Official Export Credit Support: Competition and Compliance Issues

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Aggressive competition in the official export credit support market has resulted in an increase in activity that lies outside of the main instruments regulating competition and sustainable development in export finance terms – the OECD Arrangement on Officially Supported Export Credits, (OECD Arrangement on Official Export Credits. TAD/PG(2019)1) and the OECD Common Approaches(OECD Recommendation of the Council on Common Approaches for Officially Supported Export Credits and Environmental and Social Due Diligence (The 'Common Approaches'). TAD/ECG(2016)3). By default, the World Trade Organization's Agreement on Subsidies and Countervailing Duties (SCM) is becoming the main legal deterrent, despite its weakness in not covering trade in services or the sustainable development dimensions of official export credit support. Yet the playing field is also unruly because of the apparent reluctance on the part of WTO Members to challenge these measures.

The current economic slowdown in export growth, coupled with the rise of unruly export credit support programmes, presents a strategic dilemma for the Participants to the OECD Arrangement. They are faced with the difficult choice between taking a strong pro-competition position domestically, or by fighting fire with fire and developing their own non-Arrangement type export credit support programmes. The former option is the more preferable for economic efficiency considerations and long-term competitiveness, although it may result in a controversial reduced role for their ECAs.

There is a collective interest in preventing publicly-funded, yet opaque, subsidy wars in export credit terms and conditions, with negative economic, political, social and environmental repercussions. This calls for heightened cooperation among ECA governments within international bodies such as the WTO, OECD and the International Working Group (IWG) on Export Credit Support.

Keywords: Export Credit Agencies (ECAs), the OECD Arrangement, the OECD Common Approaches, the WTO SCM, International Working Group on Export Credit Support (IWG)

1 INTRODUCTION

There are over 110 national export credit agencies (ECAs) competing internationally to promote their domestic exporters in a globally stagnant trading

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Dawar, Kamala. 'Official Export Credit Support: Competition and Compliance Issues'. *Journal of World Trade* 54, no. 3 (2020): 373–396.

environment.[1] Together they provided approximately USD 211 billion in total trade-related medium-to-long term (MLT) official export credit support in 2017.[2] With so many ECAs seeking to promote their domestic exporters overseas through export credits, there is a real risk of an export credit race in which exporters compete on the basis of being granted the most favourable financing terms from their respective governments, rather than on the price or quality of the goods or services themselves. The terms of the support a foreign buyer can obtain from an ECA have become an increasingly important factor in its choice among different exporters.

So, although export credit support is seen as the fuel that powers the international trading system,[3] in competing for overseas contracts there is a potential for governments to use public resources to provide subsidies to exporting firms in the form of export financing. This has been characterized as corporate welfare that simply 'pads the profits of politically connected corporations on the taxpayer's dime'.[4] For while export credit subsidies can be used to address market failures in international financing, they can also divert business away from more efficient competitors, and trigger subsidies wars in which exporting nations waste resources competing with each other to confer a competitive advantage on exporters.[5] Indeed, 'among the various forms of export subsidies, subsidized export credits arguably have the most immediate and thus greatest potential to distort trade flows'.[6]

Numerous policymakers and commentators have decried the potential economic distortions associated with government subsidies, including those implemented through export financing.[7] As a result, a range of legal disciplines on subsidies have evolved. At the multilateral level, the World Trade Organization (WTO) Agreement on Subsidies and Countervailing Measures (SCM) provides a binding framework for controlling export subsidies. Under the WTO SCM,

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1 In 2017 trade growth stood at 4.6%, dropping to 3% in 2018 and is expected to drop further to 2.6% in 2019. *See* https://www.wto.org/english/news_e/spra_e/spra255_e.htm (accessed 3 July 2019).

2 Report to the US Congress on Global Export Credit Competition. EXIM Bank. June 2018, at 30 https://www.exim.gov/sites/default/files/reports/competitiveness_reports/2018/EXIM-Competitiveness-Report_June2018.pdf (accessed July 3 2019).

3 Hidehiro Konno, *From Simple to Sophisticated*, *The Export Credit Arrangement: Achievements and Challenges 1978/1998* 95 (Paris: OECD Publishing 1998, Paris)..

4 *Corporate Welfare Wins Again in Trump's Washington*, New York Times Opinion (7 May 2019), https://www.nytimes.com/2019/05/07/opinion/export-import-bank-trump-corporate-welfare.html.

5 Kyle Bagwell & Robert W. Staiger, *The Economics of the World Trading System* (Cambridge, MA: MIT Press. 2006); Kyle Bagwell & Robert W. Staiger, *Will International Rules on Subsidies Disrupt the World Trading System?,* 96 Am. Econ. Rev. 877–895.

6 WTO Panel Report, *Canada – Measures Affecting the Export of Civilian Aircraft* – Recourse by Brazil to Art. 21.5 of the DSU (Canada – Aircraft (Art. 21.5 – Brazil)), WT/DS70/RW, adopted 4 Aug. 2000. para. 5.137.

7 For a discussion on the desirability of subsidy control *see* Alan O. Sykes, *The Questionable Case for Subsidies Regulation: A Comparative Perspective*, 2(2) J. Legal Analysis. (2010).

export credit support is deemed to be a subsidy if it confers upon the foreign buyer an export credit at terms not available on the commercial market. At a 'club' level, the 1979 OECD 'Arrangement' on Officially Supported Export Credits is a specialized instrument regulating the activities of ECAs. The OECD Arrangement seeks to create a level playing field among its Participants. Its objective is to encourage fair competition between exporters goods and services, rather than on the basis of more favourable support from their governments.[8]

This article examines the export credit support options open to OECD Arrangement Participants, with reference to the international legal obligations agreed to under the OECD and the WTO. The article is set out as follows: It first examines the rationale for official export credit support, and the rationale for regulating any such public support. The article then focuses on the current international market for official export credit support which increasingly includes non-OECD Arrangement type programmes from its Participants, as well as more active ECAs that are not participants of the OECD Arrangement. This development has detracted from the role of the OECD Arrangement, and it places more pressure on the WTO system to regulate official export credit support. However, the SCM does not provide the necessary specialized instruments for regulating export credit subsidies, nor does it address environmental, social and human rights. Moreover, the need for stronger regulation comes at a time when the WTO system is already under strain. The article then looks at the current concerns regarding compliance with non-economic objectives, with reference to the European Ombudsman's investigation of EU Member States ECA activity reporting.

This article concludes that in a changing financial and regulatory environment, there is a two-fold challenge for the OECD Arrangement Participants. First, the broader need to identify new ways to promote economic efficiency and competitiveness while avoiding corporate welfare. This competition approach is necessary to secure new export markets regardless of the need for official export support, which respect international rules on subsidies and environmental, social, human rights and ethical standards. Second, there is a need for collective action to regulate export subsidies effectively, which requires the OECD Arrangement Participants to work with renewed effort internationally to develop more comprehensive rules for regulating official export credit support and promote competition and sustainable development within the international trading global system.

