United States General Accounting Office

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Report to the Chairman, Subcommittee on International Monetary Policy and Trade, Committee on Financial Services House of Representatives

June 2002

EXPORT PROMOTION

Export-Import Bank and Treasury Differ in Their Approaches to Using Tied Aid

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Abbreviations

Ex-Im Bank	Export-Import Bank
OECD	Organization for Economic Cooperation and Development

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United States General Accounting Office
Washington, DC 20548

June 28, 2002

The Honorable Doug Bereuter
Chairman, Subcommittee on
International Monetary Policy and Trade
Committee on Financial Services
House of Representatives

Dear Mr. Chairman:

The Export-Import Bank (Ex-Im Bank) provides assistance to U.S. exporters facing foreign competitors supported by tied aid. Tied aid is government-to-government concessional financing of public sector capital projects in developing countries that is linked to the procurement of goods and services from the donor country. Tied aid can distort trade when it is used to influence competitions for foreign government procurement rather than allowing those procurements to be decided on the basis of quality, price, or service. The provision of tied aid is subject to a nonbinding Organization for Economic Cooperation and Development (OECD) arrangement, to which the United States is a party, that sets rules restricting the instances in which such offers can be made.

Through the Tied Aid Capital Projects Fund,[1] known as the War Chest, Ex-Im Bank may provide tied aid financing to support the negotiations and policing of OECD tied aid rules and to match foreign tied aid offers to level the playing field for U.S. exporters. In consultation with the Department of the Treasury (Treasury), Ex-Im Bank assesses applications from U.S. exporters for tied aid financing to counter foreign offers. In March 2001, the interagency decision-making process for determining the eligibility of applications for tied aid financing broke down when Ex-Im Bank and Treasury disagreed on two applications and Treasury "vetoed" them.[2] While Ex-Im Bank and Treasury at the time agreed that Treasury had the authority to veto these applications, Ex-Im Bank changed its position in June 2001 and challenged Treasury's veto authority. The dispute over the handling of the two cases and the extent of Treasury's authority over the

[1]The Tied Aid Capital Projects Fund had an available budget of $288 million, as of February 2002.

[2]Treasury provided its recommendation against the two cases in advance of the Ex-Im Bank Board meeting.

tied aid program was highlighted in congressional hearings on reauthorization of Ex-Im Bank during May and June 2001.[3] While the two agencies instituted formal consultation procedures in July 2001 to prevent future breakdowns in the interagency decision-making process, these new procedures did not address the issue of whether Treasury had statutory veto authority over the use of tied aid.

You expressed concern about the nature of Treasury's authority over the use of tied aid and the underlying reasons for Ex-Im Bank and Treasury's differences. As requested, we assessed (1) whether Treasury had a statutory veto over the use of Ex-Im Bank's Tied Aid Capital Projects Fund, (2) what the principles were for using tied aid, and (3) how Ex-Im Bank and Treasury applied these principles.

To determine whether Treasury had a statutory veto over the use of the tied aid funds, we examined the program legislation in effect at the time of the disagreement, legislative history, and relevant Ex-Im Bank and Treasury memorandums. To identify the principles governing the use of tied aid, we examined agency records related to the tied aid policy and decision-making principles, and we interviewed agency officials. To assess how the principles for tied aid financing were applied, we examined eight tied aid applications, including the two applications that led to the March 2001 disagreement. Of the eight selected cases, half were approved and half denied. Appendix III provides further information on our scope and methodology.

Results in Brief

Under the tied aid program legislation,[4] Treasury had the authority to direct and control the use of Ex-Im Bank's Tied Aid Capital Projects Fund,

[3]The House Financial Services Subcommittee on International Monetary Policy and Trade held hearings on May 2 and 8, 2001. The Senate Banking Subcommittee on International Trade and Finance held hearings on May 17, and June 19, 2001.

[4]This legislation, codified at 12 U.S.C. 635i-3, was amended by the Export-Import Bank Reauthorization Act of 2002, enacted June 14, 2002. The reauthorization act deletes from 12 U.S.C. 635i-3 the language requiring Ex-Im Bank to administer the tied aid program in accordance with the Treasury Secretary's recommendations. Also, it requires that Ex-Im Bank and Treasury develop the process, principles, and standards for governing use of War Chest funds; that Ex-Im Bank make final case-by-case decisions on use of the funds; and that Ex-Im Bank's approval of use of funds in any case be subject to a presidential determination based on consultation with Ex-Im Bank and Treasury. Throughout this report, we refer to the tied aid program legislation in 12 U.S.C. 635i-3 before its amendment by the 2002 reauthorization act.

in effect allowing Treasury to veto individual tied aid proposals. This legislation required Ex-Im Bank to administer the program in consultation with the Secretary of the Treasury and in accordance with the Secretary's recommendations on the most effective use of the fund in carrying out the program's purposes of achieving certain U.S. trade policy objectives, a responsibility assigned to the Secretary. The provision's legislative history makes clear that, to assist the Secretary in carrying out this responsibility, Congress gave the Secretary control of the fund as a negotiation and enforcement tool and intended that the Secretary's authority to direct use of the fund extend beyond the policy level to a case-by-case basis. Therefore, the legislation required Ex-Im Bank to comply with a Treasury recommendation that the fund not be used to support an export financing package for a particular project.

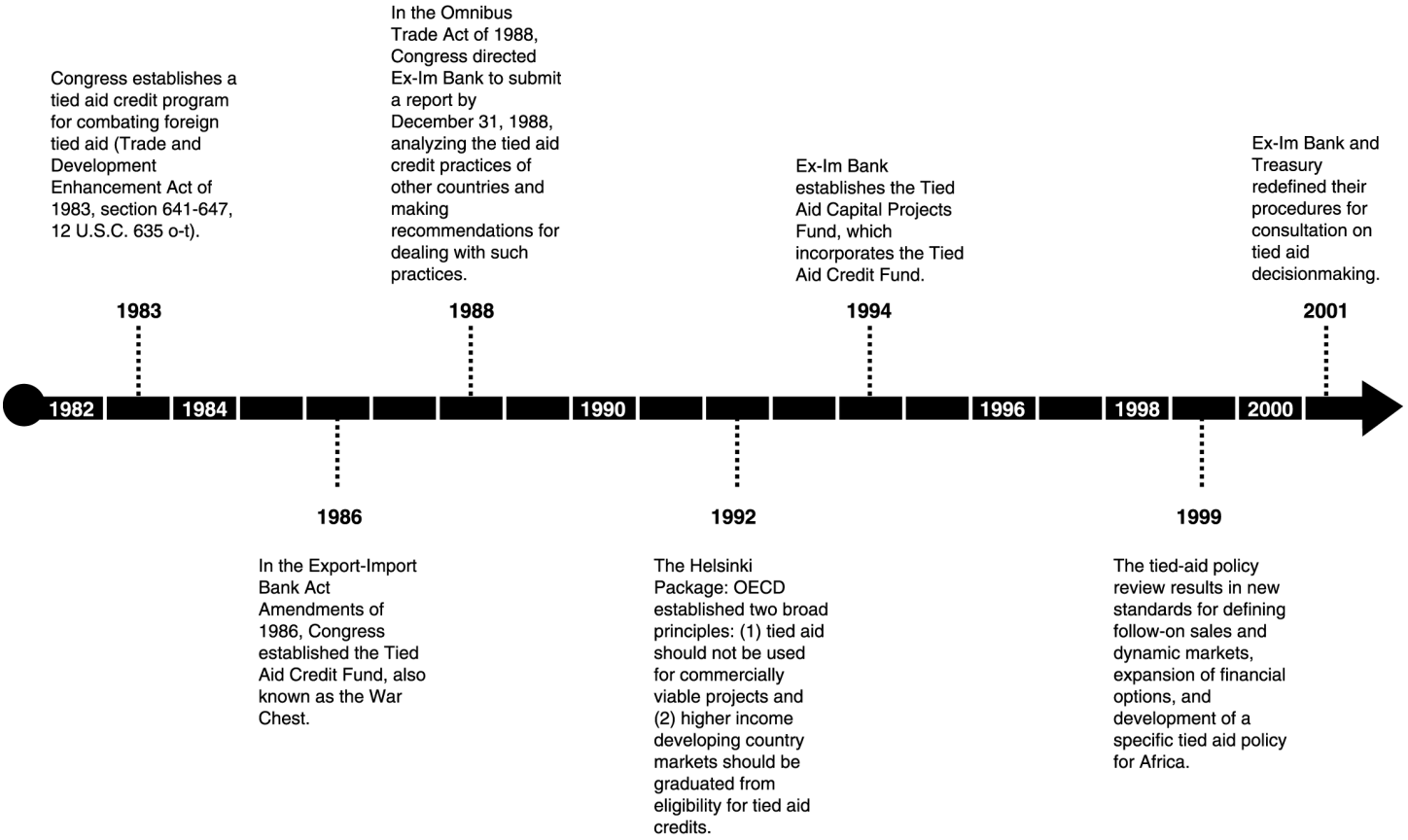
Ex-Im Bank and Treasury have agreed on a set of broadly stated principles for making decisions on using the Tied Aid Capital Projects Fund. Tied aid can be used to support the negotiation and policing of the OECD tied aid rules. It can also be used to match otherwise allowable foreign tied aid offers that would disadvantage a U.S. exporter's competitive position for future commercial-term sales. In the latter case, two primary criteria must be met: tied aid recipient countries must have sufficient economic growth to support future commercial-term sales (the dynamic markets criteria), and the U.S. exporter requesting tied aid must demonstrate the potential for additional future sales on commercial terms (the follow-on sales criteria).

