Smart Rules for Fair Trade

50 YEARS OF EXPORT CREDITS

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OECD

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FOREWORD

Angel Gurría

Secretary-General of the OECD

As the OECD is celebrating its 50th anniversary, the Organisation continues to deliver on its mission to develop better policies for better lives. Indeed, the entire history of the OECD has been one of bringing governments and experts together to identify, design and promote sound and smart international economic policies. This is most obvious in the area of official export credits where the OECD has been the leading international forum for setting the rules of the game.

These rules are prescribed in the Arrangement on Officially Supported Export Credits which is a "Gentlemen's agreement"; they are not formally binding and have no formal procedures for settling disputes. However, national commitments to these rules are made at the Ministerial level and guide, on a day to day basis, the official element of financing of global export competition. These rules and their implementation reflect shared national objectives to facilitate fair, efficient and transparent competition among governments. It is for these reasons that the performance of the Arrangement through the years has been outstanding, both in terms of adherence of its participants to its rules, and its flexibility in adapting to changing economic conditions and priorities.

One recent accomplishment worth mentioning is a new agreement to guide governments in supporting export sales in the highly competitive market of commercial aircraft. The full participation of OECD's partner country Brazil make this a path-breaking agreement, even among the solid set of export credit rules governing other capital goods.

The OECD's export credit community has also adopted good governance issues, including OECD Recommendations in areas such as avoiding bribery and promoting sound environmental policies, as

well as setting guidelines to ensure that market-determined export credits do not undermine the debt management situation in low-income countries.

Fifty years ago, our founding Convention recognised that "the further expansion of world trade is one of the most important factors favouring the economic development of countries and the improvement of international economic relations." This is even more relevant in today's globalised world. Government financing of this ever-increasing trade will continue to be an important component of the financing mix. The next major objective must be to extend this co-operation to the emerging economies which represent a new and important group of global export competitors.

This publication, issued to commemorate the 50th anniversary of the OECD as a standard setter and pathfinder, provides the reader with an insight into the OECD export credit work from the perspective of those who have been instrumental in setting these smart rules.

Part I

STRATEGIC OVERVIEW

1. *Open markets matter*

2. *Smart rules for fair trade: Why export credits matter*

OPEN MARKETS MATTER

Ken Ash

Ken Ash is Director of the OECD's Directorate for Trade and Agriculture.

An open trading system is vital for global prosperity and smart economic policies: more open economies grow much faster than closed ones and trade can be a powerful tool in the fight against poverty. Over the last 50 years the trade to GDP ratio for the world has grown from less than 15% to 27% today, reflecting the dismantling of import and export barriers through unilateral domestic reforms, regional integration arrangements and multilateral co-operation through the WTO. The OECD Trade Committee (TC) has contributed much to these reform efforts, supporting the WTO rules-based trading system, promoting freer trade in goods and services and helping governments address the related challenges.

As it celebrates its 50th anniversary, along with the OECD, the TC can look back on some of its achievements with pride. These achievements include contributing to the creation of the generalised system of preferences for developing countries in the 1960s; negotiating a "trade pledge" among OECD Ministers to avert protectionist responses during the economic crisis of the 1970s; developing a conceptual framework for trade in services which served as a major input in shaping the General Agreement on Trade in Services in the 1980s; analysing a range of "trade and…" issues in the 1990s; addressing the relationship between trade and labour, environment, investment and competition.

When the world faced the recent financial crisis, the TC was again quick to proclaim the dangers of protectionism, to provide substantive analysis of the impact of policy responses to the crisis and to advise governments on pro-trade, pro-growth policy measures – including timely exit strategies. Analysis is on-going on how increased market openness, along with complementary policies, can contribute to more inclusive growth and employment.

The TC is also investing considerably in generating new and internationally comparable policy information on services sectors, which together generate more than two thirds of gross domestic product globally and provide over 50% of employment in major economies. Relevant regulations will be reflected in a Services Trade Restrictiveness Index that will provide policy makers and negotiators with the information they require to improve the domestic policy environment, negotiate international agreements and open up international trade in services. One common aspect in all of the TC's work is its increasing engagement with countries outside the current OECD membership, in particular Brazil, China, India, Indonesia and South Africa, on issues of common interest and where there is considerable mutual benefit from greater policy analysis and dialogue.