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[8] The Arrangement applies to all official support for exports of goods and/or services, or to financial leases, which have repayment terms of two years or more. This is regardless of whether the official support for export credits is given by means of direct credit/financing, refinancing, interest rate support, guarantee or insurance. Special sectoral Guidelines apply to ships, nuclear power plant, aircraft and project finance transactions. The Arrangement does not apply to military equipment and agriculture products.

2 RATIONALES FOR OFFICIAL EXPORT CREDIT AGENCIES – AND FOR THEIR REGULATION

ECAs are fundamentally mercantilist in nature – they seek to promote domestic exports to secure employment and create national wealth. Yet despite such economic nationalism, ECAs are seen to be legitimate and even encouraged, particularly during financial crises. This is because ECAs can address market failures or information asymmetries in the private export financing market. For some commentators, official export financing support can ameliorate distortions in domestic and international markets and may represent the best policy instrument for addressing distortions to the degree that they operate directly on the distorted margin.[9] More specifically, through ECAs, governments can offer support for export transactions not readily offered by the private sector either through lack of availability, or because the private capital market lacks sufficient information to properly assess the risks of the transaction. Governments on the other hand, are better positioned to access the necessary information to assess the risks of the transaction.[10]

Others argue that unbridled and competing national subsidies can undermine world prosperity and require regulation.[11] Indeed, competition among ECAs to offer their exporters the best support has significant budgetary implications and, by cancelling out other offers, could result in a zero-sum game. Moreover, no government can unilaterally decide to stop subsidizing export credits without its exporters losing sales. As such, preventing a subsidy war through export credit support requires international cooperation. Accordingly, a range of organizations and legal instruments have been developed over the past sixty years to provide a wider rules-based system for the more orderly market for export subsidies, including official export credit support.[12]

The OECD Arrangement is the most specialized legal instrument for controlling official export credit support. The Arrangement provides substantive conditions requiring that forms of officially supported export credit support are subject

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9 Harry G. Johnson, *Optimal Trade Intervention in the Presence of Domestic Distortions*, in *Trade, Growth and the Balance of Payments* (Richard Caves, Harry Johnson & Peter Kenen eds, New York: Rand McNally 1965) cited in Sykes fn. 8.

10 D. Coppens, *How Much Credit for Export Credit Support Under the SCM Agreement?*, 12(1) J. Int'l Econ. L. 66, 63–113 (2009).

11 Gary Clyde Hufbauer & Joanna Shelton Erb, *Subsidies in International Trade* (Washington: Institute for International Economics 1984); Gary Clyde Hufbauer, Meera Fickling & Woan Foong Wong, *Revitalizing the Export-Import Bank,* Peterson Institute of International Economics: Policy Brief 11–6 (May 2011).

12 This includes institutions such as the IMF, Multilateral Development Banks (MDBs) and Development Finance Institutions (DFIs), the OECD Development Assistance Committee (DAC), the OECD, the Paris Club and the WTO.

to repayment requirements. Such support can take the form either of 'official financing support', such as direct credits to foreign buyers, refinancing or interest-rate support, or of 'pure cover support', such as export credits insurance or guarantee cover for credits provided by private financial institutions. The Arrangement's Participants offering official financing support for fixed-rate loans through direct credits or interest rate support mechanisms must apply the relevant Commercial Interest Reference Rate (CIRR) as the minimum interest rate.[13] The OECD Arrangement Participants are also obliged, under the Knaepen Package, to charge premium to cover the risk of non-payment of export credits that are risk based and adequate to cover long-term operating costs and losses. Alongside setting out the financial conditions for export credit support, the OECD Revised Council Recommendation on Common Approaches on the Environment and Officially Supported Export Credits (the OECD Common Approaches) further requires OECD Participants' ECAs to address anti-bribery, environmental, social and human rights (ESHR) impacts, and sustainable lending to heavily indebted poor countries, when they support exports through the provision of export credits.

The OECD Arrangement and Common Approaches are soft law instruments that do not create enforceable rights and duties.[14] Yet despite this weak enforcement character, the soft law approach has hitherto played a positive role within international negotiations between diverse parties seeking to respond to complex cross border export credit support issues that challenge domestic sovereignty.[15] The OECD Arrangement has been a rational choice for governments – but only as long as the benefits of deterring violations exceeds the costs of the expected loss from any violations. The Arrangement emerged as the most sensible option in an area where there was uncertainty about the appropriateness of hard rules on export credit activities due to unknown future circumstances. It provided the governments and industry of the major ECA countries with the essential knowledge and security that competition was based on the quality of products and services. Moreover, by incorporation into the WTO SCM through implicit reference (See section 4), those ECAs following the Arrangement terms and conditions have been provided with a safe harbour from the WTO's general prohibition on export subsidies.

However, the rationale behind participating in the OECD Arrangement is changing. It is increasingly suffering from its limited membership.[16] The new

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[13] CIRRs should represent final commercial lending interest rates in the domestic market of the currency concerned and closely correspond to the rate for first-class domestic borrowers. Participants are allowed to provide 'pure cover' to export credits extended by private actors with interest rates below the CIRR.

[14] R. R. Baxter, *International Law in Her Infinite Varieties*, 29 Int'l & Comp. L. Q. 549 (1980).

[15] Andrew T Guzman & Timothy L Meyer, *International Soft Law*, 2(1) J. Legal Analysis (Spring 2010).

[16] As of 2019, the thirty-five participants to the Arrangement include: Australia, Canada, Japan, Korea, New Zealand, Norway, Switzerland, the United States, the United Kingdom and all other the EU

active players in export financing, such as China, India, Brazil and Turkey, are not members and therefore do not have to abide by these guidelines. Moreover, while the Arrangement offers some flexibilities for its Participants to adopt more competitive programmes, there has been an emergence of a significant volume of export credit support mechanisms used by its Participants that also lies outside of the OECD Arrangement's scope. Consequently, the OECD Arrangement's influence over export credit agencies is shrinking in relative terms, both geographically and in volume, just at a time when governments are increasingly seeking to spur domestic growth through exports.

The evolution of the export credit support market has implications for Participant's to the OECD Arrangement domestic competitiveness as well as their compliance with international obligations. The following sections look more closely at these developments.

3 OECD PARTICIPANTS AND INTERNATIONAL COMPETITIVENESS

The OECD Arrangement's Participants are competing to support their exporters overseas activities within an export credit industry that has been undergoing a fundamental change. Traditionally, a public ECA was perceived to be the lender of last resort, operating only in cases of market failure, caused by a lack of resources or commercial appetite in the private financial sector. Indeed, as commercial financial markets became more robust in 1990s, it was thought that the role and significance of ECAs would suffer a commensurate decline. However, after the onset of the 2007 financial crisis, ECAs were brought centre stage, once more as lenders of last resort. Official export credit support became critical to ensuring liquidity in the international trading system, as commercial banks retreated as funders and risk takers of medium and long-term export finance. ECAs have been redefining their activities as a crucial element of a strategic big picture of government's industrial policies.