While Ex-Im Bank and Treasury both seek to help U.S. exporters, they place different emphases on the principles used for matching tied aid financing, based on their different missions and perspectives. Treasury, which takes the lead in negotiating and policing the OECD tied aid rules, takes a strategic approach to financing tied aid. It focuses more on the use of tied aid financing to advance U.S. interests at OECD negotiations, police foreign competitors' compliance with the rules, and deter other governments from offering tied aid. Ex-Im Bank, which works directly with exporters, takes a transactional approach to financing tied aid, placing emphasis on helping U.S. exporters by matching foreign tied aid offers that would disadvantage their competitive position for future commercial-term sales. Treasury and Ex-Im Bank sometimes differ in their assessment of whether the requirements for follow-on sales have been met, particularly regarding whether there will be sufficient additional U.S. economic benefits.

Background

Congress first established the tied aid credit program in 1983 to counter foreign tied aid offers and to encourage OECD members to negotiate a reduction in the use of tied aid credits, as shown in figure 1. In the Export-Import Bank Act Amendments of 1986, Congress established the Tied Aid Credit Fund, also known as the War Chest. This fund was intended to (1) make other countries aware of the United States' willingness to challenge foreign tied aid offers when U.S. exporters were in a disadvantageous competitive position and (2) create bargaining leverage in U.S. negotiations with the other OECD members to discipline or set rules for tied aid.

Figure 1: The Evolution of Tied Aid Policy, 1983-2001



Source: Ex-Im Bank.

OECD negotiators concluded a landmark tied aid agreement in 1992, known as the Helsinki Package. It established a comprehensive framework for the use of tied aid based on two major principles: (1) tied aid should

not be used for commercially viable projects and (2) higher-income developing countries should be graduated from eligibility for tied aid credits.

In 1994, Ex-Im Bank established the Tied Aid Capital Projects Fund, which incorporated the Tied Aid Credit Fund. The $150 million fund was established to provide the United States with the means to support its efforts to discipline tied aid in OECD and to match trade-distorting foreign tied aid offers that were undermining U.S. exporters' competitiveness. Appendix I provides more information on activity under the U.S. tied aid program.

Ex-Im Bank became concerned that the Fund's restrictive criteria might have discouraged U.S. exporters from bidding on projects in which tied aid was offered by foreign competitors. In 1998, Ex-Im Bank initiated an internal policy review, followed by an interagency review with Treasury in 1999. These reviews resulted in modifications of the criteria for matching foreign tied aid offers, making them somewhat less restrictive. The review also resulted in a set of separate criteria that were designed to facilitate the matching of foreign tied aid credits in Africa.

Although the policy review was intended to ease the criteria and facilitate additional opportunities for tied aid matching, the lasting effects of international events, such as the Asian financial crisis of 1997 and the enhancement of the Highly Indebted Poor Countries Initiative in 1999, as well as reductions in the level of foreign tied aid offers, had a significant impact on its implementation. The devastating effects of the Asian financial crisis of 1997 on Indonesia, the second largest recipient of U.S. tied aid matching funds (see app. I), made meeting the U.S. tied aid criteria, especially for follow-on sales on commercial terms, more difficult to satisfy. The 1999 debt relief initiative, which accelerated and deepened debt relief treatments, specifically prohibited participating countries from receiving financial capital on commercial terms. The result was that fewer countries were eligible for tied aid under the U.S. program rules.

Treasury Had Authority to Direct and Control Use of Tied Aid Credit Funds

During Ex-Im Bank's reauthorization hearings in May 2001 before the Subcommittee on International Monetary Policy and Trade, House Committee on Financial Services, the Bank's then Deputy General Counsel, representing the position of the Bank's then General Counsel, testified that Ex-Im Bank's ability to use the Fund must be done in consultation and in accordance with the Treasury Secretary's recommendations, and that the legislative history "makes it fairly clear"

that the Secretary "has the final word in how and when the [Fund] is used."[5] At the time, Ex-Im Bank and Treasury officials were in agreement regarding this view of Treasury's authority. Subsequently, Ex-Im Bank's new General Counsel issued a memorandum dated June 19, 2001, that concluded that Treasury does not have a statutory veto or other unilateral decisional authority over Ex-Im Bank's use of tied aid funds on a case-by-case basis. This latter memorandum reflects Ex-Im Bank's current official position on the issue of Treasury's veto authority under the program legislation prior to enactment of the 2002 reauthorization legislation.

We reviewed the General Counsel's memorandum and the legislation establishing the Fund and its legislative history. Our review of that legislation and its history indicates that Congress intended to place control of the Fund under the Secretary of the Treasury as a negotiation and enforcement tool of U.S. trade policy and that the Secretary be able to direct the use of the fund at a policy level and on a case-by-case basis. Therefore, under the legislation, Ex-Im Bank was required to comply with a Treasury recommendation that the fund not be used to support an export financing package for a particular project.

Subsection 10 (b)(2)(A) of Ex-Im Bank's charter, at 12 U.S.C. 635i-3(b)(2)(A), required the Bank to administer the tied aid program "in consultation with the [Treasury] Secretary and in accordance with the Secretary's recommendations on how such credits could be used most effectively to carry out the [program's] purposes." Subsection 10 (a)(5) of the charter, at 12 U.S.C. 635i-(a)(5), defined the program's purposes as enforcing compliance with the existing international agreement restricting use of tied aid credits for commercial purposes and facilitating efforts to negotiate, establish, and enforce new international agreements.

The conference report on the Export-Import Bank Act Amendments of 1986 (Public Law 99-472), the legislation originally establishing the Fund, states that

> [t]he structure and purpose of the War Chest have been carefully designed.… Its overriding purpose is to strengthen the hand of the Secretary of the Treasury in negotiating a comprehensive agreement to limit the use of mixed credits. To serve that purpose, it is

[5]Reauthorization of the Export-Import Bank, Hearing Before the Subcommittee on International Monetary Policy and Trade of the Committee on Financial Services, House of Representatives, 107th Cong., 1st Sess. 28 (May 28, 2001).

essential that the Secretary, who is in charge of these negotiations for the United States, play a role in the use of the funds from the War Chest. Thus, though the War Chest is lodged administratively in the Bank, the Secretary's role is assured by the statutory language in this section that requires the Bank to administer this tied aid credit program 'in consultation with the Secretary of the Treasury and in accordance with the Secretary's recommendations.'[6]

In addition, statements during debates on the House floor regarding the authority intended to be given to the Treasury Secretary over the use of War Chest funds reflected, as the Congressional Record makes clear, the views of the Banking Committees of the House and Senate conferees. These statements specifically indicate that the language requiring Ex-Im Bank to administer the program in accordance with the Treasury Secretary's recommendations was intended to give the Secretary "practical control over the use of the funds" and the ability "to direct the use of the funds." The original legislation establishing the program was amended in 1989 and 1992, and we found nothing in the provisions or legislative histories of either amendment indicating that Congress intended any change regarding Treasury's control over, and use of, the Fund as a negotiation and enforcement tool of U.S. trade policy.

Ex-Im Bank and Treasury Agreed on Broad Principles for Tied Aid Financing

Under the broad principles established for the tied aid program, the United States will provide tied aid financing under three basic circumstances: (1) to support OECD negotiations aimed at reducing trade-distorting aid, (2) to police compliance with the OECD tied aid rules, and (3) to protect U.S. exporters when foreign tied aid that meets OECD rules threatens to undermine the exporters' competitive position for winning future commercial sales. When U.S. exporters request tied aid financing from Ex-Im Bank under the third circumstance, their application generally needs to meet two primary criteria: the country receiving the financing should be considered a "dynamic market," and there must be the potential for follow-on export sales on commercial terms.

Principles for Using Tied Aid

In setting up the Tied Aid Capital Projects Fund, Ex-Im Bank and Treasury agreed on a set of broadly stated principles that would guide its use. Overall, the agencies agreed that the United States will not initiate tied aid but only respond to and match foreign governments' tied aid offers. They

[6]House Conference Report No. 99-956, 99th Cong., 2nd Sess. 7 (1986).

agreed that the United States will provide tied aid offers to support the U.S. negotiating position at the OECD to continue to reduce trade-distorting aid, enforce other governments' compliance with the OECD tied aid rules, and protect U.S. exporters when foreign tied aid allowed under the OECD rules disadvantages their competitive position for future commercial sales. In addition, in using the fund, the United States is to preemptively counter potential foreign tied aid offers without triggering foreign tied aid use[7] and to defend potential U.S. sales to projects that are developmentally and environmentally sound.

