents comparable argu-ments in support of imports.)

At the other end of the spectrum is William A. Niskanen, who voices the skepticism of many liberal economists. Niskanen does not believe that financial market imperfections justify the existence of the Bank: "The lack of private credit on terms acceptable to a foreign borrower is not an example of market failure but an important signal of the risks of lending to that borrower, even by Ex-Im Bank." Even when acknowledging that financial markets are not always perfect, in his view, US exports do not provide any economic benefit beyond the benefits that would flow from additional government-financed production in other sectors of the economy. Niskanen cites the Congressional Research Service: "Ex-Im Bank's activities draw from the financial resources within the economy that would be available for other uses"; and the General Accounting Office: "Government export finance assistance programs may largely shift production among sectors within the economy rather than raise the overall level of employment in the economy." To be sure, Niskanen accepts the level playing field rationale for government intervention. But he would rather answer foreign export subsidies with retaliatory responses other than Ex-Im credits and guarantees.

In Richardson's world, if exports are frustrated because of failures in the financial markets, overall economic benefits are diminished. In Niskanen's world, if a given export fails to take place because of a lack of financing, something else will get produced instead; and employment will just be redirected away from one export industry to another, or to production for domestic consumption.

Be "Fully Competitive"

Export credit subsidies offered by foreign governments have always been a rallying force behind the idea that Ex-Im Bank should level the international playing field for US exporters. In 1971, Congress enshrined this position by explicitly directing Ex-Im to "be competitive with the Government-supported rates and terms and other conditions available for the financing of exports from the principal countries whose exporters compete with United States exporters" (Public Law 92-126). In 1983, Congress further mandated Ex-Im to be "fully competitive." Even liberal economists like Niskanen, who do not see a rationale for Ex-Im as an answer to financial market imperfections, agree that it is unfair for US exporters to have to compete with foreign governments. Summers believes Ex-Im has a role in "our national economic defense . . . a strong and credible Export-Import Bank . . . can help to deter abusive subsidies by other countries—and to reduce the chance that we will need to resort to costly subsidies ourselves."

Ex-Im Bank and the Treasury Department have carried out the competitive mandate with a two-pronged approach: match, or even overmatch, the financing terms offered by foreign governments in specific transactions; and negotiate with foreign governments to establish common export credit support rules with a view toward the eventual elimination of export credit subsidies altogether. The venue for negotiations has been the Organization for Economic Cooperation and Development (OECD). Peter C. Evans and Kenneth A. Oye, together with Mendelowitz, present excellent summaries of these negotiations and their accomplishments as of 2000 (see chapter 8).

By most accounts, the OECD negotiations have been a great success. Summers estimates that annual US budget savings from these negotiations probably exceed $500 million annually. Since they were launched under President Jimmy Carter, the OECD negotiations have received strong support from every Congress and administration. But governments and ECAs always try to stay "one step ahead of the judge." Hence, despite more than 20 years of progress in the negotiations, the authors of the essays in this volume emphasize current competitiveness problems. Indeed, Ex-Im Chairman James A. Harmon sees the Bank as losing ground to increasingly sophisticated and aggressive ECA competitors abroad (see chapter 3).

Find "Reasonable Assurance of Repayment"

The competitive mandate calls for Ex-Im to level the playing field for US exporters who face foreign ECA competition. But Ex-Im is limited in fulfilling this mandate by two lines of demarcation. One of them is the injunction not to compete with the private financial markets. This establishes a line of demarcation on how far into "good" credits Ex-Im should venture. The second is the injunction that Ex-Im should lend only when there is a "reasonable assurance of repayment." This establishes a minimum level of creditworthiness, below which, "in the judgment of the Board of Directors," Ex-Im should not go. From the beginning, Ex-Im was designed to operate as a lender that expects to be repaid, and not at all as a donor.

A continuing tension exists between US exporters who think Ex-Im should be more aggressive in establishing a level playing field, and Ex-Im's concern for creditworthiness. A tension has also persisted between the Bank's desire to maintain minimum credit standards and the desire in other Executive Branch departments for a more forthcoming Bank to support foreign policy and developmental goals. In recent years, this tension has been most visible in the case of credits to Russia and the Newly Independent States of the former Soviet Union, and more recently to sub-Saharan African countries.

The potential for conflict between Ex-Im's creditworthiness assessment and foreign policy considerations also exists in the opposite direction. A conflict arises whenever an otherwise creditworthy transaction does not meet the US government's foreign policy objectives-–when, for example, the US government imposes sanctions on a creditworthy country.

Current Challenges for the Bank

The contributors to this book have identified several current challenges to the US Export-Import Bank in fulfilling its mandates. In this overview chapter, challenges are broadly grouped according to their main source:

- Private financial markets: disintermediation and financial crises;
- Foreign government competition: market windows, untied aid, and project risk;
- US government policy: foreign aid, country sanctions, and the environment;
- US labor-business compact: domestic-content rules;
- Ex-Im itself: business culture, governance, and organization.

Challenges from Private Financial Markets

Recent developments pose new challenges for Ex-Im to fulfill its mandate to supplement private financial markets. Two of these challenges are the recurrence of international financial crises and the disintermediation of international capital flows.

The rapid growth of private capital flows to emerging markets during the years 1991-96 might be read to suggest that Ex-Im's supplementary role will be greatly diminished in the twenty-first century. Unfortunately, as William R. Cline reports in his essay below, the 1997 Asian crisis and its aftermath dampened these flows (see chapter 7). Even in 2000, 3 years after crisis struck, private-capital flows to emerging markets do not match earlier records. In addition, as much as 90 percent of the surviving net private flows in 1998-99 took the form of direct investment. Unlike revolving credit lines, direct investment cannot support export financing beyond the original investment. So, in spite of an overall shift of export credit business in the more industrialized countries to the private sector, Daniel M. Zelikow points out in his essay that "among developing countries, ECA financing still represents 20 percent of total debt, and 50 percent of total debt to the official sector" (see chapter 13).

The composition of private credit flows is also a concern for export financing. Cline paints a picture of disintermediation in the international capital markets, with the bond market playing a larger role at the expense of commercial banks. Cline attributes this change in private credit structure to the response to risk perceived by institutions with different levels of financial leverage. Banks, which are highly leveraged, are hit harder by a 5 percent increase in loan losses than are unleveraged pension fund bond holders when bond prices drop 5 percent.

This simple arithmetic, multiplied and extended many times, goes far to explain why commercial banks have become wary lenders. Cline speculates that the disintermediation of the past few years may not be a temporary phenomenon. The new risk-return trade-off for leveraged commercial banks may point them toward the role of investment bankers: issuing bonds to the capital markets and not putting their own capital at risk. Consistent with this prediction, John P. Lipsky identifies securitization as the dominant trend in global financial markets (see chapter 12). He explains how Chase Manhattan Bank not only has a capital-market capability but also syndicates the loans it originates—just as it does with original issues of bonds and equities.

Financial disintermediation associated with the retrenchment of commercial banks affects the viability of small-scale, international trade financing, especially financing for inexperienced exporters. Traditionally, a commercial bank both arranged the financing and played an advisory role in putting the transaction together. Commercial banks are withdrawing from this role. Now the funding is increasingly done in the bond market, and the advisory role is performed by an investment banker who is not interested in small transactions, especially with inexperienced exporters.[2]

In the midst of the apparent retrenchment of bank export credit, private export credit insurance has been a notable exception. Over the last dec-ade, private credit insurance companies have played a larger role, particularly for short repayment terms. As Schomerus points out, "Government-insured export business tends to account for a shrinking share of total exports in the major exporting countries." Private insurers, such as American International Group, have increasingly occupied the market.

Given current developments in the capital markets, it is easy to see a continued need for Ex-Im to insure or guarantee commercial banks against export credit risks. Lipsky clearly states that "Chase would not be making these loans at all--virtually at any price--without Ex-Im participation." What are the options for Ex-Im in responding to the evolution of private financial markets?