OECD Participant government are seeking to introduce new types of export credit support against a backdrop of decreasing global exports and increasing export finance emanating from the emerging economies. As a result, the OECD Participants are now competing not only against other OECD Arrangement Participants ECAs but also with the newer ECAs in emerging economics that are not Participants to the OECD Arrangement. Additionally, rather than operating from a lender of last resort rationale or from a market failure rationale, ECAs are also increasingly competing with the private sector.

Member States except for the Czech Republic, Poland and Hungary, who are observers. Membership is only by invitation to become a Participant by the current Participants.

Table 1 sets out the value of the ten most active ECA in 2017. The two largest providers, China and India, are not Participants to the OECD Arrangement. China was the world's largest provider of Medium-Long Term (MLT) export credits at USD 36.3 billion – one-third the global MLT export credit total. China outstrips the value of export support provided by EU Member States' ECAs by at least four times. By 2017, Chinese trade-related ECA activity had risen above the OECD Arrangement covered activity.[17] The absence of the US from this list is because for the past three years the Export-Import Bank of the US (ExIm) board was without the necessary quorum of three members and unable to authorize transactions greater than USD 10 million.[18] In May 2019, the US Senate confirmed three new Member of the ExIm board, however ExIm's authorization expires on 30 September 2019. If Congress reauthorizes the Ex – Im Bank,[19] it will further add to the competition among ECAs offering overseas business support.

Table 1 Top 10 ECA Providers 2017 [20]

	Country	*Billion USD*
1	China	36.3
2	India	9.7
3	Italy	8.9
4	Korea	7.9
5	Germany	7.0
6	France	6.8
7	Finland	5.5
8	Belgium	3.1
9	Netherlands	2.4
10	United Kingdom	2.1

[17] Chinese MLT Tables are composed of CEXIM's Buyer's and Seller's Credit programmes and Sinosure's MLT activity. Report to the US Congress on Global Export Credit Competition, EXIM Bank (June 2018), at 19.

[18] The Report to the US Congress on Global Export Credit Competition, noted: 'As of 6 June 2018, there are nearly $43 billion in transactions in Ex-Im's pipeline that require a vote by Ex – Im's Board of Directors that could support an estimated 250,000 US jobs'. EXIM Bank, June 2018 at 3.

[19] *See* One More Item for the 2019, '*To Do' List: Reauthorize the Export-Import Bank,* US Chamber of Commerce, https://www.uschamber.com/series/above-the-fold/one-more-item-the-2019-do-list-reauthorize-the-export-import-bank (accessed 5 July 2019).

[20] Reproduced from The Report to the US Congress on Global Export Credit Competition, EXIM Bank (June 2018), at 22.

3.1 Utilizing flexibilities under the OECD Arrangement

In response to greater competition, the Participants to the OECD Arrangement have been recalibrating their export credit support programmes to better meet the needs of their exporters. Under the OECD Arrangement, Participants may finance up to 85% of an export contract's value regardless of the level of domestic content that contract contains.[21] Subject to this rule, Participant ECAs are free to implement a content policy that supports its own domestic economy. This flexibility under the OECD Arrangement has led to significant variation. Content requirements are one of the primary areas of flexibility that Participants' ECAs can use to support national champions and to help internationalize domestic suppliers. Aggressive content policies give ECAs the ability to help pull sourcing to their own countries in sectors of strategic interest.

ECAs operating under the Arrangement have two content-related policies they can adjust to maximize flexibility. First, they can lower the minimum domestic content an export contract must contain in order to qualify for maximum allowable support. For example, in all UK credit contracts, the maximum level of support for all foreign content is 80% of the contract value, thus requiring a minimum 20% UK content.[22] The US EXIM bank content policy, on the other hand, will support the lesser of either 85% of the value of goods or services within the US export contract, or of 100% of the US-produced or US-originated content within the US export contract.[23] Second, ECAs operating under the Arrangement are also free to determine what qualifies as eligible domestic content. Some Participant ECAs use a content policy based on perceived national interest or value-creation. These are broader concepts than, for example, the US EXIM's content policy, which uses domestic content as a proxy for US jobs. In contrast, in using national interest or value-creation concepts other factors are considered, such as overall company exports, research and development, dividends and royalties associated with a given transaction, or an evaluation of how a given transaction will contribute to the long-term competitiveness of a national champion. A broader concept of domestic content by Participant ECAs clearly offers a more flexible approach towards their transactional assessment for support.

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[21] Foreign content consists of any portion of an export that originates outside the ECA's, the exporter's, and the foreign buyer's countries.

[22] https://www.gov.uk/government/consultations/public-consultation-on-foreign-content-policy/foreign-content-policy-consultation-document.

[23] Report to the US Congress on Global Export Credit Competition, EXIM Bank (2017), at 31.

To take advantage of these Arrangement flexibilities, in 2019, the UK government put forward proposals to provide the UK ECA – UK Export Finance (UKEF) – further flexibility in foreign content.[24] First, it is proposed that the current 80:20 foreign content rule should apply to the value of UKEF's participation in the financing of a contract or a project that consists of multiple contracts under a single supply chain, in addition to the traditional one-buyer/one-supplier/one-contract model. As a result, the UKEF could consider the amount of UK Content contained within related (but not directly financed or supported) contracts or projects when forming a view about a specific contract or provide support for a share of a contract where there is a specified amount of UK content.[25] This would facilitate the aggregation of UK content relative to a financing tranche. The UKEF also proposes to provide support if it can be demonstrated that the proposal is conducive to supporting or developing UK exports. Examples of this could include increasing future production in the UK, increasing the value or proportion of spend in the UK supply chain in the future, or increasing the number of jobs created in the UK in the future.[26]

The OECD Participants have also exploited flexibilities under the OECD Arrangement to expand their risk appetite. Participants to the OECD Arrangement are required to charge a minimum premium rate for all relevant transactions based on two risk-related factors: a country rating, which is standardized; and a buyer rating, where the discretion is given to ECAs. In the case of the latter rating, there is significant inter-ECA variation in the assignment of buyer-risk ratings for the same buyer in the same country in a given year. A two-notch difference in risk rating can correspond to differences in up-front exposure fee pricing of more than 1.5%. Remaining in line with the Arrangement, UKEF has grown its risk appetite, doubling its maximum exposure limits from USD 3.4 billion to USD 6.8 billion.[27] This change was supplemented by an expansion in the types of programmes UKEF offered in

[24] UK Export Finance. Foreign Content Policy Consultation Document (3 Apr. 2019), https://www.gov.uk/government/consultations/public-consultation-on-foreign-content-policy/foreign-content-policy-consultation-document (accessed 3 June 2019).

[25] Such a commitment would involve a statement by the applicant justifying the application of this Principle, which in UKEF's determination justifies UKEF's provision of support. UK Export Finance. Foreign Content Policy Consultation Document (3 Apr. 2019), https://www.gov.uk/government/consultations/public-consultation-on-foreign-content-policy/foreign-content-policy-consultation-document (accessed 3 June 2019).

