

REPORT TO THE U.S. CONGRESS ON
TIED AID CREDIT PRACTICES
ADMINISTRATION RECOMMENDATIONS FOR
A U.S. RESPONSE

SEPTEMBER 1989

Introduction and Summary

In April, 1989 the Export-Import Bank forwarded the report to the Congress on the tied aid credit practices of other countries mandated by the Omnibus Trade and Competitiveness Act of 1988. In his transmittal letter, Acting Chairman Ryan observed that the report supported the need for continued, and possibly broadened, U.S. negotiating efforts. He promised that, after reviewing the available options, the Administration would offer its recommendations on how best to support such negotiations and on whether it would be desirable to establish an ongoing tied aid credit program.

On the basis of this review, the Administration has concluded that the U.S. response should center on a vigorous new negotiating effort aimed at reducing the commercial disadvantages for American exporters engendered by the tied aid credit practices of other countries.

The Administration further recommends that available budgetary resources be used aggressively to support the negotiations. Eximbank, the Agency for International Development (AID), the Trade and Development Program (TDP), and other interested agencies are reviewing ways of doing so. We are proposing to modify the way in which we use the War Chest. We also are developing procedures for ensuring that opportunities for financing capital projects receive consideration within the constraints of our current aid programs.

As a separate though related exercise, the Administration will be considering whether and how U.S. foreign assistance programs might provide greater support for infrastructure and capital projects.

Given the other options at our disposal for responding to the problem, as well as our budgetary constraints, the Administration has decided not to seek new resources for a separate tied aid credit program at this time.

International Negotiations

The Administration reconfirms its commitment to vigorous pursuit of negotiations with our major trading partners, with the aim of achieving further improvements in multilateral discipline over the use of tied aid credits. Our specific objectives are to minimize the trade distortions caused by tied aid practices to the detriment of U.S. exporters and to ensure that tied aid credits serve the legitimate development needs of recipient countries.

The groundwork for further negotiations on tied aid credits was laid at the spring meeting of Ministers of Foreign Affairs and Finance of the Organization for Economic Cooperation and Development (OECD) and at the Arche Summit in July. At the latter, leaders of other G-7 countries joined President Bush in sending a strong signal of support for further progress in this area. They urged that, at the earliest possible date, competent bodies in the OECD pursue and achieve improvements in the present guidelines governing the use of tied aid credits.

A number of possible avenues for negotiation have been suggested in meetings of OECD countries participating in the Arrangement on Guidelines for Officially Supported Export Credits. This is the forum in which the 1987 tied aid credit agreement was negotiated and in which -- along with the OECD's Development Assistance Committee -- the search for multilateral solutions continues. The Administration is assessing various negotiating objectives and strategies with a view to achieving maximum progress toward international agreement on a new negotiating mandate at this autumn's round of OECD meetings.

The principal directions identified so far in which progress might be sought include (1) effectively untying donor countries' aid programs for capital projects; (2) limiting the use of tied aid in problem sectors and/or markets; (3) limiting the use of relatively low-concessional aid to a certain proportion of a donor's total program; (4) requiring open competitive bidding for transactions below a certain concessionality level as a way of precluding commercially motivated aid; (5) banning the late introduction of tied aid credits into project bidding; and (6) otherwise improving guidelines to enhance the developmental orientation of tied aid.

We recognize that it may not be possible to remove all distortions of trade and aid arising from differences in national approaches to development assistance. Nor do we underestimate the difficulty and effort that a new round of negotiations will entail. But we can and will attempt to minimize the scope of such distortions. We expect to provide a progress report on our efforts to OECD Ministers in the spring of 1990.

The War Chest

Since the March 1987 tied aid credit agreement was reached, the Tied Aid Credit Fund (the "War Chest") has been

used to encourage early and full implementation of the agreement by countering offers from other countries that deviate from its provisions. In practical terms this has resulted in few new War Chest transactions, since most tied aid credits conform to the agreement.

The Administration now believes that the War Chest should be used more directly to support our negotiators. In our FY 1990 budget submission, we proposed the extension of the War Chest at the \$100 million level to ensure implementation of earlier tied aid credit agreements and to support further negotiations.

When blended with commercial credits guaranteed by the Export-Import Bank, a \$100 million War Chest will allow us to offer a total of almost \$300 million of "mixed credit" export financing at minimum concessionality levels specified by international agreements. Since not all offers are taken up, it would not be imprudent for the Bank to extend an even higher volume of offers. By using foreign assistance funds from other agencies to supplement the War Chest, the available financing would be larger still.

There are three principal ways of utilizing the War Chest directly in support of international negotiations. One is specifically to target export markets of countries that resist stronger discipline over tied aid credits (i.e., resist further negotiations). This is a course we have followed at times in the past. However, we would be reluctant to recommend such a provocative approach without evidence that countries are not adhering to the tied aid credit agreement or that narrow commercial interests are leading them to block cooperative multilateral solutions to remaining tied aid problems.