Establish standby credit facilities with key Ex-Im borrowing countries. Cline suggests standby facilities that would support US exports in periods

2. See Dobson, Wendy, and Gary C. Hufbauer. *World Capital Markets: Challenge to the G-10*. Washington: Institute for International Economics. Forthcoming 2001.

of increased uncertainty. Such facilities could also help stabilize the financial markets. Because Ex-Im has already served as a catalyst to maintain open trade lines *during* earlier financial crises, the novelty of Cline's suggestion is to establish credit lines in *advance* of a crisis. They could be activated at the onset of the crisis, without competing for the attention of senior government officials. These facilities need not be the sort of automatic credit lines that require the payment of fees and encroach on Ex-Im's limited budget. Instead, they might require mutual consent to be activated. However, Ex-Im would still face a tough call to ensure that only countries with strong medium-term prospects activated the lines. Moreover, Ex-Im's refusal to activate an announced credit line to a troubled country would have a negative impact on an already difficult situation.

Create economies of scale in processing traditional trade finance. In addition to the guarantee it provides against credit risk, Ex-Im could also influence the risk-return trade-off by helping to reduce the operational costs of export credits. Trade financing is a paper-intensive, time-consuming process. Whatever Ex-Im can do to reduce these costs would improve the profitability of export business. Whatever Ex-Im can do to facilitate securitization of the guaranteed and unguaranteed portions of the credit would increase the attractiveness of export finance. Specific measures could include:

- *Standardize and simplify*. Review standards and procedures with a view to simplification.
- *Give banks more responsibility*. Greater delegation to commercial banks of responsibility for collection and preparation of transaction information would save time and increase the bank's financial reward.
- *Automate more processes*. The automation of Ex-Im short-term insurance, which is already under way, will reduce the transaction costs for market participants by giving them immediate access to Ex-Im. This example could be followed in other areas inside the Bank. The Internet could then be used to submit and process credit administration documents, such as shipment reports and disbursements. In his essay below, Robert L. Nardelli strongly encourages Ex-Im to follow this path (see chapter 11). (Also see the section on "Commercial Cultures.")

*Introduce new market participants***.** The way to start is by transferring risk from Ex-Im to the capital markets. This will release credit capacity at Ex-Im. But perhaps the greatest significance of risk transfer is that it could introduce new players to export credit financing. Two new ideas have been offered on this theme:

- *Securitize Ex-Im loans*. As Zelikow points out, "Even credits for which there are no liquid markets can be securitized." Both Zelikow and

Robert D. Hormats (see chapter 14) suggest that Ex-Im transfer credit exposure from its books to the capital markets. Hormats further believes that Ex-Im's credits, once they are properly bundled, will be perceived by the capital markets as of better quality than the average portfolio of emerging-market debt. The reason is that Ex-Im has an above-average collection record and a reputation for good banking practices. To obtain the best possible market risk rating, he proposes that Ex-Im should target the buyers of low-risk paper by first stripping Ex-Im credits of emerging-market risk. (This can be done using financial derivatives.) The approach offered by Hormats and Zelikow is consistent with Ex-Im's experience. In early 2000, Ex-Im issued an invitation to submit proposals to transfer political and credit risk from *future* Ex-Im transactions to the capital markets. The Bank received eight proposals, made an award to Citibank, and jointly completed a risk-sharing facility to be presented to the capital markets.[3]

- *Provide incentives for dot-com trade finance*. The economies of scale made possible by dot-com trade finance may be just what is needed to overcome the inertia of many traditional trade financial institutions and attract new ones. With a few clicks, they could get involved in the financing of US exports.

Challenges from Foreign Governments

The OECD Arrangement on Guidelines for Officially Supported Export Credits succeeded in leveling the playing field for "officially supported" export credits—at least with regard to interest rate, tenor, and risk-premium charges. The age of blatant export credit subsidy competition among governments appears to be over, and Ex-Im can declare comfortably that it is "fully competitive" with the "official export credit" terms offered by other countries. However, more subtle competition––but perhaps no less trade distorting––appears to have emerged in two areas not currently addressed by the Arrangement: "market windows" and ostensibly untied aid.

Market Windows

Sponsoring governments argue that market windows do not distort trade, because they operate just like a commercial financial institution —that is, on market terms. These governments argue that, as market institutions, market windows are not bound by the OECD rules on export credits. Other governments, less sympathetic to the market-window argument, contend that market-window institutions confer a competitive

3. As this book goes to press, the Bank was waiting for final interagency concurrence before proceeding to approach the market.

Table 1.1 Market windows, Ex-Im, and OECD exports compared, 1999 (billions of dollars)

	KfW	EDC	Ex-Im	OECD
Total activity	47.9	27.0	13.1	n.a.
Total export credits	9.6	22.7	13.1	47.9[a]
More than 1-year term	9.6	4.1	9.4	47.9[a]
Official window	1.3	0.2	9.4	47.9[a]
Market window	8.3	3.9	n.a.	n.a.

KfW = Kreditanstalt für Wiederaufban.
EDC = Export Development Corporation.
n.a. = not available.
a. Projected.

Note: Euro, Canadian dollar, and Special Drawing Rights (SDR) figures are converted to US dollars at the 1999 average market exchange rates. Euro per US dollar = 0.9386; Canadian dollar per US dollar = 1.4857; SDR per US dollar = 0.7314.

Sources: Annual reports and data presented in this volume and personal estimate. Exchange rates are from International Monetary Fund, *International Financial Statistics*, June 2000.

advantage on their exporters. Critics claim that the financing terms offered by market windows are better than those offered by private financial markets. Market windows offer more and larger credits to emerg-ing markets than a regular commercial financial institution might do. Moreover, the market window terms are more flexible than the terms allowed under the OECD Arrangement.

Several institutions in various countries qualify as market windows. The two largest, fastest-growing market windows are in Germany and Canada: Kreditanstalt für Wiederaufbau (KfW) and the Export Development Corporation (EDC). Table 1.1 provides a very rough idea of the relative importance of these institutions. In these two institutions, market windows dominate official credits.

Market-window institutions were established in each country for reasons specific to the sponsoring government-–and often in response to deficiencies in national banking systems. This was particularly true of EDC in Canada. In the case of Germany, KfW's market window sought to supplement limitations in the "official" export credit subsidy system. (Gillespie and Hans W. Reich, in his essay (see chapter 15), provide further details on the rationale for the market windows in their respective countries.) EDC and KfW have broad "national" mandates and engage in other activities besides export financing. They also support financing of foreign direct investment and offer credit in the domestic market.[4]

4. In the United States, the Overseas Private Investment Corporation (OPIC) supports, in a limited way, foreign direct investment by medium and small firms. In the domestic US credit market, quasi-official support is focused on housing (Fannie Mae and Freddie Mac).

Both Reich and Gillespie expect continued growth of their respective market windows in the future.

Ex-Im's concerns with market windows arise from (1) their potential for creating an environment of unregulated export credit subsidies, and (2) the "commercial" efficiency and flexibility with which these market windows are reported to operate.

Subsidies in market windows. The two major market windows argue that there is no subsidy in their operations. Gillespie points out that "EDC is . . . expected to be financially self-sustaining, based on commercial practices." In a similar vein, Schomerus calls market windows simply banks "providing financing in individual cases for promising projects at their own risk. . . . They are not a subsidy instrument." Because of lack of transparency in the operations of market windows, however, these defenses remain controversial.

Unlike transactions financed under "official windows," there are no rules governing market window activity, and there is no reporting of this activity to the OECD or elsewhere. And, unlike commercial financial institutions, market windows limit their export financing to support a "national interest." Requests for information on particular export trans-actions are usually rebuffed on grounds that "confidentiality agreements" exist between the market window and the borrower. Similar confidentiality agreements are somehow not required by borrowers for transactions subject to reporting under the OECD Arrangement.

Despite this cloak of obscurity, Mendelowitz uncovered several market window transactions that appear to deviate not only from OECD standard terms, but also from what might be considered standard commercial bank practices. Boeing, in particular, reports that it has had to offer lower aircraft prices, or to provide financing on its own account, to compensate for market window financing in support of Airbus.[5]

Gillespie recognizes that "a commercial ECA fulfills public policy objectives that the private sector, mandated by profit, cannot. The ECA can take on higher levels of risk in a greater number of markets, including emerging markets. . . . And it can avoid subsidies entirely . . . the commercial ECA's ability to combine the best of public policy with the best of private practice results in a highly valuable tool." Commenting on this quote, Niskanen wonders: "Does this sound too good to be true? That is because it is too good to be true. There is no way to meet these noncommercial policy objectives without a subsidy."