The OECD also supports an open trading system through the Arrangement on Officially Supported Export Credits. Indeed, the history of the Arrangement is one of extraordinary success in creating and maintaining a level and transparent playing field for industrial equipment and projects among official export finance providers. It has reduced subsidies and trade distortions related to officially supported export credits, contributed to saving considerable taxpayers' resources, and greatly reduced international litigation on export credits. A high priority at this time is to build on this success by welcoming into the Arrangement countries which are not currently OECD members. The Arrangement is sufficiently flexible to accommodate this possibility; Brazil, for example, recently signed the agreement on civil aircraft. Other large emerging countries, including China and Russia, would be equally welcome participants.

SMART RULES FOR FAIR TRADE: WHY EXPORT CREDITS MATTER

Steve Tvardek

Steve Tvardek was appointed Head of the OECD's Export Credits Division in 2010, prior to which he was Director of Trade Finance in the Department of Treasury of the United States.

The 50th anniversary of the OECD is the opportune time to examine the Organisation's less well understood role in the disciplines of governments' export financing programmes. Over the years, these disciplines have become more complex as financial markets have become more sophisticated and have broadened in scope, the need for specialised sector agreements have emerged and good governance has become an important policy objective of member governments. These disciplines now face the new challenges of accelerating globalisation and, perhaps most challenging of all, the concomitant rise of significant export financing competition outside established disciplines from emerging markets. The latter threatens the OECD's ability to maintain a level playing field within the existing system of enlightened "competitive co-operation." This concept may seem like an oxymoron, but not so, and the challenge is to convince emerging-market governments of this fact.

That the OECD – the successor organisation to the Organisation for European Economic Co-operation (OEEC) – became the repository of disciplines to control governments' ability, unilaterally, to promote exports with financing subsidies and, therefore, promote national jobs and economic well-being at the expense of others, is fitting. An important impetus for World War II (and consequent need for the reconstruction managed by the OEEC) was the harsh terms of the Treaty of Versailles. This, like most post-war treaties before it, looked narrowly at national well-being: victors were compensated financially and losers punished. Such narrow nationalism was also not an uncommon view for national economic policies more generally. The infamous Smoot-Hawley Tariff Act in the United States in the 1930s sought to reduce economic pressures of the Great Depression by, in effect, exporting them to others. Tariff increases and currency devaluations that were pervasive in that period were self-defeating competitions that, along with misguided monetary policies, reduced overall welfare and seriously exacerbated the depth of the Depression.

The US Secretary of State George C. Marshall and the OEEC embarked on an enlightened policy of post-war rebuilding recognising that all forms of beggar-thy-neighbour policies undermined longer-term national and collective interests, and that co-operation that promoted joint prosperity reduced political tensions and enhanced prospects for peaceful relations and economic wellbeing. Multilateral co-operation in the field of export credits disciplines is a direct extension of this co-operative spirit and Marshall Plan principles. The rise and spread of economic prosperity in the post-World War II period has been unprecedented in human history and is built on such a constructive spirit of competitive co-operation.

The most basic economic theory teaches the dynamic benefits of competition for the individual and, ultimately, for collective welfare. The role of the State is primarily to provide the rule of law and to protect individuals' economic freedoms and property. Ironically, the "animal spirits" motivation that Keynes described includes competitive actions that can ultimately result in undermining the fundamental benefits of competition. Virtually all economic actors ultimately seek super competitive market advantages in the form of monopoly, monopsony and other mechanisms of market power that, if successful, ultimately degrade economic welfare. The role of governments has, therefore, been properly expanded to ensure that the outcome of economic competition does not itself lead to the demise of that competition, and the importance of regulating competition is particularly high when that competition is between nations.

The contrasts in the outcomes of economic (and political) competition among nations post-World Wars I and II are as clear and dramatic as differences in their respective post-war policies; the latter were anchored in partnership and co-operation in economic relations. However, there is always the danger that successive generations will become complacent and undervalue the continuing importance of this co-operative management of national competition. Moreover, government policies, in the face of international competition, can sometimes be steered by narrow national jobs, growth, development, and export promotion agendas, leading to an unbridled effort to "win" in each competitive situation by whatever means possible. Private firms have limited budgets for pressing loss-leader policies. However, because governments have tax revenues at their disposal, and can create credit and focus massive national resources to pursue international export competition, ground rules need to be set to ensure that competition is constructive, not destructive, both for trading partners and for the international economy as a whole.

In the end, exports that are driven by the best combination of price, quality and service, rather than financing or other subsidies, bring the most overall value to the global economy and, therefore, its participants. This approach rewards efficient producers and most efficiently allocates global resources not merely at a point in time but more importantly over time. It is this enlightened policy view that gave rise to multilateral export credit disciplines at the OECD. The maintenance and evolution of these policies over the years is a testament to their success and continued importance and the collective wisdom of policy makers.

