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INTERNATIONAL TRADE

U.S. Efforts to Counter Competitors' Tied Aid Practices

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INTERNATIONAL TRADE: U.S. EFFORTS TO COUNTER COMPETITORS' TIED AID PRACTICES

SUMMARY OF STATEMENT BY JAYETTA Z. HECKER, DIRECTOR INTERNATIONAL TRADE, FINANCE, AND COMPETITIVENESS GENERAL GOVERNMENT DIVISION

Competitors' tied aid practices are of concern to the United States when those practices can cause trade distortions. Such interference in market decision-making can distort recipient countries' development decisions and place U.S. exporters at a competitive disadvantage. Recognizing the difficulty of determining whether exports associated with tied aid would have occurred even without that tied aid, GAO estimated that the potential loss of U.S. exports because of the tied aid practices of U.S. competitors could have been as high as $1.8 billion per year during 1989-91. However, some studies have pointed out that the greatest impact on the United States of competitors' tied aid practices involves losses in potential long-term opportunities that could result from U.S. businesses' exclusion from certain overseas markets.

U.S. trade policy has generally been to oppose tied aid and, through international negotiations, dissuade U.S. competitors from using it. A 1992 Organization for Economic Cooperation and Development (OECD) agreement strengthened previously established guidelines to discourage the use of trade-distorting tied aid. For 2 years following the agreement's implementation, the U.S. Export-Import Bank's (Eximbank) policy was to use its "war chest" (a fund for responding to other countries' tied aid practices) only to enforce the agreement. Under the new policy for the war chest, renamed the "Tied Aid Capital Projects Fund," Eximbank is to become more actively involved than before in trying to deter tied aid at an earlier stage in a project's development. Eximbank may now issue tied aid "willingness to match" indications and "letters of interest," which are contingent commitments to match foreign tied aid should it be offered.

Early evidence that the OECD agreement and the Tied Aid Capital Projects Fund have reduced trade-distorting tied aid is encouraging. For example, one initial indicator of progress is that the total value of tied aid notifications reported to OECD for 1993 and 1994 is substantially below the level reported for 1992. However, the new agreement and Eximbank's new policy have not been in effect for a sufficient period to permit an analytical assessment of their impact.

Mr. Chairman and Members of the Subcommittee:

I am pleased to be here today to testify before this Subcommittee on the issue of tied aid and the U.S. Export-Import Bank's (Eximbank) response, including its Tied Aid Capital Projects Fund. "Tied aid" refers to foreign assistance that is linked to the purchase of exports from the country extending the assistance. Tied aid can consist of (1) foreign aid grants alone, (2) grants mixed with commercial financing or official export credits ("mixed credits"), or (3) concessional (low-interest-rate) loans.

In my testimony, I will discuss (1) the harm that foreign tied can cause U.S. exporters, (2) U.S. efforts to address this problem, and (3) our initial observations on the effectiveness of the U.S. efforts.

My statement today is an update of our May 1994 report, International Trade: Competitors' Tied Aid Practices Affect U.S. Exports,[1] and our May 1994 testimony before the House Foreign Affairs Committee, Subcommittee on Economic Policy, Trade and the Environment.[2]

TRADE-DISTORTING TIED AID CAN BE HARMFUL TO U.S. INTERESTS

Competitors' tied aid practices are of concern to the United States when these practices can cause trade distortions. These distortions may occur when contract awards for overseas projects are based on the availability of such subsidies, instead of on the price and quality of the goods or services exported. Such interference in market decision-making can distort recipient countries' development and place U.S. exporters at a competitive disadvantage in bidding on projects.

While it is difficult to determine the impact of tied aid on the U.S. economy, in our May 1994 report we estimated that the potential loss of U.S. exports because of the tied aid practices of U.S. competitors could have been as high as $1.8 billion per year during 1989-91. We arrived at this figure by updating a methodology that Eximbank previously used to estimate the U.S. exports potentially lost due to tied aid for 1984-87. We used the most current data we could obtain from the Organization for Economic Cooperation and Development (OECD).[3] Our analysis estimated the additional U.S. exports that would have occurred if U.S. exporters had captured their historical market share of capital goods for all tied aid-supported projects.

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[1]International Trade: Competitors' Tied Aid Practices Affect U.S. Exports (GAO/GGD-94-81, May 25, 1994).