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[27] Report to the US Congress on Global Export Credit Competition. EXIM Bank (2018), at 26.

2016, including its first long-term Euro-denominated direct loan for a gas-fired power plant into Turkey, supporting roughly USD 26 million in British exports. Additionally, UKEF expanded the number of local currencies in which it can provide support.[28]

However, the UKEF is not alone in re-designing its activities to take advantage of these flexibilities under the Arrangement. For example, in 2017, Servizi Assicurativi del Commercio Estero (SACE) in Italy agreed to fully provide support to buyers of Boeing 787 aircraft, despite the Boeing 787 only containing approximately 14% Italian content.[29] The government of France transferred its guarantee from Compagnie Française Assurance pour la Commerce Extérieur (COFACE), a private insurer, to Banque publique dinvestissement (Bpifrance), which is a government bank, in December 2016. Bpifrance now offers a direct state guarantee as opposed to COFACE's guarantee on behalf of the French state. This enhances France's export credit support, making it more accessible to commercial banks in the context of a challenging regulatory regime through circumventing the capital adequacy rules applicable to commercial banks. For under the Basel III standards, commercial banks such as COFACE need to hold additional capital and to undertake initiatives to address maturity mismatches between their assets and liabilities. In Germany, Euler Hermes has increased its political and commercial risk coverage to the OECD Arrangement maximums of 100%. Germany has also made its content policy more streamlined and flexible, now allowing 49% foreign content for all transactions (including local costs) with room to negotiate the percentage even higher on a case-by-case basis.[30] Euler Hermes has also made an agreement with OeKB and Serv, the ECAs in Austria and Switzerland respectively, to join forces to improve opportunities and visibility for their German speaking exporters. This collaboration is in response to Asian state banks that 'increasingly offer financing at non-standard conditions thus distorting international competition'.[31]

3.2 OECD Arrangement participants use of non-arrangement covered export credit support

OECD Participants also face a rapid expansion of trade-related export support programmes that fall outside the scope of the OECD Arrangement rules altogether. These new mechanisms include most notably investment insurance and

[28] *Ibid.*, at 28.
[29] *Ibid.*, at 19.
[30] *Ibid.*, at 19.
[31] Eleanor Wragg, *Europe's German-Speaking ECAs Ink Collaboration Pact,* Global Trade Rev. (19 June 2019), www.gtreview.com/news/europe/europes-german-speaking-ecas-ink-collaboration-pact/ (accessed 09 Aug. 2019).

window-arrangements. OECD mid-to-long term (MLT) activity was approximately USD 66 billion in 2016, down 15% compared with the year prior.[32] This fall continued the trend of declining MLT official export credits under the Arrangement that began in 2013, with a corollary surge in trade-related activity occurring outside Arrangement terms.[33]

Another example is the move towards providing untied investment financing by OECD Arrangement Participants. Under this activity, an ECA provides support to a domestic company seeking to take an equity stake overseas. This investment is a form of untied support in that there may not be any international trade of goods or services. Technically, untied investment financing does not fall under the Arrangement and appears to be a reaction by some OECD Arrangement Participants to promote national interest in the face of the increased activity by non-OECD Arrangement ECAs. In an untied financing programme, an ECA provides debt financing that facilitates international trade, but for which procurement from the ECA's home country is not a prerequisite. As a result, untied financing can still lead to procurement or a host of other benefits, such as access to the natural resources resulting from an ECA-funded project. Many programmes use strategic sourcing of raw materials or other national interests as their justification, versus the traditional export promotion model. By taking an equity stake, domestic companies can also potentially drive future procurement or play a role in the selection of an engineering, procurement, and construction contractor.

While the UKEF has not fully entered into official investment financing, its fellow OECD ECAs, Export Development Canada (EDC), Nippon Export and Investment Insurance (NEXI) and Japan Bank for International Cooperation (JBIC), the Export-Import Bank of Korea (KEXIM) and Korea Trade Insurance Corporation (K-sure), and Euler Hermes (Germany) have provided more than USD 35 billion in investment support, representing the vast majority of OECD investment support. In Japan, export loans now make up less than 10% of their total business, compared with nearly 80% in overseas investment loans.[34] This is also a response to market developments from non-OECD Arrangement ECAs. Figure 1 indicates, the Chinese ECAs provided more MLT investment support than the rest of the world combined, at nearly USD 45 billion.

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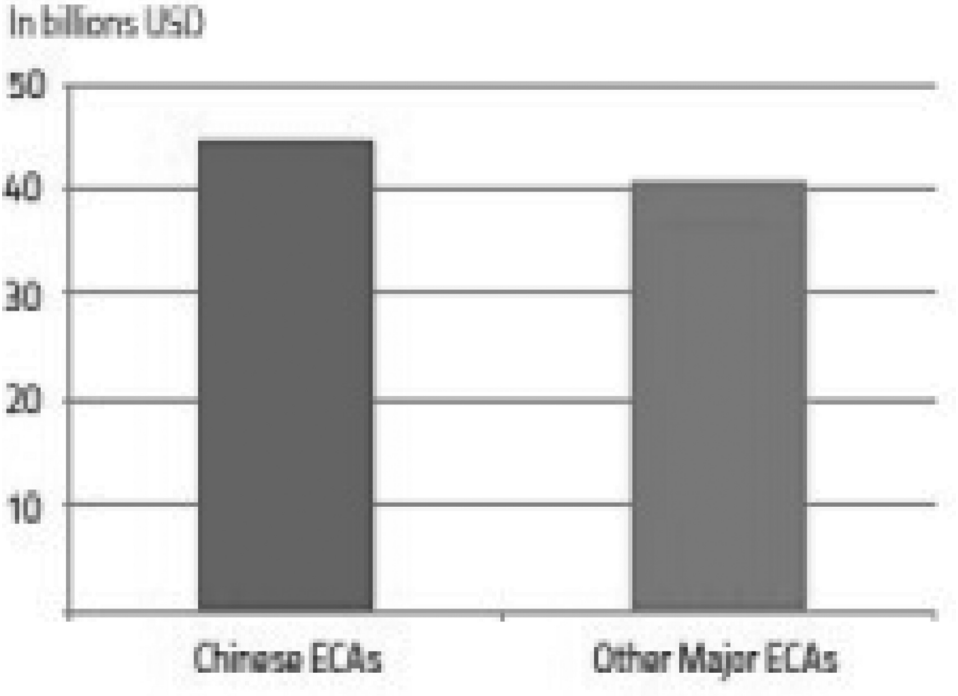
[32] Report to the US Congress on Global Export Credit Competition. EXIM Bank (2017), at 18.

[33] Activity under the Arrangement was not down across the board. For example, UKEF increased its activity under the Arrangement (+198%), along with France (+24%), Italy (+93%), Sweden (+141%) growth in their MLT programmes. Although this growth was offset by falling volumes in the US (-97%), Japan (-63%), Germany (-39%), and Korea (-23%). *Ibid.*, at 18.