KfW and EDC argue that because they do not receive government appropriations and are in the business of making money, their operations do not involve a subsidy. Critics, however, point out that the

5. In 1999, Ex-Im loan authorizations for Boeing export sales amounted to about $6 billion, or 40 percent of Ex-Im's loan budget. Nevertheless, terms were not as good as German market window financing for Airbus sales.

significant benefits these institutions receive from their respective governments permit them both to make profits and to generate a competitive advantage for their national exporters. (For a brief explanation of how Ex-Im's appropriated budget works and a contrast with EDC and KfW's statements of profitability, see footnote 17 in Mendelowitz's essay.)

Among the government benefits market windows enjoy, Mendelowitz enumerates the following: (1) the initial capitalization of the market windows came from government sources; (2) they borrow with the full faith and credit of their governments at rates below those paid by the best of private financial institutions; (3) they do not pay dividends to their shareholders; and (4) they do not pay taxes on profits. In addition, both EDC and KfW receive support for their administrative expenses from their respective governments.

What is the consequence of these benefits conferred by the government? KfW argues that the profits derived from the operation of its market window cross-subsidize the cost of domestic credit activities such as housing and small business finance. EDC asserts that its profits are simply ploughed back into the capital base—just like Microsoft. In the absence of greater transparency, however, critics fear that these benefits can be used to support export financing offers better than the market provides and more flexible than those allowed by the OECD terms.

Operational efficiencies in market windows. In his essay, US Commerce Secretary William Daley (see chapter 18)—along with Mendelowitz—reports the concerns of US exporters about the competitive threat posed by the private-sector mentality of market windows. US exporters think that the flexibility, speed, and aggressiveness of market windows are difficult for Ex-Im to match. Flexibility is the norm of market window transactions—and a big advantage in winning orders. Beyond the requirement to find "a national interest," market windows have few nonfinancial policies to follow—not even a minimum domestic-content requirement.

There are various explanations for the reported operational efficiency of market windows. Not bound either by the OECD rules on permitted financing terms or the strict implementation of high domestic-content requirements, market windows can show much more flexibility than "official" export credit agencies in tailoring financial offers to the specific cash flow and sourcing decisions of a transaction. Having a larger product line—including financing of foreign investment—further increases the flexibility of market windows. The end result can be a one-stop financing shop. Second, these institutions possess a pool of talented, experienced personnel with an intimate understanding of the market and ample administrative resources.

What policy options does the United States have for responding to the competitive threat of market windows? This section considers policies to address noncompliance with OECD agreements. Policies to address other possible sources of market window flexibility and efficiency, such as their "commercial culture," are considered in the section below, "Challenges from within Ex-Im." There are three major possible policy approaches to the issue of market windows: (1) benign neglect—simply accept the market window phenomenon; (2) negotiate to establish "rules of the game" for market windows; or (3) imitate some or all of the attributes of market windows. These approaches are not necessarily consistent with one another.

Benign neglect. As Mendelowitz reports, most US-based multinationals do not see themselves seriously disadvantaged by the rise of foreign market windows. Multinationals can work with market-window financing because they can source equipment in countries that will provide attractive financing—and, according to Mendelowitz, this is exactly what they report doing. However, when sourcing decisions are shifted in response to market window financing, the outcome clearly distorts production and employment.

Moreover, at the company level, not all US producers have the same access to foreign sourcing; Mendelowitz cites the case of Boeing. Small business firms may be similarly disadvantaged and not even know they are facing competition financed by a market window. Finally, even if the market window problem could be considered manageable today, market windows are establishing a precedent for effective unilateral withdrawal from the OECD Arrangement. The precedent could easily be imitated by others. Such an outcome would undermine more than 20 years of achievement of multilateral negotiations to reduce and eliminate export credit subsidies.

Mendelowitz suggests a variant of the benign-neglect policy: Offer financial terms appropriate to the transaction and, if different from the OECD standards, just "derogate and notify"—the Arrangement's standard escape hatch. In other words, implement within existing export credit agency programs the flexibility that market windows claim markets require and, if necessary, derogate. In fact, the OECD Arrangement itself provides some room for this approach without needing to derogate. The agreement on project finance adopted in June 1998 allows some flexibility on the terms permissible for limited-recourse project financing, subject to notification of other OECD participants. Recently, many countries have used this flexibility to tailor repayment terms to project cash flows. This provision was entered into for a trial period of 3 years, beginning September 1998, and is subject to review beginning September 2000. The review could be an opportunity to analyze what additional flexibility "the market" requires that is provided by market windows.

An important consideration in deciding whether to derogate from the Arrangement is the individual and cumulative impact derogations might exert on the tenor of OECD discipline. Up to now, derogations from the Arrangement have been few and far between, and have often been explained in terms of "political necessity." Wider use of this escape valve could make the exception the rule and vitiate the value of the Arrangement itself. Years of progress in the negotiations might be lost.

Negotiate rules for market windows. This approach has been responsible in the past for a successful OECD Arrangement. It is endorsed by Summers, and it is consistent with a long-standing US policy and philosophy of preeminence for private markets and the belief that governments should not compete with the market. The US objectives for these negotiations could be transparency on market window transactions and a mechanism to monitor congruence between market window pricing and indicators of the private capital market. (The Private Market Indicators model being developed in conjunction with the OECD risk-premium system might be a first step.) Schomerus—a great supporter of OECD negotiations—reports that Canada and Germany are willing to enter into discussions to increase the transparency of their respective market windows.

The US Treasury Department and Ex-Im will have to decide on the best strategy to "motivate" meaningful negotiations by all governments that sponsor market windows, as well as what negotiating venue to choose. Traditionally, the United States has "motivated" other governments to come to the negotiating table by following a policy of matching, and even overmatching, the financing offers of other governments. This is usually a strategy of last resort, following a period of slow or no progress in prior negotiations.[6] Under this strategy, the United States would have to decide whether to pursue specific transactions—for example, in markets favored by historical trade relations between the market window country and the destination country—or whether to execute the policy across the board.

As an initial step, all standard financing offers could include language to the effect that Ex-Im Bank is willing to match (or overmatch) financing offers from identified market windows. To the extent that market windows tend to avoid the riskiest markets, Ex-Im budget requirements may not be onerous. However, an across-the-board response would be more expensive in budget terms. Leach also suggests that Congress would support market window negotiations coupled with the use of the existing tied aid capital fund to support matching offers.[7]

As the United States pursues negotiations at the OECD, it will have to answer the objections of Germany and Canada (represented in this volume, again, by Reich and Gillespie). They contend that Arrangement rules conflict with market practices and, if anything, the Arrangement should be amended to conform with the market. Fumio Hoshi states in his essay that he believes "punitive elements were introduced through excessively

6. Ray, John E. 1995. *Managing Official Export Credits: The Quest for a Global Regime.* Washington, DC: Institute for International Economics.

7. As of December 2000, the size of the tied-aid capital fund was $325 million. For current policies in using this fund, see the section "US Foreign Aid and Tied Aid for Commercially Nonviable Projects."

stiff regulations [in the OECD Arrangement]. This is where the 'market window' operation was born" (chapter 17).

Finally, the United States should consider whether the World Trade Organization (WTO) would be a better venue to pursue negotiations on market windows. This is especially relevant following the recent WTO decision in the Brazil-Canada trade dispute, which addressed export credits along with other subsidies. The WTO ruling has opened the door to a general reconsideration of subsidies in export credits. The pros and cons of the OECD *versus* the WTO, or the OECD *cum* WTO, will be an important debate within the US government.

Niskanen recommends an alternative negotiating strategy to do away with *all* remaining export credit subsidies, not just market windows. His strategy, however, does not require Ex-Im to make counteroffers. He recommends starting with a unilateral *reduction* of US export credit subsidies, accompanied by a commitment to a series of further reductions if the governments of other OECD nations respond in kind and in magnitude. If the other governments do not respond as desired, then Niskanen recommends countermeasures. He suggests countervailing duties—for example, a 10 percent incremental US tariff—on all goods and services imported from nations that do not reduce their export credit subsidies. The penalty Niskanen recommends goes well beyond a measure that merely neutralizes an export credit subsidy in third markets. Instead, he proposes to penalize *all* exports from that country to the US market. The intended result of the Niskanen plan is to put the few firms that benefit from maintaining an export credit subsidy at odds with all firms in the same country that export to the US market.