A second option is the "defensive" one of matching other countries' tied aid credit offers in cases we judge relevant to our negotiating strategy, whether or not the offering country is resisting negotiations. The defensive approach has been useful because it demonstrates to other countries that the United States is seriously challenging the misuse of tied aid for commercial purposes. Since it is essentially reactive, however, it may bring us into the bidding too late to have a significant impact either on the exporter's chances for winning the order or on the initiating country's tied aid practices.

A third, more activist option is to target offers in sectors and markets of specific commercial interest to U.S. exporters, particularly where tied aid credits are offered extensively. This approach has the potential to have the most impact for a given expenditure of funds, because it allows the United States to control the timing, the location, and the size of tied aid credit offers. It would have to be used judiciously, however, in order not to contribute to an expansion of the tied aid credit problem.

Of these options, the Administration prefers to emphasize the third: targetting the War Chest and other tied aid funds where available in sectors and markets of commercial interest to U.S. exporters where tied aid credits are used extensively. In addition, we propose to use such funds defensively to match or overmatch on a case-by-case basis when it serves our negotiating purposes. Used in this manner, a War Chest of the magnitude proposed would send a convincing message to our trading partners of our firm intent to level the tied aid credit playing field.

Should international negotiations not proceed seriously and expeditiously, the Administration would be willing to review whether the resource levels we have committed are sufficient to address the problem and may be prepared to ask the Congress for additional appropriations in subsequent years. In that case, we also would be prepared to reconsider, if necessary, the ways in which available funds are targetted.

Foreign Assistance Funds

Within the framework of its existing funding and legislative authority, AID will maximize its support for capital projects. As part of this effort, AID, together with TDP, will look for opportunities to cooperate with Eximbank in project financing, particularly in support of the third option above. Exchanges of information early in the program and project evaluation processes of all three agencies will allow joint financing opportunities to be identified.

In cases where AID and TDP funds are available for joint initiatives with Eximbank, such transactions would be expected to (1) contribute to the development of the importing country, (2) meet Eximbank's creditworthiness standards, (3) be of long-term benefit to the U.S. economy, and (4) have a significant impact on competitors.

While some portion of AID's current appropriations can be used to finance the transfer of U.S. capital goods to developing countries, the scope for doing so is limited by the other purposes our aid programs must serve and by the high degree of congressional earmarking. Within overall budget constraints, however, AID will make available what funds it can under established programs.

In addition, TDP's programs will continue to provide substantial tangible support for U.S. capital goods exporters.

Focus of U.S. Foreign Assistance Programs

Over the medium term, the Administration will be considering whether and how U.S. foreign assistance programs might provide greater support for infrastructure and capital projects. Although this would be a shift in emphasis compared to our aid programs of the last two decades, there is ample precedent in AID's history for doing so. Such a shift would have to be accomplished in ways consistent with the broad objective of meeting the development needs of recipient countries. We would continue to insist that programs and projects meet development assistance standards and priorities.

New Resources for a Tied Aid Credit Program

The Administration gave careful consideration to the feasibility and utility of seeking new resources to establish a tied aid credit program. Such a program would be aimed at meeting the developmental needs of recipients, but also would provide more direct support to those of our exporters whose interests suffer most directly from the tied aid credit practices of other countries. It was recognized that a program of this nature could be designed to bolster our negotiating efforts.

On balance, however, the Administration did not find a tied aid credit program of this nature to be of such high national priority as to warrant the expenditure of substantial additional resources at this time. Output and employment in the United States are at healthy levels. Our trade balance is improving as a result of improved international coordination of economic policies and the revitalization of our domestic economy. We also were acutely aware of current budgetary constraints. In these circumstances, the steps we are proposing should be sufficient to accomplish our purposes without the commitment of additional resources required by a new program.

Conclusion

The Administration will keep under continuing review the magnitude of the tied aid credit problem we face and the progress we are able to make in improving multilateral discipline. We retain the option of recommending that additional resources be devoted to the establishment of a tied aid credit program in the future if sufficient progress is not made toward achieving our negotiating objectives. In evaluating our progress, particular attention will be paid to the willingness of other countries to work with us to limit the scope of trade distortions emanating from their foreign aid programs.

The Administration recommitts itself to working with Congress and the U.S. export community to ensure that, to the maximum possible degree, export sales competition is conducted on a basis of price, quality, and service rather than concessional financing. We recognize that perseverance will be necessary if this effort is to produce its intended results, particularly in sectors and markets where tied aid credits are extensively used. We believe the course we have outlined will help otherwise competitive U.S. exporters maintain their presence in those sectors and markets.