[2]International Trade: Combating U.S. Competitors' Tied Aid Practices (GAO/T-GGD-94-156, May 25, 1994).

[3]OECD is a forum for monitoring economic trends and coordinating economic policy among its 24 member countries, which include the economically developed, free market democracies of North America, Western Europe, and the Pacific.

This analysis relied on two key assumptions that have opposite yet unquantifiable effects on the size of the estimate. The first assumption was that recipient nations would have bought the same amount of capital goods with or without tied aid. If, however, recipient nations were to buy fewer capital goods due to the absence of tied aid, the estimate would likely overstate the potential loss to U.S. exporters. The second assumption was that U.S. companies would not have had a higher market share in these nations in the absence of foreign tied aid. If, instead the U.S. market share in each region would have been larger in the absence of other countries' tied aid, then our analysis would underestimate the potential loss to U.S. capital goods exports.

However, some studies have pointed out that the greatest impact on the United States of competitors' tied aid practices involves losses in potential long-term opportunities that could result from U.S. businesses' exclusion from certain overseas markets. Tied aid capital projects have tended to be in technology-intensive, competitive industries. When competitors' tied aid prevents U.S. firms from participating in these capital projects (especially telecommunications and energy projects), the United States may miss opportunities to establish itself in high-growth, developing country markets where U.S. exporters could make substantial follow-on sales using commercial financing terms. Also, the U.S. firms would likely be denied related exports such as maintenance equipment and replacement parts required for upkeep once projects have been completed.

U.S. EFFORTS TO ADDRESS THE TIED AID PROBLEM

The United States has used a two-pronged strategy to prevent trade-distorting tied aid: (1) negotiating multilaterally within OECD to restrict tied aid's use and (2) authorizing funds for maintaining a capability to match and thus deter tied aid not prohibited by an agreement but still harmful to long-term U.S. interests. The United States has also attempted to address concerns over untied aid that could implicitly or actually be tied.

The OECD Agreement

U.S. trade policy generally has opposed trade-distorting tied aid. Consequently, the United States has sought, through international negotiations, to dissuade our competitors from using it. Since the early 1980s, the United States has negotiated a series of increasingly stronger versions of the "Arrangement on Guidelines for Officially Supported Export Credits" within OECD to restrict the use of trade-distorting tied aid.

The most recent OECD agreement, sometimes called the "Helsinki agreement," became effective in February 1992. The agreement did not attempt to eliminate tied aid but instead to minimize the trade distortions that could arise from its use. The 1992 agreement is designed to (1) prohibit the use of tied aid for projects in countries whose per capita income was sufficiently high to make them ineligible for 17- or 20-year loans from the World Bank;[4] (2) restrict the use of tied aid for

[4]Examples of countries in this category are Argentina and Kuwait.

commercially viable projects (except for least-developed countries);[5] and (3) increase transparency (openness) about tied aid use by strengthening notification and consultation procedures.

Under the terms of the 1992 agreement, a participating member country planning to use tied aid must "notify" OECD. The agreement provides for a consultation process, during which other member countries may challenge the notifying country's tied aid offer if they believe it does not meet the agreement's guidelines. Once challenged, the initiating country must justify to the member countries opposing the offer the use of tied aid on developmental grounds and show how the project does not meet the "commercial viability" test. A project is considered to be commercially viable if it is able to generate cash flow sufficient to cover the project's operating and capital costs or if it can be financed by the private market or official export credits.

If other countries are not satisfied with the justification, the offer may fail to win the substantial support of the member countries opposing the offer, in which case the donor may withdraw the offer. The donor country can, however, still decide to go forward with its offer, if it provides a "derogation letter" to the OECD Secretary-General, citing non-trade-related national interest reasons for opting not to follow the 1992 agreement guidelines.[6]

The agreement also requires that participating members notify OECD of "untied" aid offers, which member countries may also challenge if they believe such offers are actually tied. Untied aid consists of loans or grants that are freely and fully available to finance procurement from substantially all developing countries and from OECD countries.

While the framework that the OECD agreement established constrained some of the most trade-distorting tied aid, as we said in our May 1994 report, the agreement did not prohibit certain tied aid that is harmful to long-term U.S. interests. In the rest of my testimony, I will discuss ways in which the United States is trying to address this problem, and how the progress of these efforts can be evaluated.