Niskanen acknowledges that this negotiating strategy would require WTO authorization. The United States would need to litigate two or three test cases in the WTO before a clear jurisprudence emerged—both as to what practices constitute an impermissible export credit subsidy and what penalty is authorized. This would take time and persistence. Another difficulty is that US consumers—who would be tagged with higher import duties—might protest.

Establish a market window. This would be the ultimate matching strategy to protect US export competitiveness. Although there is no guarantee that market windows will continue to be exempt from the WTO subsidy code, both Reich and Gillespie invite Ex-Im to follow their example. In Gillespie's words: "The US Export-Import Bank . . . should not consider the . . . EDC model a competitive threat, but rather an . . . opportunity to embrace a model that addresses customer needs—exporter and foreign buyers alike." Emulation of the market window concept in the United States could be achieved by establishing a government-sponsored enterprise—an institution such as Fannie Mae. Alternatively, a market window capability could be developed within Ex-Im itself.

Mendelowitz analyzes the US philosophical and budgetary difficulties in duplicating certain market window provisions, such as borrowing against the full faith and credit of the US government. He suggests alternative ways to achieve a similar result. Two of these suggestions take advantage of the depth of US capital markets to establish a fund to operate as a market window. The fund could be enhanced by providing additional benefits, such as exemption from taxes on retained profits. A possible manager for such a fund could be the Private Export Funding Corporation, which already arranges funding for loans guaranteed by Ex-Im Bank.

Niskanen's objection to the establishment of a US market window captures the reaction of most liberal economists: "As an American, I can hardly imagine worse advice than to create another huge government-sponsored enterprise, in this case to provide general trade finance." Leach, the one voice from Congress in this volume, is skeptical about creating another government-sponsored enterprise at a time when government support for Fannie Mae and Freddie Mac is being questioned. Leach, like Federal Reserve Chairman Alan Greenspan and some US Treasury officials, would like to curb the growth of Fannie Mae and Freddie Mac. A new US market window for export credits would run contrary to this broader strategy.

Two further considerations in establishing a market window institution are the adverse impact it might have both on the OECD Arrangement and on private financial support for US exports. To the extent that market windows undermine OECD discipline, a US market window runs the risk of resurrecting the expensive subsidization of the pre-OECD Arrangement era, as more countries follow the US lead. This, in turn, could increase the budget cost of supporting US exports and inspire a congressional backlash. Moreover, to the extent that the nature of market windows is to compete with private financial institutions, a market window would undermine private export finance.

Pseudo-Untied Aid

In principle, untied aid is a good thing. Aid not tied to the donor's exports does not distort trade. That is why, in the past, untied aid has not been subject to international rules. Nonetheless, untied aid poses two competitive issues: whether it is truly untied from the viewpoint of the donor country and, therefore, legitimately not subject to OECD rules on tied aid (the so-called Helsinki Agreement); and whether the receiver country is unduly sympathetic to procuring from the donor country.

Some commercial practices that often accompany the provision of untied aid create the potential for de facto tying. Summers refers to project design advice ("technical assistance") as a mechanism by which the procurement of the eventual project can be influenced, even if the project funding is ostensibly untied. Similarly, he points to the influence of "technical advice" provided by the donor during the bidding process. This advice can affect the procurement of goods financed with otherwise untied aid. Summers alludes to (without naming) cases involving these practices in which the US exporter with a better, lower-priced bid lost the sale to the exporter from a country offering the untied aid.

The mixture of aid and commercial objectives is also evident in cases cited by Evans and Oye in their essay. They point to the Japanese Ministry of Trade and Industry's untied Green Aid Plan, which has in fact provided approximately $1 billion during a 10-year period to support the demonstration of Japanese energy-efficient, clean environmental tech-nologies in Asia. Likewise, Japan's special environmental aid program, announced in 1997 at the time of the Kyoto conference, is also not officially tied, but it opens the possibility of tying on a case-by-case basis. Furthermore, the project list includes not only metropolitan areas and regional infrastructure but also several power plants, even though "commercially viable projects" (see Evans and Oye's section on "Export Credit Practices under the OECD Arrangement") are not supposed to receive untied aid.

Donor practices that might influence procurement financed by untied aid are not by any means the largest source of potential tying. That honor goes to the goodwill earned in the recipient country. When Japan or any other country offers substantial amounts of untied aid, Japanese and other home-country firms will almost certainly enjoy an aura of goodwill in the recipient countries. Furthermore, recipient countries can also be expected to want to earn goodwill for themselves with the donor country and follow procurement practices that may support additional aid in the future.

It is difficult to separate the impact of questionable practices from the goodwill effects of untied aid. Regardless, the data compiled by Evans and Oye on procurement of coal-fired power plants in China is worrisome. The figures show a much higher success rate for Japanese suppliers when the plants were financed with Japanese "untied" aid than when financing was provided by ECAs subject to OECD Arrangement conditions, or by multilateral banks subject to the multilateral banks' administration of international competitive bidding rules.

A variant of the issues associated with untied aid is presented by the "untied *credit*s" offered by the Japan Bank for International Cooperation (JBIC; formerly the Export-Import Bank of Japan, or JEXIM). Like untied aid, these credits are "untied" to Japanese supply and, following the same logic as for untied aid, currently they are not subject to any rules within the OECD Arrangement. Unlike market windows, JBIC does not claim that these credits are offered on market terms.

Untied aid (and credits) raise the specter of eroding the competitiveness of US exports whenever that aid (or credit) becomes de facto tied. What are the policy options for the US government and the US Export-Import Bank?

Benign neglect. The untied problem, which is largely confined to Japan, may be getting smaller. Evans and Oye point to an increase in the proportion of Japanese aid that is being tied and therefore is subject to the OECD rules for tied aid. The change in policy is attributed to internal political pressures demanding assurance that the commercial benefits associated with aid are fully captured by Japanese suppliers. If this trend continues, the problem may disappear and benign neglect may be the appropriate US posture with regard to untied *aid*. However, there are no signs of reduction in the untied *credits* offered by JBIC.

Negotiate multilateral rules for untied aid. Untied aid discipline and transparency have been part of the official OECD agenda since the Helsinki Agreement in 1992. Summers now invites OECD partners to undertake serious negotiations aimed at a multilateral agreement on rules that would clarify the status of untied aid. Failure of these negotiations would risk unilateral action by the United States. To support these negotiations, Ex-Im Bank has the authority under current legislation to utilize the funds available in its existing tied aid capital projects fund to match or overmatch any untied aid offer suspected to be effectively tied. However, any substantial matching operations would require additional budget ap-proval for the fund.

The United States would have two negotiating objectives: extend Helsinki rules to de facto tied aid, and establish rules for greater transparency over activities that could effectively tie aid that is formally untied. Rules for greater transparency would apply to feasibility study grants, design and engineering assistance, technical assistance in evaluating bids, and the final contract awards, among other activities. One negotiating outcome might be agreement that a combination of activities creates a presumption of de facto tied aid and makes the aid subject to the Helsinki rules. This would prohibit untied aid (and credits) in commercially viable projects and in countries with higher per capita incomes.

Consider implementing an untied aid program. This approach to restoring US export competitiveness appears highly unrealistic and finds no advocates in this volume. US foreign aid programs are tied to US procurement in order to increase political support for the foreign aid budget altogether. Truly untied aid would garner little if any political support. Any efforts to address US export competitiveness in the US foreign aid program would be better handled as tied aid. (The section below, "US Foreign Aid and Tied Aid for Commercially Nonviable Projects," looks further into this issue.)

Support for Limited-Recourse Project Financing

Although the typical developing-country buyer of US exports, particularly components of large projects, has been a government department or enterprise, today a private company is more likely to be the buyer.

US Export-Import Bank credits and guarantees increasingly deal with a diverse group of private borrowers and less so with the finance ministries that traditionally provided sovereign guarantees of repayment. Ex-Im Bank's leadership in financing private projects on a limited-recourse basis in the early years of privatization of government projects, as well as its willingness to accept private-sector corporate risks, are generally well recognized.

