

## **Room Document No. 3**

# **10th Informal Consultation between Civil Society Organisations and the Working Party on Export Credits and Credit Guarantees (ECG) and the Participants to the Arrangement**

## **REMOVAL OF RESTRICTIONS ON SUPPORT FOR LOCAL COSTS**

**BIAC**

5 November 2007

Salle des Nations, Tour Europe, La Défense, Paris

**Confidential**



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*The Voice of OECD Business*

31 October

**PRELIMINARY BIAC SUBMISSION TO THE STAKEHOLDER CONSULTATION WITH ECG  
AND THE PARTICIPANTS TO THE ARRANGEMENT ON OFFICIALLY SUPPORTED EXPORT  
CREDITS ON 5 NOVEMBER 2007**

**REMOVAL OF RESTRICTIONS ON SUPPORT FOR LOCAL COSTS**

**Introduction**

1. BIAC welcomes the opportunity to discuss with the Export Credit Group (ECG), the Participants and stakeholders the approaches of OECD ECA's towards official support for local costs. In the following paragraphs of this submission BIAC will present the OECD business case on why the current restrictions regarding local costs need to be removed or relaxed. This submission is of preliminary nature. BIAC will be pleased to present its final submission within two weeks after this consultation.

**Local Costs Provisions in the OECD Arrangement**

2. Local costs are defined in Annex XI to the Arrangement on Officially Supported Export Credits as "expenditures for goods and services in the buyer's country that are necessary either for executing the exporter's contract or for completing the project of which the exporter's contract forms a part. These exclude commission payable to the exporter's agent in the buying country."

3. The Arrangement stipulates that the total combined official support for export credits plus local costs shall not exceed 100% of the export contract value. As to the breakdown of this total combined support, official support cannot exceed 85% of the export contract value and support for local costs cannot exceed the amount of the down payment (a minimum of 15%). Further, the Arrangement states that Category I ("relatively rich") countries shall be limited to pure cover support (i.e. insurance). For ships and civil aircraft it does not include any restrictions on support for local costs.

The Rational for Changes

4. The limitations on support for local costs have not been changed fundamentally since the inception of the Arrangement in 1978. At the time, the objective of official support was to promote OECD exports. Local costs comprised mainly raw materials rather than manufactured goods. They were usually paid for in local currency as opposed to hard currency, and public buyers typically had sufficient access to local funding (or to the state budget). Competition from capital goods exporting non-OECD countries was virtually non-existent.

5. Meanwhile, the global economic environment has changed dramatically and so have business models. Important developments which have a bearing on the local costs discussion include the following:

- Privatisation of customers: Many of the former public buyers in developing and emerging countries have been privatised. While public buyers used to be able to fund local costs through their budgets, private buyers require long term credits including for local costs.

- Localisation of manufacturing and services: Local content is no longer restricted to raw materials. Companies in developing countries are now part of the supply chain for manufactured goods, which significantly increases the potential proportion of the contract price that can be sourced locally. Moreover, buyers are increasingly requiring significant elements of localised manufacture when inviting tenders. This trend is encouraged by the IMF and the donor community. Further, availability of cheap raw materials, low labour costs, and improving education in emerging countries result in local cost advantages.
- Increased competition from outside the OECD: Competitors from non-OECD countries nowadays have cost advantages which are further increased by official export credit support that is not bound by the OECD Arrangement. In BIAC's view, there is no logic in restricting ECA support for Local Costs when supplies from neighbouring countries can benefit from support without such restrictions.
- Increased international sourcing: Multinational companies nowadays source from multiple facilities all around the world. The sources include external suppliers as well as in-house facilities, the latter of which often being established together with local firms and with the long-term objective to facilitate future market access as opposed to focusing only on a one-time project.
- Lack of commercial long-term lending in local currency: Local financing has become increasingly available in emerging markets. However, it is usually focused on the short-term while infrastructure projects need long-term financing for commercial viability. ECA support is necessary because of the size and long-term orientation of the projects as well as political risks.
- Local costs vs. third country deliveries: ECAs sometimes prioritise third country deliveries over local costs. This practise distorts the efficiency of global supply chains and increases costs.
- Changing role of ECAs: ECAs' mandates have become broader. They are no longer focused on maximising the export of manufactured goods in their country, but are now driven by wider economic interests. After subsidies have been eliminated, there is less pressure on ECAs to restrict support to domestically produced goods and services and ECAs can act more commercially.

6. The traditional OECD ECA approach towards local costs does not reflect these developments and is therefore outdated. The existing restrictions for local costs coverage skew comparative advantages of companies and production locations on an international level. Through this ECA's restrictive approaches towards local costs reduce the potential welfare gains that trade offers to societies. The overall impact of the restrictive OECD approach towards official support for local cost financing on business and employment in OECD countries is likely to be negative. This needs to be changed.

7. Less restrictive approaches towards official support for local costs would reduce the cost base for exporters, and this could impact favourably on the price charged to the buyer. They would also provide for a more efficient use of global supply chains of OECD based companies which are distorted under the present rules. Official support for higher shares of local costs would contribute to a more level playing field regarding export credit support for exporters from OECD on the one hand and exporters from non-OECD countries on the other. All these effects would foster the competitiveness of OECD exporters and through this enhance output and employment in OECD countries. It is important to point out that increased local cost coverage by ECA's would not lead to subsidization of exports as ECA's will continue to be bound by WTO rules to break-even and therefore have to apply risk based premiums.

8. Developing and emerging countries also stand to benefit from increased OECD ECA support for local costs. Higher local costs coverage would positively impact on investment, production and employment in sectors that have comparative advantages. Further, the countries would benefit from positive spill-over effects that are usually associated with foreign investment and which include the transfer of technology and high-quality training of local workforces.

**BIAC call for elimination of local costs restrictions**

9. BIAC believes that restricting official support for local costs to the value of the down payment is no longer appropriate or necessary. We urge the OECD to remove this restriction in order to provide for a more level playing field between OECD and non-OECD exporters, foster the international labour division in accordance with comparative advantages, enhance international trade and investment and through this increased production, jobs and welfare in developed and developing countries alike. BIAC would be pleased to discuss the removal of local costs restrictions with the ECG and the Participants in more detail.