Because the fund is not nearly large enough to match all instances of foreign tied aid offers,[8] Ex-Im Bank and Treasury developed criteria designed to maximize the benefits to the U.S. economy when tied aid is used. Also, Congress required that when the United States matched foreign tied aid offers that complied with the OECD Arrangement, Ex-Im Bank was to determine that such cases were in the national trade or economic interest.[9] To maximize the benefits of each use of the fund, the agencies agreed to examine two other aspects of each tied aid application—whether the country receiving the financing could be considered a dynamic market and whether there would likely be follow-on U.S. exports financed on commercial terms. Because the circumstances of each tied aid case are so different, the criteria cannot be automatically applied and a certain amount of flexibility is inherent in how they are applied in each case, according to Ex-Im Bank and Treasury officials.

Dynamic Markets Criteria

To be considered a dynamic market, the country receiving the tied aid financing needs to show reasonable signs of future economic growth to ensure prospects for additional U.S. sales of similar equipment. The Tied Aid Capital Projects Fund is thus to be used to match foreign offers in markets where there is greater chance that future tied aid offers (i.e., concessional lending) would not be necessary for U.S. exporters to compete for sales.

[7]This principle is meant to encourage the withdrawal of existing tied aid offers.

[8]In 2001, notifications to OECD of tied aid offers amounted to about $3.4 billion. However, not all offers become actual deals.

[9]12 U.S.C. 635i-3(b)(1)(A)(ii).

Specifically, the recipient country must have an annual gross national product greater than $5 billion. It must also meet a majority of the following factors:

- Average gross national product per capita growth of greater than 1.5 percent.
- Investment as a percentage of gross domestic product greater than 1 percent.
- Foreign direct investment as a percentage of gross national product less than 2 percent.
- Net aid flows as a percentage of gross national product less than 2 percent.
- Private investment as a percentage of gross domestic fixed investment greater than 60 percent.

In addition, since 1999, there have been separate, special dynamic market criteria for Africa, designed to facilitate tied aid matching. These criteria are as follows:

- Ex-Im Bank is open for cover in the country's public sector.
- OECD does not require 50 percent concessionality (required for least developed countries).
- Average gross national product per capital growth exceeds 1.5 percent.

Follow-on Sales Criteria

To determine whether a U.S. exporter's tied aid credit application has follow-on sales potential, Ex-Im Bank and Treasury examine whether there is potential for additional business in the same or a neighboring country. Such potential follow-on sales could be by the applicant or by other U.S. exporters of the same or similar technology as long as (1) potential sales can be attributed to the applicant's tied aid sale and (2) future sales can be financed without Ex-Im Bank tied aid support. The intent behind the follow-on sales criteria is to counter foreign donor governments' efforts to use aid to "lock in" long-run commercial advantages for their exporters. The criteria are also intended to exploit an initial market penetration opportunity, to enable a U.S. exporter to gain a competitive position for winning future sales on nonconcessional terms.

The existence of any of the following factors may also meet the follow-on sales requirement:

- International financial institutions, such as the World Bank, are active in financing the technology, and follow-on sales in the same industry could

reasonably be expected to take place in the future under international competitive bidding rules.

- The project would be considered commercially viable if it were located in a different place (e.g., in an urban area).
- The sector is undergoing a credible privatization process,[10] and so part of future expansion of the sector could be financed without concessional financing and such expansion is reasonably expected in the near future.
- The project can be expected to involve significant amounts of operating expenses in spare parts.

In addition, small businesses (as defined by the Small Business Administration) are not held to the same standards as larger U.S. exporters, and favorable consideration is given to the sale of environmentally beneficial goods and services.

Appendix II provides additional information on how the tied aid matching criteria are applied.

Ex-Im Bank and Treasury Place Different Emphases on Tied Aid Principles

While Ex-Im Bank and Treasury both seek to help U.S. exporters, they place different emphases on the principles used for matching foreign tied aid financing, based on their differing missions and perspectives. Treasury, which takes the lead in negotiating and policing the OECD tied aid rules, takes a strategic approach to financing tied aid. Ex-Im Bank, which works directly with exporters, takes a transactional approach to financing tied aid, placing emphasis on helping U.S. exporters match foreign tied aid offers that would disadvantage their competitive position for future commercial sales.

Our analysis of eight tied aid cases indicated that the agencies sometimes differed in how they assessed whether the requirements for follow-on sales had been met. In particular, they differed in how they assessed whether there would be sufficient additional U.S. economic benefits attributable to the tied aid financing.

[10]The term "credible privatization process" refers to the privatization of government-owned plants or private investment taking place in new enterprises in the sector.

Treasury's Strategic Approach to Tied Aid Financing

Treasury takes a strategic approach to tied aid financing. It is the lead U.S. agency at OECD in negotiating and policing the tied aid rules agreed to under the Helsinki Package in 1992. Treasury focuses on using tied aid financing to advance U.S. interests at OECD negotiations to expand the coverage of the Helsinki Package and to bring "untied" aid[11] under the OECD disciplines. Treasury also seeks to police foreign competitors' compliance with the Helsinki tied aid rules. These policing efforts have included using the fund to combat other countries' use of untied aid that is de facto tied. Treasury's primary aim is to deter other governments from offering tied aid that does not meet the Helsinki rules in both letter and spirit. It also seeks to remove tied aid as an export promotion tool, allowing U.S. exporters to compete on a level playing field without needing export subsidies. It also seeks to ensure that matching foreign tied aid offers helps U.S. exporters compete without having these individual transactions undermine the cooperation of other governments in achieving this broader goal of a level playing field, according to a Treasury official.

Treasury does not want tied aid to be used routinely to match allowable cases, because it fears that this would cause foreign competitors to once again increase their use of tied aid and because it would be expensive for the U.S. government to engage in this kind of subsidy competition. Because the rules established under the OECD Arrangement and the Helsinki Package are voluntary rather than legally binding agreements, Treasury is concerned about losing the gains achieved over years of negotiations at the OECD to reduce use of tied aid. It emphasizes that far more benefit has accrued to U.S. exporters by the removal of tied aid from major segments of the market than could possibly have been provided by even vastly increased levels of tied aid financing.

Treasury's other concern is that the tied aid allowed under the Helsinki rules is for projects that are not commercially viable and would therefore not allow for regular commercial financing. Such tied aid is generally part of the foreign assistance programs of the other OECD members, who do not define foreign assistance as generally precluding capital projects the

[11]"Untied" trade-related aid is financing that is not contractually linked to procurement from suppliers in the donor government's country and that ought to present opportunities for multicountry procurement.

way the United States does.[12] According to Treasury officials, if a foreign tied aid offer is designed to lock in market share, the offer would meet follow-on sales criteria. Otherwise, it is generally a legitimate aid project that Treasury does not think U.S. tied aid offers should challenge. Such matches would have to be made over and over again, with no possibility of follow-on sales made on commercial terms. According to Treasury officials, this would make the U.S. appear to be preying on bona fide foreign aid programs.

According to a Treasury official, the department has been successful in achieving its objective of reducing trade-distorting tied aid. While tied aid offers accounted for about $9.3 billion in 1991 before the new rules under the Helsinki Package were put in place, that amount had been reduced to around $3.5 billion by 1998. By 2001, tied aid financing from all donors other than Japan was down to about $1.5 billion. Owing to a shift in Japanese aid programs from untied to tied aid after 1998, Japanese tied aid rose to about $1.9 billion, so that the total amount of tied aid offers in 2001 was about $3.4 billion. According to Treasury officials, despite these reductions, Treasury is aware that tied aid can still affect future commercial competitions in some cases, and it supports use of tied aid matching under such circumstances.

Ex-Im Bank's Transactional Approach to Tied Aid Financing

Ex-Im Bank takes a transactional approach to tied aid financing. Its overall mission is to finance and promote exports of U.S. goods and services. In the tied aid arena, it helps U.S. exporters counter foreign competitors that can use their government's offer of concessionary or subsidized financing terms to skew competition for foreign government capital projects. Ex-Im Bank focuses on establishing that such foreign tied aid offers have actually been made and on determining whether the exporter has a reasonable prospect of follow-on sales on commercial terms from that tied aid deal. If

[12]According to a Treasury official, understanding the historical context of the tied aid debate is important. Tied aid became a problem when the United States unilaterally cut aid (foreign assistance) for capital projects and refocused it on human development needs. Having done so, it found that U.S. exporters were disadvantaged because they could not compete for capital projects against foreign competitors with subsidized loans from their national aid programs. As a result, the United States negotiated the Helsinki Package, which was a compromise with those who see capital projects as legitimate aid. The Helsinki compromise was that if a project is commercially viable, its financing should come from market term financial resources, while if it is not commercially viable, but has a high social value, then it is normally considered an aid project, and subsidized tied aid financing is acceptable.

so, and if Ex-Im Bank finds the borrower government and the exporter to be creditworthy, it is ready to move the transaction through its decision process to final approval by its Board of Directors.