With one exception, the Bank's attitude toward risk in general, and private credit risk in particular, is not mentioned in this book as a competitive problem. The one exception is Evans and Oye's reference to Ex-Im's hard stance against financing power plant projects in China on a limited-recourse basis. This stance is blamed for contributing to the loss of a significant number of orders for US exporters between 1988 and 1998. ECAs from other countries were willing to accept Chinese risk struc-tures that Ex-Im would not. These authors, however, do not pass judgment as to whose assessment of the underlying risk of limited-recourse power plant loans in China will prove to be more accurate. It should be noted that the power plants financed in this manner are not expected to pass the development stage before 2000.

ECA competition on credit standards for financing limited-recourse projects appears to have been limited to China and power plants—a sec- tor that, as Evans and Oye report, experienced large excess supply during the period. Ex-Im now reports a willingness to finance future projects in China on a limited-recourse basis, and has suggested that it may accept some of the financial structures that eventually emerged on the power projects. However, exporters continue to be concerned with Ex-Im's approach to project financing in general, and China in particular. They regard Ex-Im's procedures as simply too cumbersome and restrictive.

Challenges from US Government Policies

Some government policies not directed at US exports nevertheless have a direct impact on US export competitiveness in general and on Ex-Im export credit financing in particular. They are justified on their political merits. The national objectives at stake are believed to warrant the resulting loss of US exports and jobs. Because these policies usually have no counterpart in other countries, they place US exports at a disadvantage. Three of these policies are addressed in this volume: foreign aid policy, country sanctions, and demands from civil society.

US Foreign Aid and Tied Aid for Commercially Nonviable Projects

The OECD Helsinki Agreement on tied aid is considered a great accomplishment. Summers estimates the tied aid agreement has saved $300 million annually in comparison with the cost of supporting the same level of exports through competing subsidies. Consistent with this aggre-gate estimate, Evans and Oye report a decline in European and Canadian tied aid financing for the industry they studied, coal-fired power plants in China, since the Helsinki Agreement. However, tied aid financing has not disappeared, and US exporters must still face distorting competition for certain projects.

The crux of the problem for US exporters lies in the size and nature of the US foreign aid program. US aid funds are low relative to the size of the US economy. Outside the Middle East, they are relatively small in terms of the recipient country. Aid administered by the US Agency for International Development (AID) is tied to US exports, but US policy calls for spending foreign aid funds only on important social objectives—such as peace in troubled regions, democracy in other countries, and health and education programs for the poor—rather than on infrastructural capital projects.

Unlike the aid agencies of other donor countries, AID has eliminated most of its capital projects in the energy, environment, or physical infrastructure fields in emerging markets.[8] In AID's words, "US foreign aid policy is about aid, not trade." Unfortunately for US exporters—and probably for the recipient countries as well—this policy is at odds with that of almost every other donor country in the world. Foreign aid is gladly used by other OECD nations to finance infrastructural capital projects. They do this without embarrassment, and they justify the practice as both good for development abroad and successful in garnering political support at home. Evans and Oye show that—whereas 100 percent of US aid supported social, health, and policy initiatives—only 15 percent of German overseas development assistance went to comparable projects. The other 85 percent of German aid went to support rail, shipping, water, sanitation, and other infrastructure projects. Most significant, about 76 percent of all German aid was tied to German exports. US aid is also tied to US exports when merchandise is involved (such as medical equip-ment). However, most US aid has a small merchandise component.

To further complicate the predicament of US exporters, the United States seems more prone than other countries to deny foreign aid because of policy considerations. Thus, the US aid program is the only one among major donor countries not to operate in China—on the argument that China runs a communist economic system.

---

8. When Clinton became president and Brian Atwood took charge of AID, they steered away from capital projects, but the major exception is Egypt. Egypt has their aid program administered under "Host Country Contracting," which means that the Egyptians do the administration of the projects. They continue to work on power projects (including power plant rehabilitations), wastewater projects, and telecom. But their involvement in telecom has slowed to almost a trickle because the Egyptian economy has improved enough so that they can undertake projects on a commercial basis involving both European and American firms.

The OECD negotiations on tied aid succeeded in reducing the overall level of tied aid and restricting the use of tied aid offers to projects that are "commercially nonviable" and are therefore unlikely to obtain financing in the private markets. The agreement also restricts eligibility for tied aid to poor countries—which in 2000 were defined as countries with income per capita below $2,995—and requires a minimum concessionality of 35 percent. These requirements bring tied aid closer to true aid.

However, US exporters do not have a US window where tied aid is offered for capital projects. When a US exporter encounters competition from another country that is prepared to offer legitimate tied aid in its financing package, the US exporter faces a disadvantage of at least 35 percent in price terms. The fact that a project is deemed to be commercially nonviable obviously does not mean that export sales could not be profitable. Commercially nonviable projects go well beyond social projects to include bridge construction, hospitals, metropolitan transit systems, locomotives, and sewage and sanitation systems.

In confronting this situation, Congress expanded the former war chest used to support the Helsinki negotiations into a capital projects fund—$325 million as of December 2000—available to pursue transactions of special commercial value. Ex-Im Bank, in conjunction with the US Treasury, developed a tied aid policy geared to address the commercial implications of tied aid practices abroad. Tied aid initiation was dismissed as compromising the US high-road negotiating position, in which initiating tied aid is considered bad economic policy for all parties concerned. That left matching as the only option to protect US exporters' competitiveness.

Ex-Im considers matching foreign tied aid offers when the commercial value of the project—in contrast to its developmental value—appears to justify a match. To measure this commercial value, before offering to match a legitimate tied aid offer, Ex-Im assesses factors such as follow-on sales and the expectation that the sector in the given country will graduate into export sales on regular terms. To avoid extending a matching offer too late, Ex-Im issues "willingness-to-match" letters in support of projects with commercial value when it fears other countries may offer tied aid support. In the early years after the Helsinki Agreement, the Bank was asked to issue many willingness-to-match letters and tied aid offers, which it did. US exporters won a few of these transactions. However, in recent years, exporters' demands for tied aid matching offers have declined substantially, and Ex-Im currently issues less than a handful of such offers annually.

Assuming that the US approach to foreign aid enjoys strong domestic political support, and also assuming that the other national approaches enjoy similar support, then the question is whether US export competitiveness is worth a 35 percent grant—the minimum required by the Helsinki Agreement. Instead, should the United States reconsider its foreign aid policy? The following are some of the policy options to be considered:

Establish a capital projects program in AID. Evans and Oye see hope for this approach, stemming from the dissatisfaction of environmental and developmental constituencies with the lack of US aid support for infrastructure. These groups may form a coalition in support of more US aid, with sensitivity to commercial, developmental, and environmental goals. Evans and Oye point out how coalitions of export-oriented firms and environmentally and socially oriented movements in Germany and Japan favor both de facto and de jure tied aid. "If noble programs of developmental and environmental aid in the United States are fused with mercantile commercial purpose, support for aid is likely to increase. . . . New activities in this area should be funded by increasing appropriations, not by diverting funds from what may only be described as minimally funded existing programs."

Evans and Oye favor emulating the practices of other countries, instead of negotiating to end them, fearing that if developmental and environmental aid is severed from "crassly bilateral commercial purposes," aid supplied by donor countries is likely to decline. "Doing good in terms of limiting trade distortions may do harm by reducing development and environmental assistance to emerging markets." The approach suggested by Evans and Oye has merits, even though it represents a big departure from current US aid philosophy.

*Expand Ex-Im Bank's tied aid matching capabilities***.** A larger Ex-Im budget would enable Ex-Im to match *more* tied aid offers. However, it is unlikely that even under the best circumstances the Ex-Im budget will be expanded enough to match *all* tied aid offers. Even with a much larger budget Ex-Im will need to consider, in making the decision to match, whether the commercial benefit of the transaction justifies the high cost of a 35 percent grant.

Negotiate to increase the concessionality level. Earlier OECD negotiations increased the required concessionality level to ensure that the donor's motives were primarily developmental. As a by-product, they reduced the number of projects that could be supported with tied aid. The United States could try to increase the current minimum 35 percent grant element to, say, 50 percent. However, further negotiations do not appear on the horizon during the next few years. Although Summers views the OECD discipline of tied aid as a major achievement, he does not mention enhancing this discipline in his agenda for OECD negotiations.