[34] Japan Bank for International Cooperation, Annual Report (2017).

Figure 1 Comparison of Global Trade-Related Investment Support – Chinese ECA vis-à-vis Other Major ECAs in 2017[35]



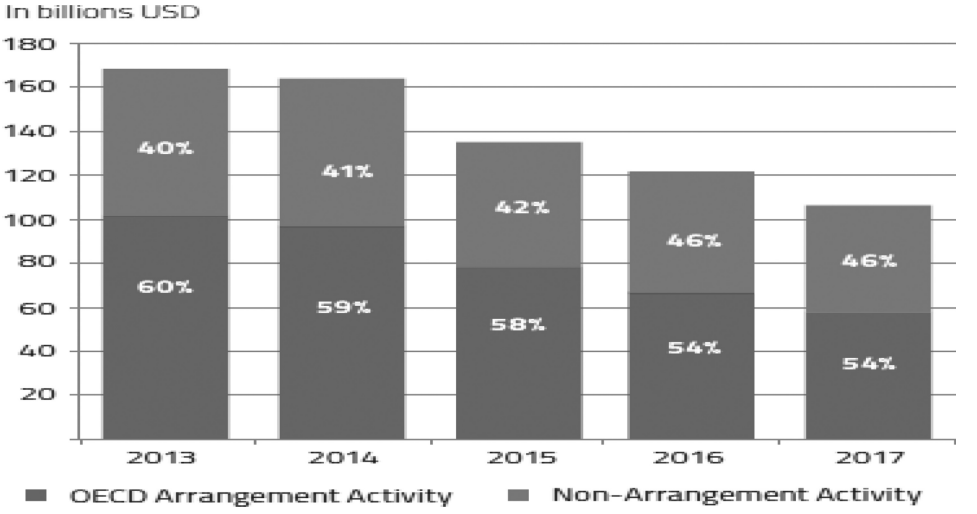
There has also been an increase in creating export credit programmes operating under market-oriented principles, thus competing with commercial banks to support domestic exports rather than acting as a lender of last resort. These programmes are referred to as 'market windows' and they also lie outside of the scope of the OECD Arrangement. In a market-window programme, an ECA offers pricing competitive with the commercial market; as such a market window does not necessarily result in lower financing costs compared with financing provided under the OECD Arrangement. However, ECAs have more flexibility on amortization structures, down payments and fees, or allow for local cost financing in excess of 30%, as the transaction is not covered by OECD rules. Historically, Canada's EDC and the German Kreditanstalt für Wiederaufbau/International Project and Exportfinanzing (KfW/IPEX

[35] Reproduced from The Report to the US Congress on Global Export Credit Competition, EXIM Bank (2018), at 19.

Bank) – both OECD Participants – have offered such commercial approaches to official financing. Japan and Korea are now also following such an strategy.

As Figure 2 indicates, OECD Arrangement Participants have been shifting increasingly towards such non-Arrangement activity since 2013. It highlights that between 2013 and 2017, OECD Arrangement covered activity dropped 6% to just under 55% of total activity, with a commensurate gain in non-arrangement covered export support. This shift has occurred at the same time that the total value of export support has decreased by approximately USD 60 billion.[36]

Figure 2 Arrangement vs. Non-Arrangement Activity By Participants to the OECD Arrangement[37]



3.3 Non-OECD participants' export credit support

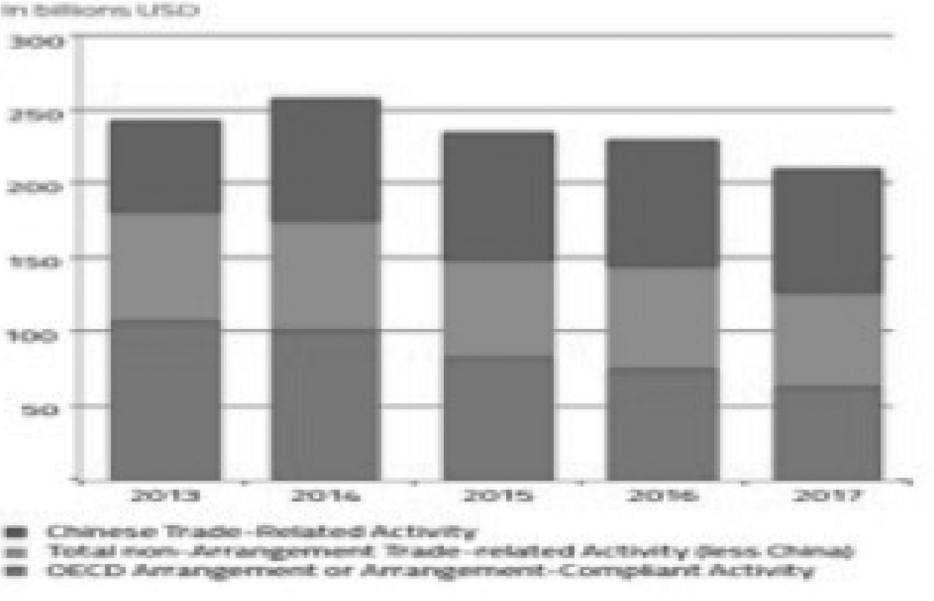
In addition to competing against these new non-OECD Arrangement export credit support programmes implemented by OECD Participants, there is the unavoidable competitive pressure from non-OECD Participants such as China, India, Turkey and Brazil. For example, in China, the China Export Import Bank (CEXIM) Preferential Export Buyer's Credit offers a 2% interest rate, five year

[36] Report to the US Congress on Global Export Credit Competition, EXIM Bank (2018), at 19.
[37] Reproduced from The Report to the US Congress on Global Export Credit Competition, EXIM Bank (2018), at 19.

grace period and a 10–20 year repayment period. It will finance 85% of the contract value and with the denominated currency in US dollars. The Government Concessional Loan also offers a 2% interest rate, five year grace period and 10–20 year repayment period. However, it finances 100% of the contract value, denominated in Renminbi (RMB). CEXIM is able to offer these loans in combination with standard loans depending on what gives Chinese exporters the best chance to win an export contract in line with China's foreign policy strategy. The features of these programmes can also be modified, such as extending the grace period, to further attract the borrower.[38]

Figure 3 indicates the relative size of OECD Arrangement compliant activity; non-Arrangement compliant activity by both OECD Participants and non-Participants less China, and China trade-related export support activity. It suggests that in less than five years, OECD arrangement compliant activity has been displaced as the primary source of export support, by China and non-Arrangement activity.