Ex-Im Bank works directly with U.S. exporters who are competing with foreign tied aid offers. Although Ex-Im Bank officials do not specifically advocate the routine use of tied aid to match allowable cases, they cite the very low level of exporter applications for tied aid and the even lower level of approved cases that get funded (see table 2, in app. I). They also state that more should be done to assist U.S. exporters facing tied aid in overseas markets. The belief that U.S. tied aid rules were too restrictive led to Ex-Im Bank's internal policy review in 1998 and an interagency review in 1999, resulting in modifications to the tied aid criteria that were designed to expand the potential for tied aid matching. In fact, however, the level of U.S. matching has steadily decreased, because the lasting effects of international events—such as the 1997 Asian financial crisis and the 1999 restrictions on concessional borrowing by African participants in international debt relief programs—have made meeting U.S. tied aid rules for commercial-term follow-on sales more difficult. Another reason is related to the reduction in the level of foreign tied aid offers. According to an Ex-Im Bank official, the tied aid criteria were developed in order to ration limited War Chest funds at a time when a high level of foreign tied aid offers was expected, so that the justification for the strict adherence to these eligibility criteria has since been eroded.

According to an Ex-Im Bank official, the Bank does not share Treasury's concern about harming foreign governments' "legitimate aid" programs. Ex-Im Bank's view is that when the foreign aid offer is used to tilt the playing field against the U.S. exporter of a better product, Ex-Im Bank offers the recipient government an alternative and the chance to get the best value for its money. Ex-Im Bank officials also did not share Treasury's concern that increasing the amount of U.S. tied aid provided to exporters would jeopardize the gains made at OECD on restricting tied aid use.

According to an Ex-Im Bank official, the Bank is also concerned about the sometimes predatory character of foreign tied aid offers and the potential impact on the U.S. exporters competing for the bid. The predatory effect of foreign tied aid offers is seen, for instance, when a U.S. exporter is successfully competing with a foreign company for a commercial bid, and the foreign competitor suddenly makes a concessionary tied aid offer. Ex-Im Bank is also concerned about the potential impact of losing the sale on the U.S. exporter, which may have invested extensive time and money to develop the deal.

Differing Assessments of Follow-on Sales Criteria

One result of Ex-Im Bank and Treasury's differing approaches to tied aid has been that they sometimes have differed in assessing the requirements for follow-on sales. Our analysis of selected tied aid cases indicated that when the two agencies disagreed on the eligibility of a tied aid case, their disagreement was based on differences in how they assessed the potential for follow-on sales to provide sufficient additional U.S. economic benefits attributable to the tied aid financing.

Ex-Im Bank has tried to keep the assessment of follow-on sales straightforward by determining whether there is a potential for follow-on sales to occur in the recipient or neighboring country that can be linked to the tied aid sale without more Ex-Im Bank tied aid financing. Ex-Im Bank prefers that follow-on sales be on commercial terms. However, under the revised criteria, it is prepared to accept future sales on concessional terms as long as another institution, such as the World Bank, provides the concessional financing. According to an Ex-Im Bank official, if the application fits the criteria, then Ex-Im Bank is ready to consider financing the tied aid transaction. In this view, a finding of potential follow-on sales in itself meets the need to demonstrate economic benefits from the tied aid financing.

In applying follow-on sales criteria, however, Treasury assesses whether the tied aid will provide substantial additional U.S. economic benefits. In Treasury's view, a finding of potential follow-on sales is necessary but not sufficient; there must also be a concomitant finding that there would be substantial additional economic benefits for the United States that are attributable to the original tied aid financing.

In the eight selected tied aid cases that we reviewed, half were approved and half were denied, and all had been decided since the 1999 revision of tied aid criteria (see table 1). The decision-making process was fairly straightforward when, as in case B, the decision to approve a case was strategic, either to support negotiations or police compliance with the Helsinki rules. Again, in cases in which the foreign tied aid offer was allowed under the Helsinki rules and the U.S. eligibility criteria were clearly met or not met, the decision-making process was generally concluded without major disagreement (cases C, F, G, and H). Thus, in three of the denied cases, there was no real disagreement between the two agencies. However, in cases in which the eligibility criteria were not clearly met (cases A, D, and E)—generally involving the follow-on sales criteria—then the two agencies' differing approaches to tied aid heightened the potential for disagreement. On the basis of the cases we reviewed and interviews with agency officials, we observed that

differences arise when follow-on sales potential is marginal or its attribution to the tied aid sale is questioned.

Table 1: Decisions Made in Selected Tied Aid Cases

Case elements	Approved cases				Denied cases			
	Case A	Case B	Case C	Case D	Case E	Case F	Case G	Case H
Recipient country	Ghana	Indonesia	China	Ghana	China	Ghana	Uzbekistan	Senegal
Goods and/or services exported	Equipment for solar street lighting	Simulators and trainers for seafarer training facility	Wind turbines	Medical equipment (MRI, CT & X-ray)	Irrigation machinery and equipment	Electrical distribution equipment	Medical equipment	Mapping survey information services for water sources
Country offering tied aid	Spain	Japan and Germany	The Netherlands	Spain and Austria	Austria	Spain and Sweden	Finland, Germany, Japan, and Spain	France and Spain
Key tied aid criteria	Follow-on sales	Policing compliance of Helsinki Package	Follow-on sales	Follow-on sales	Follow-on sales	Follow-on sales	Dynamic market	Dynamic market

Source: Ex-Im Bank case files.

In the three cases we reviewed that raised significant disagreement between Ex-Im Bank and Treasury, the disagreement arose over the agencies' differing assessments of whether the application met the follow-on sales criteria. Ex-Im Bank determined that the criteria had been met in all three cases. Treasury determined, in the first of these three cases (case E), that follow-on sales would not be attributable to the tied aid sale; in the second case (case A), that linkage to follow-on sales in the private sector in a neighboring country needed to be better established; and in the third case (case D), that stronger assurance was needed that product sales would supplant the foreign tied aid offer instead of being used to supplement the offer. These three cases are discussed in detail in the following paragraphs.

In case E, Treasury and Ex-Im Bank disagreed over whether the follow-on sales would be attributable to the tied aid sale. Ex-Im Bank thought that the exporter, a manufacturer of irrigation machinery, had made a strong case for follow-on sales. The company had made prior sales on commercial terms in China. The Xinjiang provincial government had plans to irrigate vast tracts of agricultural land, and Ex-Im Bank believed that follow-on sales potential existed. Ex-Im Bank also believed that Austria's

numerous tied aid offers showed its intent to lock in market advantage. However, Treasury did not accept that the follow-on sales criteria had been met because it believed (1) that the U.S. exporter had superior technology and an already well-established market position in China and (2) that the technology involved was not unique and the foreign competitor could not use it to lock in market share. Thus, Treasury's view was that the U.S. exporter did not need tied aid to get follow-on sales, because its position was so strong that it would get follow-on sales in any case. Treasury also believed that demand for financing such equipment in the future would far exceed expected aid financing, therefore ensuring commercial competition. The follow-on sales thus would not be attributable to the tied aid. Treasury also explicitly warned the Austrian export credit agency against any future tied aid offers, stating that Treasury would support tied aid matching if the Austrian agency continued to offer tied aid in this sector when in competition with U.S. firms.

In case A, Treasury and Ex-Im Bank disagreed over whether the linkage from the tied aid sale to follow-on sales in the neighboring country's private sector had been adequately established. This case involved a U.S. exporter of solar lighting equipment, which faced a tied aid financing offer from a Spanish competitor for a project in Ghana. Follow-on sales on commercial terms were problematic in that the government of Ghana could enter only into concessional borrowing arrangements, owing to the provisions of an International Monetary Fund program to which it was a party. However, the U.S. exporter claimed that because of the demonstration effect of the tied aid deal in Ghana, it would be able to make follow-on sales on commercial terms to the private sector in Nigeria. Ex-Im Bank concluded that the exporter had made a credible case for follow-on sales in Nigeria, that this transaction offered the kind of initial market penetration opportunity intended by the follow-on sales provision, and that many potential projects in the region could follow. Treasury, however, did not believe that the follow-on sales criteria had been met, saying that the exporter needed to establish a clearer connection between the Ghana project and the follow-on sales in Nigeria. It required the exporter to provide additional information establishing the potential private sector buyer's actual intent to purchase similar equipment and their ability to obtain such financing. Once the exporter provided this information, Treasury removed its objection to the transaction. By that time, however, Ghana had defaulted on other Ex-Im Bank debts and the transaction, although officially approved, was not made operative.