Country Sanctions

When the United States imposes foreign policy sanctions, it often acts unilaterally. US sanctions frequently deny access to Ex-Im Bank financing, among other economic punishments. Evans and Oye point out that the United States is alone in conditioning access to aid and export financing on compliance with foreign policy concerns in such areas as human rights, narcotics, terrorism, and nuclear proliferation. Hormats worries that the scope of sanctions for these and other foreign policy goals may be extended to further limit access to private US capital markets —as happened with South Africa more than a decade ago and was proposed by Senator Fred Thompson (R-Tenn.) in a failed Senate amendment of the China Permanent Normal Trade Relations Bill.

The impact of sanctions on Ex-Im financing is a moot point whenever the sanctioned country is not creditworthy and Ex-Im has already closed its doors for business. Syria is an example. However, several very large, creditworthy countries and companies have been the target of US sanctions. Examples of countries where Ex-Im was precluded temporarily from supporting US exports in recent years include Colombia (because of deficient counternarcotics efforts), India (because of its nuclear test), and Russia (for a $500 million transaction, because of concerns about corruption in the Tyumen Oil company and broader concerns about the Chechnya conflict). Although these sanctions lasted, Ex-Im Bank was closed in Colombia and India, and stalled on the $500 million credit to Tyumen Oil.

Harmon notes that the day after the United States sanctioned India, Airbus made an immediate offer to fill the void. Evans and Oye report that the General Electric (GE) bid from the United States to supply major components to the Dabhol power plant in India was endangered when the United States imposed sanctions. GE survived, but US exports did not. GE changed its supply sources to Belgium and Japan, financed by their export credit agencies. Although Japan imposed sanctions on India, its sanctions applied only to aid programs, not export credits.

The cost of these sanctions in US exports and jobs goes beyond the direct loss while sanctions are in place; it also includes the lost exports associated with follow-on sales. Perhaps the highest cost is the "unreliable supplier" tag pinned both on US firms and on Ex-Im Bank.[9]

Unilateral economic sanctions are now generally considered ineffective in achieving their intended foreign policy objectives. The argument for unilateral sanctions must be cast in other terms: Moral distaste for association with the particular country—the one tangible result of the unilateral sanction—is worth the cost in lost US exports and jobs. The balance on this trade-off is a political issue, and the final outcome usually depends on episodic circumstances.

In suggesting policy options to address the impact on Ex-Im Bank of foreign sanctions, it is helpful to distinguish whether these sanctions are imposed automatically by US law (Colombia and India) or by the presidential administration in exercising discretion given it by law (Tyumen

9. Hufbauer, Gary C., Jeffrey J. Schott, and Kimberly Ann Elliott. *Economic Sanctions Reconsidered*, 3rd Edition. Washington, DC: Institute for International Economics. Forthcoming 2001.

Oil in Russia). Sanctions imposed by the administration on Ex-Im credits invoke the so-called Chafee Amendment: "Only in cases where the President determines that such action would be in the national interest . . . should the Export-Import Bank deny applications for credit for nonfinancial or noncommercial considerations" (Public Law 95-630, 10 November 1978).

US laws imposing foreign sanctions. Leach, Mendelowitz, Daley, and Robert Rubin (see chapter 2) all support legislation currently under consideration by Congress to reform laws and approaches to US foreign policy sanctions. With respect to Ex-Im financing, there are at least four possible options:

- *Prohibit unilateral export sanctions*. The argument would be that, unless a significant number of competitor countries join the United States in sanctioning a third country, the United States should not impose sanc-tions that are likely only to hurt US exports without accomplishing their foreign policy objective. Instead, if the United States decides to impose unilateral sanctions, it should use other economic tools.
- *Require that unilateral sanctions involving Ex-Im have significant—for example, two-thirds—support in Congress*. Under this approach, when a strong legislative consensus deplores the egregious violation, Ex-Im financing would be withheld. By a supermajority congressional vote, the American public would express its view that the United States does not want to be associated with the country, whatever the potential cost in terms of US exports.
- *Negotiate multilaterally to have other countries join the United States*. This approach is almost always present when the United States imposes sanctions. Unfortunately, Japan, Europe, and other countries often do not agree that the objectionable behavior is worthy of economic sanctions. This avenue is not promising. However, the G-7 Summit countries might form a "sanctions committee" to improve coordination.
- *Accept the status quo*. Although the business community generally finds the status quo unacceptable, politics may say otherwise.

Chafee Amendment to Ex-Im charter. When the US State Department instructs Ex-Im Bank to deny support to a country or company, it does so under the Chafee Amendment. This amendment has been invoked in a handful of cases in recent years, often in consultation with relevant congressional committees. Altering the restrictive nature of Chafee might involve two possible approaches:

- *Require that a significant number of relevant ECAs join Ex-Im in the sanctions before Ex-Im denies credit on foreign policy grounds*. Given policies abroad, and long-standing practices in other ECAs, this requirement would be rarely met and hardly acceptable to the administration or Congress.

- *Establish a board within the administration to evaluate prospective cut-offs of Ex-Im financing*. Members of this board would include the secretaries of commerce, labor, treasury, state, and the national security adviser, as well as Ex-Im Bank's chairman. This approach would ensure that economic considerations were heard when invoking Chafee, along with foreign policy arguments.

Civil-Society Requirements

Bribery and environmental abuse are also causes for restricting Ex-Im Bank financing. For many years, and for its own protection, Ex-Im has required certification, on a case-specific basis, that the parties to a transaction have not engaged in illegal practices, including violations of the Foreign Corrupt Practices Act (FCPA). Ex-Im also requires prior analysis and adherence to guidelines whenever a transaction could affect the environment. US exports to the Three Gorges Dam project in China were a casualty of these guidelines. No other ECA currently imposes comparable requirements.

The United States has been pursuing OECD negotiations in these two areas. In the bribery area, it succeeded to some extent when, in 1997, the OECD adopted the OECD Convention on Combating Bribery of Foreign Public Officials in International Business Transactions. However, this convention, by itself, does not require enforcement by ECAs. An additional US objective is to require all ECAs to adopt procedures comparable to those of Ex-Im. In the environmental area, the US negotiating objective is for all ECAs to adopt common environmental guidelines drawn from World Bank procedures, taking into account that ECAs offer their support at the bidding stage of a project, not the early planning stage—or even the conceptual stage—at which the World Bank normally gets involved. So far, both efforts at the ECA level have met with resistance.

At least in one important industry, unilateral Ex-Im environmental requirements do not appear to have had a negative impact on US exports. Evans and Oye report that Japan and European nations operate with greater flexibility on environmental standards than Ex-Im Bank does; how-ever, they believe environmental considerations did not unduly influence contract awards in the China coal-fired power plant market during 1988-98.

It is a truism that no one, particularly in government circles, favors polluting the environment or condoning corruption. Evans and Oye also point to transnational nongovernmental organizations (NGOs) that continually press for higher standards. These factors suggest that bribery and the environment are areas in which further progress can be made through OECD negotiations. Summers clearly considers them priority US negotiating goals. Hoshi and Schomerus also saw room for these issues to be included in the dialogue. Two possible policy options would address the current US competitive disadvantage overseas from pro-environmental and anticorruption policies:

- *Pursue OECD negotiations with greater fervor*. Current US government efforts might be buttressed by greater coordination with the NGOs and their affiliates in foreign countries. The July 2000 communiqué from the Group of Eight (G-8) leaders gathered in Okinawa provides the political framework: "We reaffirm our commitment to develop common environmental guidelines, drawing on relevant multilateral development banks' experience, for export credit agencies by the 2001 G-8 Summit. We will cooperate to reinvigorate and intensify our work to fulfill the Cologne mandate." The objective must be ex ante quantitative standards and qualitative criteria drawn from World Bank procedures.
- *Impose US requirements on foreign companies operating in the United States.* Foreign companies that operate in the United States could be penalized when their parent and sister companies located elsewhere do not comply with environmental or corruption standards. Speaking about FCPA, Nardelli favors this policy; effectively, it would put GE in this regard on the same footing as, for example, Asea Brown Boveri. However, one must expect that Europe and Japan would take great offense at such extraterritorial application of US law, and that the European Union (EU) and Japan might counter with some kind of retribution. This has been the experience with US efforts to apply its foreign policy sanctions on an extraterritorial basis.[10]

Challenges from the US Labor-Business Compact

Several contributors to this volume believe current US Export-Import Bank rules and procedures do not fully reflect modern realities. Mendelowitz captures this sentiment: "The quaint world of national champion companies battling for sales in foreign markets is gone." "Ex-Im Bank's legislation, policies, and operating procedures reflect the earlier era in which it was created." "These policies and procedures reflected a specific intent: to create as many US jobs as possible . . . and [to ensure] that foreign-produced goods and the jobs that they represented did not receive the benefit of Ex-Im financing." Needless to say, organized labor does not think these policies are antiquated. The AFL-CIO sees the tight Ex-Im

10. Hufbauer, Gary C., Jeffrey J. Schott, and Kimberly Ann Elliott. *Economic Sanctions Reconsidered*, 3rd Edition. Washington: Institute for International Economics. Forthcoming 2001.

requirements as a way to maximize US labor participation in transactions that benefit from public financial support.