Figure 3 Total Official Trade Related Support[39]

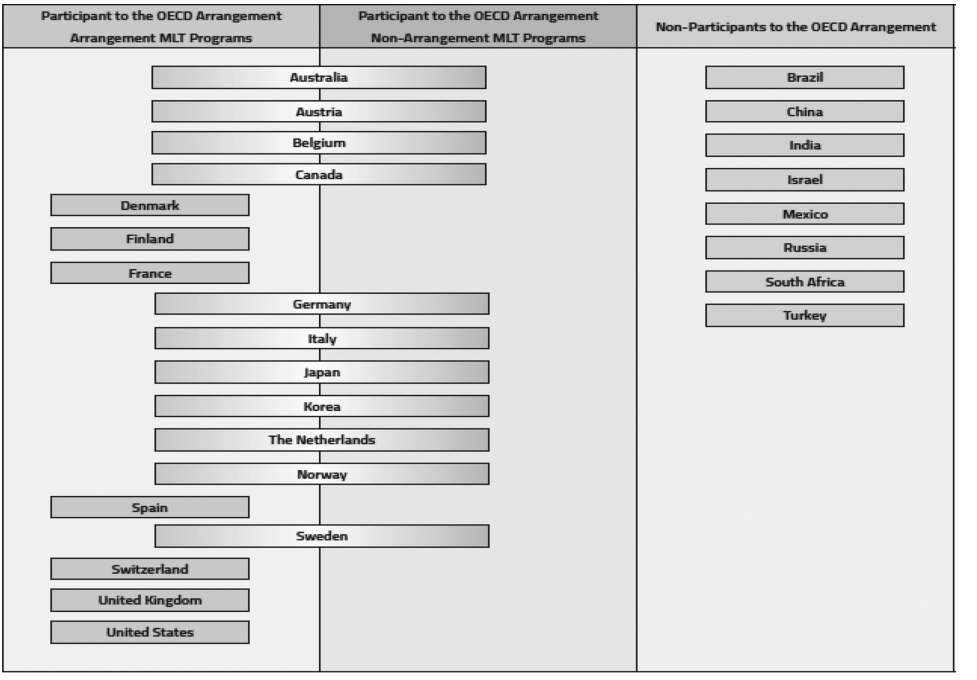


38 Report to the US Congress on Global Export Credit Competition, EXIM Bank (2017), at 35.

39 Reproduced from The Report to the US Congress on Global Export Credit Competition, EXIM Bank (2018), at 20.

Clearly, Participants of the OECD Arrangement are faced with a strategic dilemma in the context of uneven global competition. The expansion of non-Arrangement activities increases the pressure on Participants to create their own OECD Arrangement avoidance programmes. However, this further jeopardizes the level playing field and contributes to an export subsidy race. Figure 4 sets out the distinction between the three models of ECA operating. It indicates that only a minority of seven ECAs have not expanded their Non-Arrangement activities.

Figure 4 Major ECA Countries by Programme Type[40]



5 Brazil is a member of the OECD Aircraft Sector Understanding.

6 Israel, Mexico, and Turkey are OECD members but are not Participants to the OECD Arrangement.

This expansion of non-Arrangement export credit support programmes has implications not only for the level playing field, but also for the regulatory framework governing export credit support and the compatibility of some of these new

40 Reproduced from The Report to the US Congress on Global Export Credit Competition, EXIM Bank (2017), at 10.

programmes with the obligations under the WTO SCM. The following section focuses on this issue of compliance.

4 REGULATORY SHIFTS IN OFFICIAL EXPORT CREDIT SUPPORT CONTROL

Given the relatively declining scope and membership of the OECD Arrangement, the weight of regulating export credit activities is gravitating towards the multilateral WTO Agreement on Subsidies and Countervailing Measures (SCM) with binding rules, enforced through a dispute settlement mechanism entrusted to respect the obligations of the agreement. These rules, however, are not as detailed as the OECD Arrangement, they do not address the environmental, social and human rights concerns of the OECD Common Approaches, and nor do they cover the trade in services.

Article 3 SCM stipulates, in relevant part, that a Member shall neither grant nor maintain subsidies contingent, in law or in fact, whether solely or as one of several other conditions, upon export performance, including those illustrated in Annex I. Under the SCM, export subsidies are defined as those targeted to directly affect exports by assisting the domestic producer against its competitors in foreign markets. As they inherently favour domestic goods that are exported over competing foreign goods in export markets, there is no burden of proof as to its specificity or adverse effects. A prohibited subsidy must be withdrawn.[41]

The Annex I's Illustrative List of export subsidies referred to under Article 3.1 (a) SCM further clarifies what can be considered to be a prohibited 'export subsidy'. The relevant provisions from Annex I are (j) and (k)[42]:

> Item (j) The provision by governments (or special institutions controlled by governments) of export credit guarantee or insurance programmes, of insurance or guarantee programmes against increases in the cost of exported products or of exchange risk programmes, at premium rates *which are inadequate to cover the long-term operating costs and losses of the programmes*.
>
> Item (k) The grant by governments (or special institutions controlled by and/or acting under the authority of governments) of export credits at rates below those which they actually have to pay for the funds so employed (or would have to pay if they borrowed on international capital markets in order to obtain funds of the same maturity and other credit terms and denominated in the same currency as the export credit), or the payment by them of all or part of the costs incurred by exporters or financial institutions in obtaining credits, *in so far as they are used to secure a material advantage in the field of export credit terms*.

[41] A derogation from this provision has been provided to the countries falling under Annex VII list of the ASCM until they reach a GNI per capita of USD 1000 for consecutive three years.

[42] https://www.wto.org/english/docs_e/legal_e/24-scm.pdf (Accessed 09 Aug. 2019).

Provided, however, that if a Member is a party to *an international undertaking on official export credits* to which at least twelve original Members to this Agreement are parties as of 1 January 1979 (or a successor undertaking which has been adopted by those original Members), or if in practice a Member applies the interest rates provisions of the relevant undertaking, an export credit practice which is *in conformity with those provisions shall not be considered an export subsidy prohibited by this Agreement*. (Emphasis added)

In the WTO *Brazil – Export Financing Programme for Aircraft* case, the Panel stated that: 'The second paragraph of Item (k) provides that "an export credit practice" which is in conformity with the "interest rate provisions" of the OECD Arrangement shall not be considered an export subsidy prohibited by the SCM Agreement'.[43] The Appellate Body's Article 21.5 Implementation Report provided further clarity, stating that while Article 15 of the OECD Arrangement defines the minimum interest rates applicable to the officially-supported export credits as the CIRRs, it is not the only benchmark to assess the material advantage of an export subsidy. Although the Member has to provide evidence from comparable transactions in the marketplace. On the other hand, any WTO member may use the 'safe harbour' exception allowed by the second paragraph of Item (k) – when applying the OECD standards. This includes the whole content of the Arrangement and its annexes, which is to be understood in its dynamic negotiation. For any new arrangement in the OECD and its Annexes replacing the 1979 undertaking is to be considered by the WTO.[44]

However, this application of the Item (k) paragraph two 'safe harbour' is not unequivocal, most significantly in the area of 'matching' clauses. Under Article 18 of the OECD Arrangement, Participants are provided the possibility of matching the terms of an offer from an ECA operating both inside and outside the Arrangement.[45] This is seen as a form of 'self-help' for the Participants, and a deterrent against undercutting OECD Arrangement terms.[46]

In the *Brazil-Export Financing Programme for Aircraft* dispute, Canada argued that its contested subsidies were permitted because they fell within the safe harbour of paragraph 2 of Annex I Item (k) in the SCM Agreement. Further, that the OECD

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43 Panel Report, *Brazil – Export Financing Programme for Aircraft*, WT/DS46/R. WT/DS46/R. (14 Apr. 1999), paras 1.1–1.10.