In case D, Treasury and Ex-Im Bank initially disagreed over whether there was adequate assurance that a U.S. tied aid offer involving product sales would supplant the foreign tied aid offer instead of being used to supplement the offer. This case involved a U.S. exporter of medical equipment that was faced with tied aid competition from Spanish and Austrian exporters for a project in Ghana. Ex-Im Bank again concluded that a credible case had been made for follow-on sales. The Bank had obtained information from the U.S. embassy in Ghana that a potential market for new or used medical equipment in the private sector existed; it had also obtained information from the U.S. embassy in Nigeria that both the Nigerian government and the private sector were potential customers of U.S. medical equipment. Treasury thought that the case for follow-on sales was not strong, but it was most concerned by the fact that the export involved product sales, which are inherently fungible or interchangeable. A central element of the U.S. tied aid matching policy is that each use of tied aid should supplant a foreign tied aid offer, not be used to supplement the offer and actually increase the amount of tied aid in that market. For instance, a recipient government could manipulate a bid for X-ray equipment and find a way to accept both the foreign and the U.S. tied aid offer, perhaps by using the U.S. tied aid to fulfill the original bid and switching the foreign offer to another set of hospitals in another city. The result would be that the United States would be supplementing rather than supplanting the foreign tied aid offer. In the end, Treasury decided to support the use of tied aid in this case, although it had serious misgivings.[13]

Agency Comments and Our Evaluation

We received written comments on a draft of this report from Ex-Im Bank and Treasury. Ex-Im Bank declined to provide substantive comments. Treasury generally agreed with the report and its summary of the history of the Tied Aid War Chest, the legal authority for its use, and the past criteria to determine its use. It also stated that the scope of the report should have been broader. The comments we received and our evaluation of them are contained in appendixes IV and V. In addition, Treasury provided technical comments, which we incorporated in the report as appropriate.

Ex-Im Bank said that, while it does not agree with the report's characterization of the Bank's position or approach on some issues

[13]Although use of tied aid was approved, this case was never finalized, and Ex-Im Bank cancelled its offer in 2001.

identified in the report, it would not provide specific comments on the draft report. It stated that (1) its July 2001 agreement with Treasury on a new set of principles and procedures for administration of the Tied Aid Credit Program and (2) the signing into law of its reauthorization legislation, which modified its relationship with Treasury, had made the findings of this report not relevant to its future administration of the program. We believe it is important to provide transparency regarding the criteria used in decision making, as well as to explain how and why Ex-Im Bank and Treasury's differing approaches to using tied aid sometimes resulted in disagreement. Neither the July 2001 agreement between Ex-Im Bank and Treasury nor the recently enacted Ex-Im Bank reauthorization act changed this dynamic.

In addition, we were asked to clarify whether Treasury had veto authority in March 2001 when the decision-making process broke down. Between March and June 2001, Ex-Im Bank had changed its position regarding Treasury's veto authority, resulting in conflicting legal opinions between those agencies, which needed to be addressed.

Treasury, while generally agreeing with the report, stated that the scope of the report was too narrow. It said that the broader objectives of tied aid policy should have been analyzed. Our report was not intended to provide a comprehensive evaluation of the tied aid program, but rather to address the specific questions raised relating to Treasury's legal authority over the program and the problems with program administration.

Treasury raised three specific issues regarding the report. First, it said that we should not have included Ex-Im Bank's view that increased U.S. tied aid levels would not jeopardize the gains made at OECD on restricting tied aid use, without requiring Ex-Im Bank to justify this belief. We are reporting Ex-Im Bank's view, as clearly attributed in the report. Second, it objected to the statement on page 1 of the report that Treasury had vetoed two tied aid cases in March 2001. It said that this statement was misleading because it implied that Treasury had used its statutory authority to overturn two Ex-Im Bank Board decisions, while it had actually indicated its objections in advance of the Board vote. We do not believe our statement is misleading since we make clear in the report that, under the program legislation, Ex-Im Bank was required to comply with a Treasury recommendation not to fund a particular project, which in effect allowed Treasury a veto of tied aid proposals. In addition, we do not discuss the Board vote, its circumstances, or its timing, but merely describe the Ex-Im Bank and Treasury disagreement on the two applications and Treasury's objection to them. We do not intend any implication that Treasury's veto

occurred after the Ex-Im Bank Board vote, and we added a footnote to provide this clarification. Third, Treasury said it was misleading to state that half of the eight tied aid cases we examined were denied tied aid, because it might give the impression that Treasury alone denied tied aid in all four cases. Our statement that we selected eight cases to review, of which half were approved and half denied, is a simple statement of methodology. In order to prevent any misunderstanding that Treasury was solely responsible for denying these four cases, we added a statement to the detailed discussion of our findings related to these cases that, in three of the denied cases, there was no disagreement between the two agencies.

We are sending copies of this report to the Chairman of the Export-Import Bank, the Secretary of the Treasury, and other appropriate congressional committees. We will also make copies available to others upon request. In addition, the report will be available at no charge on the GAO Web site at http://www.gao.gov.

If you or your staff have any questions about this report, please contact me on (202) 512-4128. Additional contacts and staff acknowledgments are listed in appendix VI.

Sincerely yours,

Loren Yager
Director, International Affairs and Trade

Appendix I: Activity under the Tied Aid Program

Tied aid is government-to-government concessional financing of public-sector capital projects in developing countries that is linked to the procurement of goods and services from the donor country. Tied aid can distort trade when it is used to influence competitions for foreign government procurements rather than allowing those procurements to be decided on the basis of quality, price, or service. When a U.S. exporter is faced with tied aid use by a foreign competitor, the exporter can request assistance from the Export-Import Bank (Ex-Im Bank) by applying for tied aid financing to match the foreign offer.

Tied Aid Application Process

In the tied aid application process, Ex-Im Bank tries first to deter tied aid offers by foreign competitors. If the foreign tied aid offer is not deterred, depending on the stage of the offer, Ex-Im Bank can provide a number of different instruments with which to counter the foreign offer. These instruments consist of a letter of interest with willingness-to-match indication, a tied aid letter of interest, or a preliminary commitment. Approved tied aid cases have been accepted for tied aid matching; however, they do not become authorized cases until the U.S. exporter wins the bid. Ex-Im Bank financing packages for authorized cases generally include three options: a soft loan, a mixed credit, or a direct loan with 0 percent interest rate.

Once the U.S. exporter notifies Ex-Im Bank of the foreign tied aid offer and requests matching tied aid financing, the application process starts with a determination by Ex-Im Bank of whether the Organization for Economic Cooperation and Development (OECD) has been notified of the foreign tied aid offer. If it has not, Ex-Im Bank can propose a “no aid common line” at the OECD, requesting that other members agree not to offer tied aid for that particular project. If the proposal is rejected, Ex-Im Bank will start its internal process for reviewing the tied aid application.

The Ex-Im Bank Board of Directors must approve all applications for tied aid, in consultation with the Department of the Treasury (Treasury), and in accordance with Treasury’s recommendations. Both agencies determine whether the application has met the requirements of the tied aid program and review the application to ensure that the principles established by the Tied Aid Capital Projects Fund for using tied aid are met. If so, Ex-Im Bank can issue a letter of interest with willingness-to-match indication, a tied aid letter of interest, or a preliminary commitment, depending upon the evidence available (e.g., foreign government notification of tied aid offers to the OECD) to prove that a foreign government has made a tied aid offer.

Ex-Im Bank will approve a letter of interest with willingness-to-match indication when an OECD no aid common line has been rejected by other governments. The letter's purpose is to deter the foreign tied aid offer by showing the United States's intention to challenge the foreign competitor's source of advantage, the concessional financing, in the hope that tied aid will be withdrawn and the bidding continued on a commercial basis. It is not a tied aid offer but an indication of intent to match such an offer if necessary. Ex-Im Bank will consider approving a tied aid letter of interest if there is documentary evidence of a foreign tied aid offer—for instance, a bilateral tied aid protocol between the donor and recipient governments that identifies the project—but the OECD has not yet been notified of the offer. This letter offers to match a foreign offer with respect to the specific project, credit size, and equivalent financing terms. If a foreign tied aid credit offer of which OECD has been notified has cleared the OECD challenge and consultation process, Ex-Im Bank will consider approving a preliminary commitment—a formal offer that specifies the terms for financing. If the U.S. exporter wins the bid, and once the contract is signed with the recipient government and all financing requirements are met, a preliminary commitment can be converted directly to a final commitment to provide a tied aid credit.

It is important to note that in the tied aid lexicon, an approved tied aid case is one that has been found to meet the tied aid criteria and for which tied aid matching has been approved. A case can start at any one of the stages discussed above, depending on the circumstances of the foreign offer. Each time the case moves up a stage—for example, from letter of interest to preliminary commitment—the Ex-Im Bank Board of Directors, in consultation with Treasury and in accordance with Treasury's recommendations, must determine whether to approve the tied aid matching. However, the tied aid credit offer is not completed until the U.S. exporter wins the bid and signs the contract with the foreign recipient government. At that time, it is converted to a final commitment and is considered to be authorized. Thus, approved cases have been approved for tied aid matching but are still awaiting a decision by the purchasing government, whereas authorized cases have been finalized and funding has been provided for them.