Global competition involves both exporting and importing. Richardson points out that capital goods and intermediate inputs account for more than two-thirds of US exports *and* imports. "Few firms today can claim to be pure exporters or pure import competitors." Richardson refers to "swap-sourcing" as the universal, reciprocal practice of outsourcing around the world—and a potent source of growth. US firms swap-source, but so do firms in other countries. In short, US exporters compete with exporters from other countries that benefit from multicountry sourcing.

Mendelowitz explains how Ex-Im Bank will finance only the US content incorporated into US exports. Although there are no international agreements as to the amount of foreign content allowed to be financed by an ECA, international agreements limit the maximum percentage of an overall transaction that an ECA may finance to 85 percent. Ex-Im therefore permits up to 15 percent of a financed export to consist of foreign content, subject to further restrictions mentioned below. Any higher percentage of foreign content reduces the total amount of Ex-Im financing available. This policy is applied at the level of each individual contract line item, not at the total contract level. Hence, higher US content in one line item for a project cannot offset lower US content in another line item. To be eligible for any support, foreign content may not exceed 50 percent of the cost of each item being supplied. Moreover, the foreign content must be incorporated into a larger component assembled in the United States.

By contrast, Japan, for example, usually allows a generous inclusion of foreign components in its financing packages; and the European Union allows member ECAs to cover up to 30 percent content from another ECA member state (but only 10 percent of non-EU content). ECAs around the world implement their domestic-content requirements more flexibly and at a higher levels of aggregation than the Ex-Im. The fact that most other ECAs support exports through risk insurance makes it more difficult to enforce very tight requirements. Under export credit insurance, disbursement documentation is usually reviewed by the ECA only in the case of default, when a claim is submitted by the insured party. In contrast, under direct credits and guarantees, disbursement documentation is reviewed up-front. Finally, no ECA other than Ex-Im Bank requires that the foreign content be incorporated domestically and shipped from the ECA country. The differences in domestic-content requirements between Ex-Im and non-ECAs that also finance exports are even larger. When foreign market win-dows apply their national-interest standard, they do not require a minimum domestic content. Most US exporters who use the Ex-Im Bank complain about the cumulative impact of the US content requirements; however, no one has yet quantified their cost in terms of lost US export deals.

Ex-Im rules are further complicated by the requirement to ship on US-flag vessels—a requirement that for the Ex-Im loan program is built into US law.

Mendelowitz explains that the US-flag fleet is so small, and its service so limited, that the majority of Ex-Im clients seek a waiver from the Maritime Administration (MARAD). When a waiver is not granted, cost and time are added to US export performance. When it is granted, the cost of shipping on a foreign-flag vessel is included in the foreign content of the transaction.

As Evans and Oye point out, the domestic-content compliance certification—as well as many other Ex-Im requirements—translate into more complex project documentation than the paperwork required by other ECAs. In addition, the stringent rules limit Ex-Im's ability to participate in cofinancing arrangements with other ECAs. As a result, exporters are forced to duplicate their documentation. Several ECAs have already entered into cooperative agreements with each other. But Ex-Im Bank would find it difficult to accept the administration of transactions by other ECAs, because their content requirements and documentation are far less intrusive than Ex-Im's.

Evans and Oye recommend the identification of sectors and countries where winning a higher share of contracts with lower content requirements would be preferable to winning a lower share of contracts with higher content requirements. Unfortunately, an empirical rule establishing optimum domestic-content rules sector by sector and destination by destination would be very difficult to estimate. Instead, the spirit of their recommendation might be captured if the content rules were modified so that, overall, Ex-Im supported the same level of US employment, without imposing detailed content requirements on each line item. In this spirit, five policy choices can be considered:

Keep the rule of 15 percent maximum foreign content, but liberalize its implementation. Mendelowitz suggests two approaches to simplifying the implementation of the 15 percent foreign-content rule:

- Whenever a project or an export contract involves multiple line items, apply the US content requirement to the contract or the project in its entirety instead of to each line separately.
- Rely on exporter certifications as to the amount of foreign content before shipment, but enforce the requirement with postshipment audits. This would shorten the turnaround time and transactions cost.[11]

Increase the percentage of eligible foreign content from 15 percent to a higher figure on a case-by-case basis. One basis for the determination might be the percentage of imported components in a comparable product or project

11. As this book goes to press, the Bank was already in the process of adopting policies to liberalize the implementation of the 15-percent maximum foreign content rule along these lines. In addition, the requirements for offering financing to support costs incurred in the host country were also being liberalized.

sold in the United States. If a certain proportion of imports is generally used in serving the US domestic market for a given capital good, or type of project, a comparable amount of foreign content could be justified when Ex-Im finances US exports of the same capital good or project.

Richardson's methodology in measuring the import content of domestically sold goods uses the US input-output tables. The same methodology could be the starting point for guiding Ex-Im in applying its foreign-content requirements. To ensure that US employment associated with Ex-Im financing is not diminished overall, new guidelines could be coupled with additional budget support for Ex-Im when it utilizes the cofinance or reinsurance options discussed below.

Cofinance or reinsure foreign content. A multisourced export package can theoretically be cofinanced by the relevant ECAs. Under a cofinance approach, each ECA finances or insures a slice of the overall project. In practice, it is cumbersome for an exporter to deal with a multitude of ECAs, each with different requirements, corresponding to different legal systems and credit policies. An alternative approach is for only one agency to act as the lead finance agency, apply its requirements, and then share the credit risk (through reinsurance or loan participation) with the various ECAs where the respective exported components originate. In other words, ECAs could create, among themselves, a "foreign-content clearinghouse." For Ex-Im to participate in such an arrangement, in a role other than as lead ECA, it would have to accept documentation used by the lead ECA. If this barrier can be overcome, the budget scoring of the portions of Ex-Im's own credits that are reinsured by a major industrial-country ECA would be very low, because the credit risk on those portions is minimal; however, reinsurance with an ECA from a developing country would carry a higher budget score.

Daley, Reich, and Schomerus all support the reinsurance approach. As Schomerus puts it, "Taxpayers cannot be expected to cover risks in order to create jobs and generate profits outside their own country. . . . Conversely, it is quite clear that an exporter that procures components on a global basis is not interested in negotiating with half a dozen export credit insurance agencies. The solution for the future must be that export credit insurance agencies take out reinsurance on as broad a basis as possible." Hermes Kreditversicherungs, the German ECA, has reinsurance agreements with several other ECAs. As Schomerus points out, greater transparency among participating ECAs would be a bonus benefit of such cooperation. Transparency, in turn, builds confidence among ECAs.[12]

Untie Ex-Im financing from domestic-content rules. Two authors suggest using alternative criteria altogether, instead of prescribing percentages of domes-

12. As this book goes to press, the Bank was proceeding to negotiate bilateral cofinancing agreements with other major ECAs. A bilateral framework agreement with ECG of the United Kingdom was expected to be signed in January 2001.

tic content. Nardelli suggests that the foreign customer's needs should become Ex-Im's touchstone: Ex-Im should finance the whole project whenever it is "US-influenced." Mendelowitz suggests wide adoption of the criterion used by institutions providing market windows—namely, a national-interest test, broadly defined. A source of guidance could be the decisions of the Advocacy Center in the Department of Commerce, which bases its support on a determination of US national interest. The Advocacy Center will lend diplomatic support to a US export, sometimes even when the domestic content is below 50 percent, if the US national-interest test is met. It seems plausible that, when the Advocacy Center makes this national-interest determination, Ex-Im should provide financial support as well for the foreign content in the US export.