44 *Brazil – Export Financing Programme for Aircraft*: Recourse by Canada to Art. 21.5 of the DSU; Report of the Appellate Body (WT/DS46/AB/RW) and Report of the Panel (WT/DS46/RW).

45 Art. 18. Matching. Taking into account *a Participant's international obligations* and consistent with the purpose of the Arrangement, a Participant may match, according to the procedures set out in Art. 45, financial terms and conditions offered by a Participant or a non-Participant. Financial terms and conditions provided in accordance with this Article are considered to be in conformity with the provisions of Ch I, II and, when applicable, Annexes I, II, III, IV, V, VI and VII.

46 *See* Coppens, *supra* n. 10.

Arrangement permitted matching of concessional interest rates, either those offered by a competing country on the basis of provisions of the OECD Arrangement, or as was relevant here, in derogation from the Arrangement, through matching. The Panel, however, opined that while it recognized that matching of derogations is permitted under the OECD Arrangement, this did not alter the fact that both the original derogation and the matching remain, by the Arrangement's own terms, out of conformity with the provisions of the Arrangement.[47] Matching can only be permitted under the safe harbour if the matched export credit support did not derogate from the OECD Arrangement. The Panel further reasoned that if the OECD Arrangement was incorporated into the SCM Agreement such as to permit matching of derogations of participants, non-participants in the OECD Arrangement would be at a disadvantage, as they would lack knowledge of such derogations and therefore the opportunity for matching them.[48]

The relevant findings of the *Brazil – Export Financing Programme for Aircraft* dispute indicate, inter alia, that the Item (k) paragraph 2 safe harbour has been interpreted narrowly. It is available only for those forms of export credit support to which the interest rates provisions of the OECD Arrangement are applicable – that is, direct credits. It does not apply to export credit support in the form of pure cover when it is provided to exporters on terms more favourable than the market rate. This remains relevant even if it conforms fully to the minimum premium and other disciplines in the OECD Arrangement. Further, matching is no defence to export subsidy claims in a WTO dispute. Some commentators also argue that in theory, export credit support benefiting from the safe harbour remains vulnerable (1) to WTO challenge if it causes certain enumerated forms of economic harm to other WTO Members' interests – so-called adverse effects; and (2) to unilateral countervailing duty action if injury to another country's domestic industry is shown.[49]

Accordingly, for a 'matched offer' permitted under the OECD Arrangement's Article 18 derogation for its Participants to be assessed under the WTO SCM, a separate challenge would need to be brought by an injured party as a Member of the WTO. To bring a successful WTO challenge to suspected export credit subsidy programmes, the requesting party needs to make a prima facie case that: first, the other government provides export financing, second, that the financing is

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[47] Panel Report, *Canada – Aircraft* (Art. 21.5 – Brazil), para. 5.125; Panel Report, *Canada – Aircraft Credits and Guarantees*, para. 7.169.

[48] Panel Report, *Canada – Aircraft Credits and Guarantees*, para. 7.177.

[49] D. Coppens & T. Friedbacher, *A Tale of Two Rules: The Intersection Between WTO and OECD Disciplines on Export Credit Support,* The Future of Foreign Trade Support – Setting Global Standards for Export Credit and Political Risk Insurance 2015, https://www.globalpolicyjournal.com/blog/26/11/2014/tale-two-rules-intersection-between-wto-and-oecd-disciplines-export-credit-support (accessed 3 June 2019).

contingent on export performance, and third, that the rates at which the financing is provided are below market rates. Having made this case, the burden of demonstrating that the official export credits comply with the WTO SCM, or qualify for the safe harbour, procedurally shifts on to the responding party.

Yet disputes over an export credit subsidies in the WTO remain rare. Although the US has been vocal in its criticism of China's export support programmes, it has yet to bring a case to the WTO DSM nor has it attempted to countervail an export credit subsidy. This may be partly because of the lack of transparency surrounding financial details of specific transactions. It may also be due to the time-consuming nature of the WTO dispute settlement procedure, increasingly unable to respond effectively to the fast pace of negotiated trade finance transactions.

Instead, the US and other countries with major ECAs have chosen to diplomacy rather than litigation with China. In 2012, the US launched negotiations with China, through the Strategic and Economic Dialogue to try to come to an agreement on guidelines to govern export credit financing. The International Working Group on Export Credits (IWG) was established: 'To make concrete progress towards a set of international guidelines on the provision of Official Export Financing that, taking into account varying national interests and situations, are consistent with international best practices, with the goal of concluding an agreement by 2014'. The first plenary meeting of the IWG took place in 2012.[50] Many delegations in principle supported the view that the overall objective should be to eventually agree on a 'successor undertaking' to the current OECD Arrangement, in sense of Item (k) of Annex I of the SCM. However, by 2019 no clear consensus over these issues had emerged from the IWG.[51]

Yet in the meantime, the OECD Arrangement is no longer regulating most of the export credit support programmes emanating from the most active ECA providers. Furthermore, enforcement under the WTO SCM rules does not address the official export credit support to trade in services nor the sustainable development concerns of the OECD Common Approaches. With regard to the latter, concerns have been raised within the EU.[52] The European Ombudsman

[50] Altogether fifteen major export credit providers attended the plenary, including the OECD Participants as well as China, Brazil, the Russian Federation, Turkey, Malaysia and Israel.

[51] The EU, e.g. favours a horizontal approach that look first at general provisions on maximum repayment terms, down payments, interest rates, premia, etc., applicable to all export credit transactions irrespective of the industrial sector concerned. China on the other hand, prefers the option of starting the process by looking at sectors, such as medical equipment and shipping. *See* A Brief Background Note on the ongoing negotiations of the International Working Group ('IWG') on Export Credit. CAPEXIL, http://capexil.org/background-note-iwg-on-export-credit/ (accessed 3 June 2019).

[52] ECAWatch, a coalition of non-governmental organization monitoring export credit agency activities, lodged an external complaint to the European Commission. ECAWatch objected that the Commission had failed to put in place adequate benchmarks and compliance tests in the context of

responded to these complaints by making various proposals to the European Commission to ensure stricter monitoring of EU Member States' ECAs compliance with the Unions objectives and obligations under international agreements, such as the OECD Common Approaches, pursuant to Article 4 of Regulation 1233/2011, and Annex 1.[53]

Under Article 4 of Regulation (EU) 1233/2011 it is stipulated that:

> The Member States *should comply with the Union's general provisions on external action*, such as consolidating democracy, respect for human rights and policy coherence for development, and the fight against climate change, *when establishing, developing and implementing their national export credit systems* and when carrying out their supervision of officially supported export credit activities. Under Annex 1 further details as to reporting requirements are set out.