Ex-Im Bank typically includes three options in its tied aid financing packages: a soft loan with a grace period, a mixed credit with a grant and a standard export credit component, and a direct loan with a 0 percent interest rate. For example, a soft loan with a grace period might mean a 25-year loan with a 5-year grace period and an interest rate of 3.66 percent. A mixed credit might comprise a grant for 35.23 percent of the contract price

and a 10-year direct loan for 64.77 percent of the contract price, with no grace period and 6.13 percent interest. The direct loan with a 0 percent interest rate might be structured with a 12.5-year loan with no grace period and 0 percent interest. All three options would have an overall concessionality level of roughly 35 percent, as required by the OECD.

Tied Aid Program Activity

According to our review of program data,[14] there have been 73 tied aid cases approved since 1991, as shown in table 2.[15] These cases may comprise letters of interest with willingness-to-match indication, tied aid letters of interest, preliminary commitments, and final commitments, approved at each stage by the Ex-Im Bank Board of Directors in consultation with Treasury. Individual cases may have stopped at any of these stages of application; the highest level reached is shown for each case. Of the 73 approved cases that Ex-Im Bank and Treasury agreed to (totaling $2.7 billion), Ex-Im Bank offered final commitments or authorizations in 26 cases.[16] The most active period of tied aid matching approval was from 1995 to 1997, with a total of 38 cases, representing 52 percent of all activity. After 1999, the number of cases dropped significantly. From January 1, 2000, through February 22, 2002, there were a total of 5 cases, or 7 percent of the total. In terms of tied aid results, U.S. exporters lost contracts in 51 percent of cases while winning contracts in 37 percent of cases. The outcome in the remaining 12 percent of cases was deferred or pending. The largest number of authorized cases was in 1996, with 9 authorizations for a total of $135.6 million. From January 1, 2000, through February 22, 2002, there were 2 authorized cases.

[14]We did not verify the accuracy of Ex-Im Bank's tied aid data, which was the best available information.

[15]In addition, there were 4 cases that went to the Ex-Im Bank Board of Directors and were denied approval.

[16]Of the 26 final commitments that were issued, 1 (Turkey, in 1998) was deferred.

Table 2: Tied Aid Activity, January 1, 1991–February 22, 2002

	Cases approved for tied aid matching				Tied aid competition results			Ex-Im Bank authorizations	
Year	Number of cases	Letter of interest with willingness to match indication or tied aid letter of interest	Preliminary commitment	Final commitment	Cases won by exporters	Cases lost by exporters	Cases deferred and pending	Number of authorizations	Amount authorized (millions)
2002	0	0	0	0	0	0	0	N/A	N/A
2001	2	0	0	2	2	0	0	2	59.23
2000	3	2	1	0	0	1	2[a,b]	0	0
1999	11	8	1	2	3	2	6[b]	2	34.52
1998	6	3	1	2	1	4	1[b]	2	36.78
1997	7	2	3	2	2	5	0	2	75.46
1996	18	2	7	9	9	9	0	9	135.59
1995	13	3	9	1	1	12	0	1	21.99
1994	2	1	1	0	0	2	0	0	0
1993	2	1	0	1	2	0	0	1	60.58
1992	2	0	1	1	1	1	0	1	12.98
1991	7	0	1	6	6	1	0	6	501.89
Total	**73**	**22**	**25**	**26**	**27**	**37**	**9**	**26**	**$939.02**

Legend: N/A = not available.

Note: There were also 4 cases for which tied aid matching was denied, which are not shown in this table.

[a]Pending.

[b]Deferred.

Source: Ex-Im Bank.

Figure 2 shows the distribution of countries for which tied aid matching was approved (the top part of the figure), as well as those for which it was authorized. China and Indonesia are the countries in which U.S. exporters encountered the most foreign tied aid use. Together, China and Indonesia accounted for 43 of the 73 approved cases, representing 59 percent of the total, and received 15 of the 26 authorizations, or 58 percent. However, after 1997, the year of the Asian financial crisis, there were only 2 cases of U.S. exporters attempting to counter foreign tied aid offers in Indonesia, and both were authorized. Also, starting in 1999, Ghana had the highest number of cases in which U.S. exporters were trying to compete against foreign tied aid credits (8 cases); of these, 3 cases were authorized. Ghana, as well as many other sub-Saharan countries, was going through economic reforms that prohibited it from receiving international financing on

nonconcessional terms, making the tied aid criteria requiring follow-on sales on commercial terms difficult to meet.

Figure 2: Distribution of Approved and Authorized Tied Aid Cases by Recipient Countries, January 1, 1991–February 22, 2002

Year	China	Indonesia	Ghana	Tunisia	Turkey	India	Pakistan	Morocco	The Philippines	Vietnam	Venezuela	Thailand
2002	0	0	0	0	0	0	0	0	0	0	0	0
2001	0	1	1	0	0	0	0	0	0	0	0	0
2000	1	0	1	0	0	0	0	0	0	1	0	0
1999	2	0	6	0	0	0	0	0	0	0	1	2
1998	2	1	0	1	1	0	0	1	0	0	0	0
1997	2	2	0	0	0	0	0	2	1	0	0	0
1996	10	5	0	2	0	0	0	0	1	0	0	0
1995	3	8	0	0	0	0	0	0	2	0	0	0
1994	1	1	0	0	0	0	0	0	0	0	0	0
1993	0	0	0	0	1	1	0	0	0	0	0	0
1992	0	1	0	1	0	0	0	0	0	0	0	0
1991	0	3	0	0	0	0	3	0	0	0	0	1
	21 / 8	22 / 7	8 / 3	4 / 1	2 / 1	1 / 1	3 / 3	3 / 1	4 / 0	1 / 0	1 / 0	3 / 1

Total approved cases
Total authorized cases

Source: Ex-Im Bank.

Appendix II: Application of Criteria for Matching Foreign Tied Aid Offers

After an extensive review of the principles established for using tied aid, including a review of eight selected case files and interviews with Ex-Im Bank and Treasury officials, we developed an outline of the tied aid decision-making process. The following conceptual framework shows how the established criteria for matching foreign tied aid offers were applied during the May 1999 to July 2001 period. This period followed the 1999 tied aid policy review's expansion of the criteria for matching, and it preceded the two agencies' establishment of formal consultation procedures and a new, more concise statement of tied aid principles in the aftermath of the March 2001 dispute.

U.S. tied aid policy allows foreign tied aid offers to be matched under three basic circumstances:

1. To support international negotiations aimed at reducing trade distorting aid (tied aid can also be initiated under these circumstances).

2. To police compliance with the OECD tied aid rules.

3. To protect U.S. exporters when foreign aid that meets OECD rules would nevertheless undermine the exporters' competitive position for winning future commercial sales.

The following outline presents specific criteria that have been developed for matching foreign tied aid offers under the third circumstance.

I. U.S. response to foreign tied aid when U.S. exporter is *not* involved

A. Confirm tied aid eligibility of project under OECD rules

- Apply 35 percent minimum concessionality rule (50 percent for least developed countries)
- Apply country eligibility rules (no "wealthy" countries or certain Central and Eastern European/Newly Independent State countries)
- Determine project eligibility (no "commercially viable" projects)
  - Refer to OECD's Ex-Ante Guidance and recent tied aid consultations decisions; evaluate project on its merits
  - Make exception for de minimus projects (less than about $2.6 million)
- Make overall exception for projects with concessionality level of 80 percent or higher

B. If project appears ineligible, "challenge" project within OECD, perform detailed technical analysis to refute foreign analysis, debate foreign technical expert in presence of other OECD members

- If OECD declares project ineligible, project cannot receive tied aid (except via rarely used procedure requiring involvement of Ministry-level official)
- If OECD declares project eligible, project proceeds with tied aid

II. U.S. response to foreign tied aid when U.S. exporter is involved

A. Confirm whether foreign government has notified OECD of tied aid, as required

- Search OECD tied aid notifications
- Query foreign governments, as necessary
- If foreign government has not yet notified OECD of tied aid
  - Query foreign government, as appropriate, on U.S. exporter's allegation of tied aid
  - Request, as appropriate, "No Aid Common Line" to ensure that OECD members refrain from offering tied aid for that particular project

B. If OECD tied aid notification is located, or "No Aid Common Line" rejected, consider whether to issue Ex-Im Bank Willingness-to-Match Tied Aid Indication based on criteria below

III. U.S. determination whether to match eligible foreign tied aid offer

A. Screen tied aid matching request for national trade and economic interest (required by Congress)

B. Recipient country must qualify as a "dynamic market"

- Annual gross national product (GNP) greater than $5 billion *and* a majority of the following tests must be met:
  - Average GNP per capita growth of greater than 1.5 percent
  - Investment as a percentage of gross domestic product greater than 1 percent
  - Foreign direct investment as a percentage of GNP less than 2 percent
  - Net aid flows as a percentage of GNP less than 2 percent
  - Private investment as a percentage of gross domestic fixed investment greater than 60 percent