Relax flag rules. The requirement that Ex-Im clients ship on US-flag vessels might be relaxed through a more liberal interpretation of the waiver rules. For example, MARAD might give an advance waiver covering certain destinations to which US-flag vessels seldom operate.

Challenges from within Ex-Im

Several authors address the "business demands" facing a modern ECA. The discussion of market windows, in particular, identified a number of features—other than indirect financial subsidies—that make market windows fierce competitors with the US Export-Import Bank. These nonsubsidy traits are worthy of consideration by Ex-Im. They include a commercial culture, governance, and the possible consolidation of the US government's multiple trade promotion agencies.

Commercial Culture

Ex-Im Bank staff are US government civil servants, subject to the practices and pay scales of that system. Can the civil service deliver the much-admired levels of professionalism, creativity, and commercial expertise that market windows are reported to display? This question must be raised within the context of Ex-Im's current congressional mandates: strict compliance with the OECD Arrangement, and no competition with private financial markets. To answer the question, four aspects of Ex-Im's operations need to be addressed: the professional competence of the staff; the size of the staff relative to activity levels; the nature of Ex-Im's programs and procedures; and the computer technology available to the institution.

Staff professional competence. Although recognizing that the Ex-Im Bank has many talented employees, Harmon considers staff recruiting and retention to be a tremendous challenge, particularly in finance, where private opportunities are abundant. Mendelowitz attributes KfW's capability to attract personnel with high levels of competence to the fact that KfW's salary structures are determined by salaries of similar positions in

Table 1.2 Aggregate activity and staff levels: Ex-Im, EDC, and KfW compared, 1999

	KfW	EDC	Ex-Im
Total activity (billions of US dollars)	47.9	27.0	13.1
Staff levels (approximate number of employees)	1,800	800	400

KfW = Kreditanstalt für Wiederaufban.
EDC = Export Development Corporation.

Notes: Euro and Canadian dollar figures are converted to US dollars at the 1999 average market exchange rates. Euro per US dollar = 0.9386; Canadian dollar per US dollar = 1.4857.

Sources: Annual reports and chapters of this book. Exchange rates are from International Monetary Fund, *International Financial Statistics*, June 2000.

German commercial banking—not in accordance with government pay scales. At the same time, Mendelowitz reports that KfW offers some of the elements of job security of a government organization. (It is interesting to read Reich's view that many of KfW's market window skills were gained from experience with the official window and official development assistance project analysis.)

Staff levels. Mendelowitz provides numbers on staff size and the volume of business at EDC and KfW. These numbers are not strictly comparable, because the institutions have different portfolio activities from one another and from Ex-Im. However, the numbers in table 1.2 suggest that Ex-Im may be understaffed, at least relative to KfW.

Programs and procedures. Mendelowitz reports that some foreign ECAs have adopted a business model built to respond to customer needs. He does not see the same approach at Ex-Im, with its concern for the "export additionality" of its financial support. Mendelowitz points to Ex-Im requirements for exporters to document either the lack of private-sector financing or the availability of foreign officially supported competition. Nardelli mentions the cumbersome nature of the Ex-Im supplier certificate.

Computer technology. Harmon points to the great investment by some other ECAs in technology. He notes that Ex-Im Bank is already engaged in building a "virtual Ex-Im Bank" to make its programs accessible over the Internet and dramatically extend the reach of its limited staff. Nardelli presents GE Power Systems as a model: GE Power plans to purchase on- line this year 90 percent of more than $8 billion of sourced materials and components. He encourages Ex-Im to begin by digitizing all its processes and by fully automating its application processing and approval systems. Daley supports the concept of a virtual Bank and considers the new technology essential for Ex-Im's services to remain relevant. Leach suggests that Congress will support the necessary budget to reach these objectives.

Another line of inquiry is suggested by Schomerus, who encourages governments to subcontract business activities to the private sector, as Germany does with Hermes. By contrast, Hoshi argues in favor of JBIC keeping all its banking business in-house.

To the extent that the perceived level of market window professionalism is the result solely of not adhering to OECD rules and strict domestic-content requirements, the commercial culture of market windows cannot be imitated without radically transforming the US Export-Import Bank. However, Ex-Im's professionalism may be enhanced by choosing from among the following policy options:

Exempt Ex-Im from civil service pay constraints and perhaps some of the other civil service personnel standards. This change could be accompanied by a review of the appropriate number of staff at Ex-Im as compared with other ECAs and the two major market windows.

Review all Ex-Im standards and procedures for possible simplification. Mendelowitz recommends a top-to-bottom review of Ex-Im's policies, operating procedures, and corporate culture with the aim of closing the competitiveness gap. He would benchmark Ex-Im's processes and procedures against those institutions that are viewed as "best in class." Such a review would have to address the congressional mandates that initially determined many of Ex-Im's policies and procedures.

Accelerate the development of Ex-Im's venture on the Internet. Daley, Leach, and Nardelli all support this approach. This may require not only money, but consideration of an alternative office building where a modern electrical system could be installed.

Governance

Harmon considers it highly damaging for Ex-Im performance to have frequent changes in the chairmanship (Harmon is one of very few chairmen in the Bank's 65 years who, by 2001, will have held office for a full 4-year term). Harmon proposes that Ex-Im's chairman be appointed for a period longer than the current 4-year term so that the agency may have the longer-term business orientation it deserves.

A further complication of the current 4-year appointment occurs whenever the rechartering of the Bank coincides with a change in administration—the case in 2001. Under such circumstances, congressional hearings leading to the rechartering have to be conducted by an acting chairman or a newly appointed chairman. One way to address this difficulty would be for Congress to extend the charter of the Bank to a year when the calendar does not call for a change in administration. However, a more fundamental solution is to give the Ex-Im chairman and board members longer terms, akin to the Federal Reserve.

Consolidation?

Within the US government, foreign investment support is delivered by the Overseas Private Investment Corporation (OPIC), whereas export credit support is provided by Ex-Im. Meanwhile, advocacy for particular export deals is housed in the Department of Commerce, and finance for feasibility studies is centered in the Trade Development Authority (TDA). In other countries, the institutional arrangements offering these various forms of support are more integrated: Market windows such as KfW and EDC offer financing for foreign investment in addition to export credits; and most ECAs, such as Hermes in Germany, also offer political risk insurance for foreign investment. In Canada, EDC offers investment financing, or insurance, as well as export credits.

Some argue that the capability to combine the financing of exports and investment in one institution confers a competitive advantage to the country's exporters, because project developers prefer to deal with a single institution. Similarly, those who support this line of argument find it desirable to offer financing for feasibility studies in the same institution. Proponents of the advantages offered by this one-stop financing approach argue that the United States should change its institutional structure. Harmon suggests that "at a minimum . . . these agencies [TDA, OPIC, and Ex-Im] should be housed in the same building and report to and coordinate with a White House office—so we work more closely together in a complementary rather than a competitive manner."

A more radical approach would consolidate OPIC, TDA, and Ex-Im into a single agency. Supporters of this viewpoint to the synergies that could be achieved—notably, a single accounting system and fewer senior managers and political appointees. Detractors, even when acknowledging the possible advantages of consolidation, point to the transition costs. There is also the political reality that the resulting consolidated agency would have to work with two congressional committees each in the House and Senate: the banking committees (Ex-Im's oversight), and the foreign affairs committees (OPIC's and TDA's oversight). Detractors also see a possible loss of independence for the consolidated agency if it reports directly to the White House or a presidential cabinet secretary.

This is not a new issue in the United States. In the 1980s, consolidation proposals usually incorporated the Foreign Commercial Service and the Office of the US Trade Representative into the same organization, together with Ex-Im, OPIC, and TDA, to provide a "super-trade" agency reporting to the Commerce Department or the White House. The most recent debate took place during the Ex-Im Bank's rechartering in 1997 (see Leach's essay), when the proposal was limited to consolidating OPIC, Ex-Im, and TDA.

Ultimately, this is a political decision to be made by the US president early in an administration's life. Is consolidation worth the turf battles, in Congress and between Executive Branch agencies? Only the president can answer that question.