The War Chest and the Tied Aid Capital Projects Fund

In 1986, Congress authorized Eximbank to create a "war chest" fund to counter other countries' use of tied aid offers. During fiscal years 1987-91, the years before the 1992 OECD agreement on tied aid was signed, 1991 was the only year in which Eximbank spent nearly all of the funds appropriated for the war chest. For about 2 years after the treaty became effective, Eximbank's policy was to react to derogations, which meant that it would activate the war chest solely to

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[5]Examples of least-developed countries are Afghanistan and Bangladesh.

[6]"Derogations" are cases in which the countries making the tied aid offers have proceeded with their offers, despite a decision by OECD Helsinki agreement participants that the offers do not conform to the rules of the agreement.

enforce the OECD agreement. As we reported in 1993 and 1994, even if a competitor's tied aid offer conformed to the rules of the agreement, opportunities for U.S. exporters could still be affected. U.S. exporters may have been hurt by the inability to access funds to combat competitors' use of tied aid that was in conformity with the 1992 OECD agreement. In addition, because Eximbank's approach was reactive, no process was established to identify capital projects in developing countries early enough for U.S. exporters to bid on them.

In early 1994, the administration announced a new policy for responding to competitors' tied aid. It proposed a new fund to replace the war chest fund, called the "Tied Aid Capital Projects Fund." Under the new policy, the fund can be used to counter tied aid offers that the OECD agreement permits but that nonetheless are damaging to U.S. interests. The Tied Aid Capital Projects Fund was authorized $200 million in fiscal year 1993, $50 million in fiscal year 1994, and $100 million in fiscal year 1995. At the end of fiscal year 1994, Eximbank had $171 million in "carryover" from prior years' Tied Aid Capital Projects Fund that could be used in any year.

Under the new policy, Eximbank is to become more actively involved than before in trying to deter tied aid at an earlier stage in a project's development. Eximbank may now issue tied aid "willingness to match" indications and "letters of interest," which are contingent commitments to match foreign tied aid should it be offered. These letters also can allow U.S. firms to continue to negotiate in the face of potential competition backed by tied aid. The "willingness to match" indication is an innovation designed to meet exporters' concerns that Eximbank required too much documentation before issuing tied aid letters of interest.

U.S. Efforts to Resolve the Issue of Untied Aid

As we said in our May 1994 report, a number of U.S. trade officials, exporters, and experts in the field have expressed concern that some of the "untied" aid reported to OECD could implicitly or actually be "tied." These concerns are important because notifications of untied aid offers have increased substantially since the 1992 OECD agreement was signed. In June 1994, Eximbank reported to Congress that untied aid offers rose from $6.2 billion in 1992 to $12.1 billion in 1993. An Eximbank official told us that the increase in untied aid was due in part to new OECD reporting requirements that expanded the amount of foreign aid reported.

Studies indicate that there are ways that donor countries can implicitly tie their aid and still meet OECD criteria for being untied aid. One way is through funding feasibility studies, which determine the technical, economic, and financial viability of a project. For example, the United States might fund a feasibility study on the premise that if a U.S. firm performs the feasibility study, other U.S. firms will be in a more competitive position to win procurement and/or construction contracts and thus generate U.S. exports. However, as we reported in May 1994, while the United States performs feasibility studies through the Trade and Development Agency (TDA), the TDA budget is limited to $40 million, compared with the Japanese budget of $200 million for feasibility studies.[7]

Another way that aid can be implicitly tied is through joint ventures between contractors from a developing country and a donor country. For example, while a donor country may report a project as officially untied because a developing country's contractor was awarded the contract, the developing country's contractor could have a joint venture with a contractor in the donor country. Often the contractor from the donor country is the controlling partner of the joint venture and will subsequently benefit through increased exports.

In a June 1994 report to Congress,[8] Eximbank stated that the U.S. government was working with other OECD members to achieve greater transparency in the financing, bidding, and procurement procedures associated with untied aid credits (both Japanese and other). The U.S. goal is to assure greater access by non-national suppliers, including U.S. suppliers.