- Special "dynamic market" criteria for Africa
  - Ex-Im Bank open for cover in the public sector
  - Country is not a least developed country (requiring at least 50 percent concessionality)
  - Average GNP per capita growth of greater than 1.5 percent

C. "Follow-on sales" requirement

- Tied aid sale should generate substantial follow-on sales in the recipient or neighboring country that are expected to be financed on *commercial* terms. Follow-on sales of identical or reasonably similar equipment should be attributable to the tied aid sale (e.g., through brand and performance preference, technical standards compatibility, etc.)
- Follow-on sales may also be considered to exist when any of the follow conditions are met:
  - International financial institutions are active in financing the sector
  - Project would be considered commercially viable were it located elsewhere (e.g., rural vs. urban setting)
  - Sector is undergoing a credible privatization process
  - Project will require fairly significant expenditure on imported spare parts that would be financed out of current revenues or on commercial terms
- Follow-on sales requirement will be applied less stringently to U.S. small business exporters

D. Budget cost should normally not exceed 50 percent

E. Project must be environmentally sound

F. Willingness of U.S. exporter to cover exposure fee will be a positive factor

Appendix III: Objectives, Scope, and Methodology

The Chairman of the Subcommittee on International Monetary Policy and Trade asked us to examine the nature of the Department of the Treasury's (Treasury) authority over the use of tied aid and the underlying reasons for the breakdown in the decision-making process between the Export-Import Bank (Ex-Im Bank) and Treasury in March 2001. To address these concerns, we assessed (1) whether Treasury had a statutory veto over the use of Ex-Im Bank's Tied Aid Capital Projects Fund, (2) what the principles were for using tied aid, and (3) how Ex-Im Bank and Treasury applied these principles.

To determine whether Treasury had a statutory veto over Ex-Im Bank's use of the Tied Aid Capital Projects Fund, we examined the legislation establishing the fund and its legislative history, as well as relevant Ex-Im Bank and Treasury documents.

To identify the principles for tied aid financing that were in effect in March 2001, when Ex-Im Bank and Treasury disagreed on the two tied aid applications, we interviewed Ex-Im Bank and Treasury officials and reviewed tied aid policy and procedures documents from the Ex-Im Bank Policy and Planning Division. We also conducted a historical review of the tied aid policy to develop a better understanding of the policy in effect in March 2001. In addition, we reviewed the tied aid rules set by the Organization for Economic Cooperation and Development (OECD) to understand the international context in which the U.S. tied aid policy principles were developed.

To understand the application of the tied aid principles, we reviewed eight tied aid cases. We interviewed Ex-Im Bank and Treasury officials to gain their perspective on how the tied aid principles were applied and how the interagency decision-making process functioned. In addition to reviewing the two cases cited in the request, we selected six other cases to establish a broader basis for analysis. This provided us with the needed additional perspective, when examining the way that the criteria were applied and the consultation procedures were followed, as to whether and how the actions in the two cases cited in the request might differ from those cited in other cases. We selected cases that were reviewed under the criteria established by the interagency tied aid policy review of 1999, so that they would all be subject to the same decision-making criteria. Of the eight cases, four were approved and four were denied. We included five cases involving China and Ghana, the recipient countries in the two cases cited in the request, so that we could review cases that had been both approved and denied for each country. The remaining three cases involved three other countries: Indonesia, Uzbekistan, and Senegal. We also interviewed

representatives from the companies involved in the eight cases to obtain their perspectives on the application of U.S. tied aid policy.

We performed our work from September 2001 through May 2002 in accordance with generally accepted government auditing standards. We spent 2½ months negotiating access to tied aid files at Ex-Im Bank from October to mid-December 2001.

Appendix IV: Comments from the Export-Import Bank

EXPORT-IMPORT BANK
OF THE UNITED STATES

June 19, 2002

Loren Yager
Director, International Affairs and Trade
General Accounting Office
441 G Street, N.W.
Washington, DC 20548

Dear Mr. Yager:

Thank you for the draft GAO report entitled "Export Promotion: Export-Import Bank and Treasury Differ on Approach to Using Tied Aid" (GAO-02-741). As the draft report mentions, in July 2001, the Export-Import Bank and the Department of Treasury reached agreement on a new set of principles and procedures for administration of the Tied Aid Credit Program, which principles and procedures were provided to the Congress. In addition, last week, the President signed the Export-Import Bank Reauthorization Act of 2002 which made changes to the legislative provisions governing the use of the tied aid credit fund including clarification of the Bank's authority to make the final case-by-case decisions on the use of the tied aid credit fund subject to a Presidential determination.

As a result of these developments over the past year, most of the substance of this report has been overtaken by events or is otherwise not relevant to the program as the Bank moves forward with the Department of Treasury on a cooperative basis to implement the new interagency agreement and new amendments. In particular, the report focuses on past criteria and issues of legislative authority that are no longer applicable.

While the Bank does not agree with the draft report's characterization of the Bank's position or approach on some of these issues, the Bank is not providing specific comments on the draft report given the recent developments. Rather, the Bank looks forward to working with the Department of Treasury and the Congress to administer the tied aid credit fund under the revised legislation.

Sincerely,

James K. Hess
Chief Financial Officer

Appendix V: Comments from the Department of the Treasury

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

June 21, 2002

Loren Yager
Director, International Affairs and Trade
U.S. General Accounting Office
441 G Street, N.W.
Washington, D.C. 20548

Dear Mr. Yager:

Thank you for providing the opportunity to comment on GAO's draft report entitled, "Export Promotion: Ex-Im Bank and Treasury Differ in Approaches to Using Tied Aid." You and your staff did a good job of summarizing the history of the Tied Aid War Chest, the legal authority for its use, and the past criteria to determine its use. The Administration strongly believes that the interests of all US exporters are maximized by international competition that is market-based, not subsidy-based. Market-based competition is also optimal for the overall efficiency of the international economy, and is clearly the best policy for the U.S. taxpayer. Therefore, Treasury has consistently worked to build an international trading system that provides US exporters a level playing field by reducing the scope for subsidies from government sponsored institutions that distort markets. Treasury is proud of its success in limiting subsidies through the OECD tied aid disciplines and will not only continue to enforce them but also to expand them to untied aid and to any other forms of subsidies that develop over time.

U.S. tied aid policy is much broader in scope than the three specific questions on tied aid matching policy that GAO was asked to examine in its report. However, in assessing this subset of U.S. tied aid policy, the report fundamentally concludes that the principal difference between Treasury's and Ex-Im Bank's approach to matching foreign tied aid offers is that Treasury approaches the use of tied aid from a strategic perspective while Ex-Im Bank approaches it from a transactional perspective. We agree with this assessment and believe that it is important to include the broader policy backdrop to the report's findings in order to provide a better understanding of why Treasury must take a strategic approach in the use of this taxpayer-subsidized financing to achieve systemic market-opening benefits for all U.S. exporters. It is important to provide this broader policy perspective to better appreciate the few specific comments we have on the report.

History of Tied Aid

Tied aid first arose as a major competitive issue in the early 1980s. Other governments used tied aid to subsidize financing for large capital goods projects in developing countries, and thereby distorted trade. The volume of tied aid grew to $10-12 billion annually. The U.S. was therefore faced with two fundamental choices: 1) either seek to negotiate limitations on the use of foreign tied aid; or 2) operate its own tied aid export promotion program. Under the guidance of the NSC, the Reagan Administration concluded that the fundamental U.S. policy objective of free market-based export competition, coupled with the high budget cost of a U.S. tied aid program,

necessitated a negotiated solution to the tied aid problem. And every Administration since has shared this assessment, taking a systemic negotiations-based approach to disciplining the use of tied aid in order to achieve the maximum collective benefit for all U.S. exporters and taxpayers.

Using as leverage the Tied Aid Credit Fund (War Chest) provided by Congress in 1986 expressly for tied aid negotiations, the U.S., led by Treasury, made strong political representations to other governments. Coupled with a U.S. negotiating strategy that emphasized pressing a pro-market-opening, pro-development tied aid discipline philosophy, the U.S. successfully initiated negotiations in the OECD in the mid-1980s and again in 1989. The tied aid compromise reached with other governments in 1992, after almost three years of grueling negotiations, was groundbreaking. This is because, for the first time, agreement was reached to draw an objective line between the types of projects that would be viewed as inherently commercial (commercially viable) and therefore reserved for market rate financing, and projects that would be viewed as inherently not commercial (commercially non-viable) and therefore permitted to receive tied aid financing for development objectives. This represents a major compromise by some of the largest aid donors that view commercially viable projects, such as large-scale capital projects, as providing the greatest development benefits. Seen from the perspective of tied aid donors, the OECD agreement provides that if they no longer offer tied aid financing for commercially viable projects, they are free to pursue their development objectives through commercially non-viable projects. This compromise agreement, like all OECD agreements, is not legally binding and its continued successful implementation requires the ongoing cooperation of our OECD partners.