ANNEX I:

1. Without prejudice to the prerogatives of the Member States' institutions exercising the supervision of the national export credit programmes, *each Member State shall make available* to the Commission an Annual Activity Report in order to step up transparency at Union level. *Member States shall report, in accordance with their national legislative framework*, on assets and liabilities, claims paid and recoveries, new commitments, exposures and premium charges. Where contingent liabilities might arise from officially supported export credit activities, those activities shall be reported as part of the Annual Activity Report.
2. In the Annual Activity Report, Member States *shall describe how environmental risks, which can carry other relevant risks, are taken into account* in the officially supported export credit activities of their ECAs.
3. *The Commission shall produce an annual review for the European Parliament* based on this information, *including an evaluation regarding the compliance of ECAs with Union objectives and obligations*.
4. The Commission, according to its competencies *shall provide to the European Parliament an annual report on negotiations undertaken, where*

its third annual review of the activity reports of the export credit agencies for 2013. Further, that the Commission had failed to assess thoroughly export credit agencies' compliance with EU objectives and obligations, in particular with respect to human rights and environmental protection.

[53] Recommendation of the European Ombudsman in case 212/2016/JN on the European Commission's annual reviewing of Member States' export credit agencies. 212/2016/JN.

> *the Commission has negotiating authorization in the various forums of international cooperation, to establish global standards in the field of officially supported export credits.*[54]

The European Commission has responded to the concerns and recommendations of the European Ombudsman by emphasizing that it is not responsible for the information included in the Member States' activity reports. Indeed, the current ECA annual reporting exercise complies with Annex I of Regulation 1233/2011. For the European Commission is obligated to use only the information contained in the Member States' activity reports when producing the annual review for the European Parliament. Any future change in the reporting procedure would require the agreement of both the European Parliament and the Council.

The European Ombudsman has countered otherwise. Rather, to avoid committing mal administration, Article 41 of the EU Charter of Fundamental Rights and the principles of good administration obligates EU institutions, including the European Commission, to ensure the evaluations contained in the annual reports are accurate, objective, independent, thorough and based on adequate information. The Regulation 1233/2011 ECA reporting exercise seeks to increase the transparency and accountability of ECAs. It should not rely on citizens and civil society to submit complaints and evidence of infringements of EU law in specific cases. Investigations of infringements of EU law cannot be taken as a substitute for the Commission's duty to properly evaluate export credits agencies' compliance with Union objectives and obligations in the context of the annual review. In accordance with Article 3(6) of the Statute of the European Ombudsman, the Commission the European Commission was requested to shall send a detailed opinion by 23 August 2018. However, at time of writing, this opinion has not been made publicly available.[55]

5 CONCLUSIONS: THE STRATEGIC DILEMMA FOR OECD PARTICIPANTS

The Participants to OECD Arrangement are operating in a highly aggressive yet increasingly unruly environment for official export credit support. In order to secure export contracts, both domestic industry and OECD ECAs need to increase their competitiveness while abiding by the rules of the trading system. Otherwise they risk contributing to the disruption of the level playing field and hindering sustainable development. For in addition to subsidy control, the Common

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[54] Article 4 of Regulation (EU) 1233/2011.

[55] Recommendation of the European Ombudsman in case 212/2016/JN on the European Commission's annual reviewing of Member States' export credit agencies. 212/2016/JN.

Approaches and other non-economic legal frameworks are applicable[56] Ensuring compliance is a challenge in the search for more export opportunities in this overcrowded and non-transparent arena.

One domestic response has been for Participants to recalibrate their finance packages to meet the changing needs of businesses that are seeking contracts overseas and entering international supply chains. This approach has included more flexible foreign content requirements, commercial windows and taking on riskier contracts. However, this strategy risks undermining the level playing field. Moreover, it is not sufficient for maintaining export competitiveness. That is, alongside implementing flexible and more competitive terms and conditions for export support through the ECAs, the OECD Participants' governments need to work more successfully with the private sector and through better resourced and targeted education and social policies. Governments have a vital role to play in improving the international competitiveness of domestic businesses through providing skills training to match the needs of the international digital economy, start-up incentives and strengthening the ability of small businesses to identify and enter international supply chains. This is unlikely to be achieved through corporate welfare in the form of official export credit support.

The other response lies externally. The most recent surge in aggressive competition in official export credit support has been accompanied by a weakening of the complex legal framework that operated to prevent a race to the bottom in terms and conditions of export financing. Weaknesses in the WTO's control over official export credit support and the declining relevance of the OECD Arrangement require OECD governments to further develop new forms of international cooperation, such as the negotiations in the IWG for export credits. The OECD Arrangement no longer controls as much of the current export activity as before, nor the two most active ECA players of today. Previously, the linkages between the more detailed but soft law OECD Arrangement and the binding prohibitions for export subsidies under the WTO SCM operated dynamically to contain most export credit support, most of the time.

As more ECA providers emerge that are not Participants in the OECD Arrangement and Common Approaches, the WTO SCM agreement has become the main legal deterrent despite its known weakness, such as the non-coverage of trade in services or the sustainable development dimensions of official export credit support. Additionally, Participants to the OECD Arrangement have been reluctant to challenge other WTO Members' official export credit support programmes.

[56] See e.g. the Equator Principles, https://equator-principles.com/and the Paris Agreement's Nationally Determined Contributions, https://unfccc.int/process-and-meetings/the-paris-agreement/nationally-determined-contributions-ndcs.

This may be partly because the increasingly time-consuming WTO dispute settlement procedure is inadequate to respond to the fast paced market in trade finance transactions. It could also be partly because of the overall opacity surrounding officially supported export credit programmes and the fear of retaliation. Participants to the OECD Arrangement seeking to prevent unfair competition in the provision of export credits within the WTO may be deterred because they may also be operating non-compliant official export support. This could either be through 'matching' or through operating programmes that do not fall under the narrow interpretation of the safe harbour under Item (k) paragraph 2 of Annex 1 to the SCM.

The Participants to the OECD Arrangement thus face the difficult tactical choice of either taking a strong pro-competition position domestically, as well as within international bodies such as the WTO, OECD and the IWG, or by fighting fire with fire through developing their own non-Arrangement type export credit programmes. This article submits that the former option is the more preferable. This is for economic efficiency, long-term competitiveness and sustainable development considerations, even though it could result in a reduced role for ECAs. Further, the current economic slowdown in export growth along with the rise of unruly export credit support programmes urgently calls for heightened cooperation among ECA governments. They all have a collective interest in preventing publicly-funded yet opaque subsidy wars in export credit terms and conditions, with all the known negative economic, political, environmental and social repercussions.