INITIAL OBSERVATIONS ON U.S. TIED AID POLICIES

Early evidence that the 1992 OECD agreement and the Tied Aid Capital Projects Fund have reduced trade-distorting tied aid is encouraging. However, it is too soon to fully evaluate their impact: the OECD agreement has been in effect for about 2 years, and the new Tied Aid Capital Projects Fund has been in place for about 1 year. Moreover, OECD data regarding projects for which tied aid was actually provided (as opposed to intending to be provided) are current only through 1992. These data would not reveal the impact of the 1992 OECD agreement or the 1994 Tied Aid Capital Projects Fund. Therefore, in the absence of more recent data, I would like to discuss other indicators of the potential impact of U.S. policies to combat trade-distorting tied aid practices.

There is evidence that suggests the U.S. government's tied aid policies may be making progress in combating tied aid that harms U.S. interests. In the first full year after the OECD agreement was signed, the total value of notifications of tied aid offers that member countries reported to OECD fell substantially, from $15.5 billion in 1992 to $7 billion in 1993. For 1994, reported tied aid offers rose to about $8.1 billion, an amount still well below the 1992 figure. If OECD definitions

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[7]Although the amounts spent on feasibility studies are relatively small, such studies can lead to contracts for follow-on work, such as architectural and engineering design, project management during the construction phase, or work on unrelated projects. For more on TDA's role in this area, see U.S. Trade and Development Agency: Limitations Exist in its Ability to Help Generate U.S. Exports (GAO/GGD-94-9, Oct. 20, 1993).

[8]Export-Import Bank of the United States: Report to the Congress under Section 15(g) of the Export-Import Bank Act of 1945, as Amended (June 15, 1994).

of tied aid are sufficient to capture all the tied aid being offered, and all countries are accurately reporting their tied aid, the drop in tied aid notifications would indicate a reduced tied aid problem for the United States.

There is also other evidence that suggests progress. It appears tied aid is being used less frequently by donor countries to enhance their competitive advantage. According to an Eximbank official, recent notifications to OECD of tied aid offers suggest a shift in the proportion of tied aid offers from highly competitive industries such as telecommunications and energy, and in middle-income developing countries (e.g., China, Indonesia, and India) to rural, smaller-scale projects, in social service sectors. Finally, according to an Eximbank official, complaints from U.S. companies to Eximbank about foreign government use of tied aid have fallen.

While the early indicators are promising, hard data on tied aid that was actually provided in 1993-94 are not presently available. Moreover, large capital projects require long periods of time to plan--businesses have said as long as 2 or 3 years. Therefore, in about 3 years, a clearer assessment of U.S. efforts to combat tied aid may be possible since the Eximbank's policy will have been in place for an entire project planning cycle.

CONCLUSIONS

Although it is too early to determine the effect of the U.S.' tied aid strategy, we believe there are initial indications of progress. U.S. officials have negotiated to establish successively stronger international agreements to restrain trade-distorting tied aid. Specifically, the 1992 OECD agreement is an improvement because it (1) prohibited tied aid use in richer, developing countries; (2) restricted the use of tied aid for commercially viable projects (except for least-developed countries); and (3) increased transparency (openness) about tied aid use by strengthening notification and consultation procedures.

In addition, the Eximbank's new policy better addresses some of the limitations of the OECD agreement by providing greater assurance that exporters can expect earlier U.S. government support to counter competitors' tied aid offers. This policy benefits U.S. exporters by allowing them to continue to negotiate in the face of potential competition backed by tied aid.

Nevertheless, while the initial indicators are encouraging, the new agreement and the Eximbank's new policy have not been in effect for a sufficient period to permit an analytical assessment of their impact.

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Mr. Chairman and Members of the Subcommittee, this concludes my prepared statement. I will be pleased to respond to any questions you may have.

RELATED GAO PRODUCTS

International Trade: Combating U.S. Competitors' Tied Aid Practices (GAO/T-GGD-94-156, May 25, 1994).

International Trade: Competitor's Tied Aid Practices Affect U.S. Exports (GAO/GGD-94-81, May 25, 1994).

Export Finance: Challenges Facing the U.S. Export-Import Bank (GAO/T-GGD-94-46, Nov. 3, 1993).

U.S. Trade and Development Agency: Limitations Exist in its Ability to Help Generate U.S. Exports (GAO/GGD-94-9, Oct. 20, 1993).

Export Finance: The Role of the U.S. Export-Import Bank (GAO/GGD-93-39, Dec. 23, 1992).

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