Success of Tied Aid Policy

This cooperation has produced a major trade policy success. Since 1993, cumulative tied aid trade distortions have been reduced by at least $50 billion and, as a direct result, U.S. capital goods exports financed without U.S. subsidies are estimated to be $1 billion higher each year ($9 billion over 1993-2000) than they would have been without the tied aid agreement. The magnitude of this achievement is illustrated by the fact that if, in the absence of this agreement, the U.S. had to compete for these additional exports with tied aid, Ex-Im Bank would have required an additional $300 million in annual appropriations – a savings to the taxpayer of almost $3 billion since 1993.

Further evidence of the success of the OECD tied aid agreement is the dramatic decline of tied aid offered by the primary donors of tied aid at the time of the 1989-1992 negotiations (all OECD members except Japan). In 1991, they provided 93% of all tied aid and offered $8.8 billion of such aid. In contrast, these donors offered only $1.5 billion of tied aid last year – an 83% reduction and the lowest level of tied aid offers on record. Total tied aid last year, while less than 40% of its 1991 level, is now dominated by Japanese tied aid. The large increase in Japanese tied aid primarily represents the shift of a large portion of its aid from untied to tied form, and therefore a shift from a form of potentially trade distorting aid not currently covered by OECD agreement to a form that is covered. Increases in Japanese tied aid should not be seen as offsetting the massive declines in non-Japanese tied aid when analyzing tied aid volumes.

In addition, the tied aid that remains is concentrated in what are generally recognized as bona fide development sectors – social sectors such as health, education, water, and in rural

infrastructure, renewable energy and agriculture. Tied aid for major power, telecommunications, energy pipelines, manufacturing, industrial and other commercial projects is now prohibited by the OECD compromise agreement. These results clearly demonstrate that U.S. commercial negotiating objectives have been met by the OECD tied aid agreement, and the benefits for exporters and the U.S. economy have been substantial and have been achieved at very little budget cost. In addition, the quality of development assistance has been improved by the reallocation of aid financing in favor of social sector projects, while allowing for a much greater role for market financing in the development process.

Treasury Tied Aid Strategy

With our initial tied aid anti-trade distortion objectives largely met, the key and interrelated policy priorities for Treasury are to: 1) preserve the existing tied aid agreement and its market-opening benefits for all U.S. exporters and taxpayers; 2) secure disciplines on the use of so-called untied aid that creates systemic trade distortions that close markets and disadvantage U.S. exporters; and 3) ensure that the tied aid that remains is used for bona fide development purposes and not to provide longer-term commercial advantages to foreign exporters. It is the implementation of this third policy objective that gives rise to the study that GAO was commissioned to analyze.

Because it is responsible for managing overall U.S. tied aid policy, Treasury must strategically balance all three objectives. Therefore, if it is to be successful in pursuing the first two objectives aimed at the systemic opening of foreign markets to U.S. exporters, Treasury is necessarily accountable to our OECD partners/competitors for USG decisions with regard to the third objective – involving the use of U.S. tied aid matching subsidies. Therefore, Treasury believes that this matching must be compatible with the fundamental tied aid compromise in the OECD agreement. It must focus on countering trade distortions and not undermine development assistance programs. Otherwise, the U.S. will not be seen as a reliable negotiating partner and will not be in a position to protect the existing OECD agreement on tied aid. Aid Ministries in other governments are politically powerful and will not allow the U.S. to maintain tied aid rules that dramatically reduce the scope for tied aid financing and then, for short-term commercial benefit, attempt to displace anticipated sales related to the development projects that remain.

This strategic approach is also critical because the expansion of OECD rules to include untied aid, as mandated by Congress in Ex-Im Bank's reauthorization legislation, will require the strong support of existing tied aid donors. Treasury is actively working to build support in the OECD for untied aid rules and, therefore, it is critical that U.S. decisions on matching tied aid be fully defensible within both the letter and spirit of the tied aid agreement.

It is thus for multilateral negotiating credibility to open foreign markets, and for domestic budget discipline that Treasury seeks to ensure that War Chest matching is focused on tied aid that is likely to provide foreign firms with competitive advantages in future commercial competitions. Such foreign tied aid offers can be viewed as trade distorting and therefore outside of the intent of the tied aid rules. In these cases, matching can be fully justified within the OECD agreement. This necessarily means that Treasury cannot support matching tied aid offers that have little

impact on future commercially-financed sales without appearing to attack legitimate, non-trade distorting foreign aid programs for narrow commercial benefit. Such actions seriously undermine U.S. negotiating credibility and the continued cooperation of foreign governments to limit the use of their tied aid and open foreign markets. Since the strength of the tied aid rules must be reconfirmed in each case the U.S. challenges in the OECD, the loss of other governments' support for these rules would quickly lead to the U.S. losing these challenges, thereby reversing tied aid case law, and rapidly lead to a substantial increase in the level of tied aid that would likely not be reversible. With Japan now a major tied aid donor and actively seeking to weaken the tied aid rules itself, the U.S. can no longer expect the support it provided earlier in securing the current level of disciplines.

Treasury's broader policy responsibility for tied aid is at the heart of the different emphasis placed on follow-on sales by Treasury and Ex-Im Bank. Since Ex-Im Bank does not have the responsibility for U.S. tied aid policy, but rather has a general mandate to keep exporters competitive in individual transactions, it places greater emphasis on assisting the individual exporter in the individual transaction.

Finally, in assessing the potential for follow-on sales (synonymous with the concept of economic benefits referred to in the report) that could be expected to result from U.S. tied aid matching policy, Treasury also weighs these additional exports/benefits against the expenditure of taxpayer-financed export subsidies. Tied aid requires that about one third of the project's value be provided as a grant from the donor government to the recipient government. This is an extremely costly way to support U.S. exports and must be carefully justified. Treasury seeks to ensure that War Chest subsidies are used to protect the broader market position of U.S. exporters and that the use of these subsidies does not devolve into a de facto, ad hoc U.S. subsidized export promotion program in competition with foreign development ministries. This would not only undermine the U.S. anti-trade distortion policy agenda, but it would also undermine U.S. credibility in the area of development assistance policy.

Specific Comments on Report

There are three issues that I would like to highlight. First, as noted in the report, Treasury has the policy lead on tied aid within the Administration and takes a strategic approach to tied aid matching, while Ex-Im Bank approaches tied aid matching from a narrower, transactional viewpoint. Therefore, we do not believe it is appropriate to include in the report an Ex-Im Bank staff view that dissents from Treasury's strategic assessment of the impact of U.S. matching policy on OECD negotiations without requiring a detailed explanation of the reasoning behind that view.

The second is the characterization that Treasury and Ex-Im Bank disagreed on two particular tied aid cases in March 1, 2001, and Treasury (then) "vetoed" the projects. This is misleading because it implies a sequence of events that is incorrect. We strongly feel that the record should be clear that Treasury staff clearly indicated its objections before the Exim board voted on the cases in question and, indeed, in all other cases. Treasury has always provided its advice prior to a board decision. In this case, the Secretary of the Treasury himself wrote a letter recommending against the use of tied aid, and this recommendation was provided *in advance of* Board action,

not after it. Treasury took no further action after the Board approved the tied aid cases. It should be made clear that Exim wrote to the company and declined to support their application because Ex-Im Bank's General Counsel at that time recognized that the Board's action to approve the cases was *ultra vires,* having been taken in violation of Section 10(b)(2)(A) of Ex-Im Bank's charter. These facts are in sharp contrast to the characterization of Treasury having used its statutory authority to overturn two Ex-Im Bank Board decisions. Furthermore, when follow-sales potential for one of these projects was confirmed, Treasury withdrew its objection to that project, thereby ratifying the action of the Ex-Im Board with respect to that project.

The third issue is that, in the context of a report about disagreements between Treasury and Ex-Im Bank over the use of tied aid, it is also perhaps misleading to state that half of the eight cases examined by GAO were denied tied aid. This may give the impression that Treasury alone denied tied aid in all four of those cases, over the objection of Ex-Im Bank. However, this is not the case. Of the four cases where tied aid was denied, Ex-Im Bank staff, based on its own analysis, actually recommended against approval independently of Treasury. We suggest that you clearly indicate that in three of these four sample cases, as well as in vast majority of all cases, Exim agreed with Treasury's positions.

In conclusion, Treasury can support the report as a whole but would prefer a more detailed discussion of the whole range of policy issues described earlier. Specifically, the trade-offs between the three policy objectives described above need to be assessed in evaluating any use of the War Chest. In this vein, such a study should incorporate not only the major successes achieved by the Administration in reducing tied aid export subsidies (thereby opening new markets to U.S. exporters without the ongoing need for taxpayer-financed subsidies), but also the risk that the OECD disciplines could be undermined if other countries perceive any one country taking advantage of the OECD agreement. Thank you again for the opportunity to share our views.

Sincerely,

Joseph L. Engelhard

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Appendix VI: GAO Contacts and Staff Acknowledgments

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In addition to those listed above, Jose Martinez-Fabre, Ernie Jackson, Martin De Alteriis, Lynn Cothern, and Reid Lowe made key contributions to this report.

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