The fundamental principles behind the OECD export credit disciplines are two-fold: first, eliminate or minimise subsidies in government financing programmes for exports and second, ensure that the agreed terms and conditions create a level and transparent playing field among governments and exporters – for both OECD members and non-members alike. One of the outcomes of the post-World War II policy framework is the rapid growth of export-driven developing economies. Enlightened co-operative policies governing trade, competition, and development have all contributed to this growth. These growth and development successes now require that this enlightened co-operation effort be extended to a new set of global economic partners.

The OECD's ability to work effectively with non-members in the export credit area is most clearly demonstrated in work on the Aircraft Sector Understanding (ASU) and Brazil's experience in this work as described in its contribution to this publication. Brazil is a major producer of regional aircraft, but not a member of the OECD. Nevertheless, in 2004 Brazil chose to join the OECD work in structuring export credits disciplines for this sector; it became a full participant in negotiations and the subsequent ASU that went into effect in 2007. Brazil remained a full partner during the recent renegotiation of the agreement that culminated in a new ASU in February 2011. Brazil's decision to join in OECD-sponsored work followed several years of back-and-forth litigation with Canada in the WTO. However, beyond the objective success of the ASU agreement, and the practicality of this forum in resolving competitive problems and effectively regulating competition, the key point is that the OECD is prepared to work flexibly with non-member economies on export credit disciplines without the non-member having to assume other OECD obligations. Neither of the two export credit policy groups – the Participants to the Arrangement on Officially Supported Export Credits and the Working Party on Export Credits and Credit Guarantees – requires membership of the OECD. Brazil's experience can serve as a model for constructive co-operation on export financing disciplines between OECD members and other emerging-market governments going forward.

We have assembled in this publication a collection of articles by government officials, current and retired, private sector actors and non-governmental stakeholders that describe the co-operative process that defines the OECD's export credit work over the years from their various vantage points. Many describe what they consider important successes, albeit deliberate in speed, and one stakeholder also expresses frustration with outcomes that did not meet expectations. A collective reading of the articles will hopefully leave the reader with an understanding of the complexity of identifying, analysing, negotiating and implementing the broader policy of competitive co-operation. And when one adds to the equation that agreed disciplines must be approved by consensus, the results are even more impressive. Finally, these disciplines are all the more impressive given their interesting "soft law" legal status, explained in the article by Nicola Bonucci, the OECD's Director of Legal Affairs.

One indisputable characteristic of the evolution of export credit disciplines is that the disciplines and the process to create them have become increasingly transparent, and stakeholders have been continually afforded increased access to government policy makers, both in capitals and at the OECD. Of course, this does not ensure that the compromises necessary to agree policies produce exactly what each stakeholder desires. However, in most articles, stakeholders have recognised that tremendous progress has been made to open up the policy-making process over the last decade and a half.

The anchor of the publication is the article by my predecessor as Head of the OECD Export Credits Division, Janet West, who looks at the history of export credit work in the OECD over the past 50 years, especially the more recent achievements. She held the position of Head of Export Credits for 16 years and represented the United Kingdom in this work prior to joining the OECD. She has researched the history of export credit work since the earliest days of the OEEC/OECD; much of the export credits work was *ad hoc* and issue-focused until 1978 when the Arrangement on Export Credits codified disciplines more broadly. Janet also served as editor of the book published in 1998 to commemorate the 20th anniversary of the Arrangement[1] and which recorded the key accomplishments up to that point.

The work of the secretariat itself in co-ordinating, staffing, and advising the discipline-development process is also something that this publication highlights. Therefore, the authors in this publication include the secretariat's senior staff, providing their perspectives on negotiations for OECD agreements on aircraft, environment and risk premiums.

The earliest export credit policy achievements were fairly narrowly financial. First, setting minimum nominal interest rates and ultimately eliminating them in favour of minimum real rates that accounted for differences in currencies, national inflation and interest rates; then putting in place country risk premiums and then buyer risk premiums as remaining sources of subsidies were eliminated and export credit agencies' (ECAs) business increasingly shifted to private buyers. There followed the disciplines on the use of concessional aid resources to avoid distorting trade and prioritising market-based financing for commercially viable projects, as well as agreement to monitor untied aid to ensure that it meets its non-trade promotion procurement and development objectives. Reforms also required setting sector-specific terms for special classes of projects/equipment such as nuclear power plants and asset-backed aircraft structures. These kinds of agreements, although technically complex, were at least relatively straightforward as they relied on the economic, financial and underwriting expertise that has traditionally been the strength of finance ministries and ECAs.

In the late 1990s however, the scope of ECAs' obligations began to expand to include good governance issues such as anti-bribery measures and environmental standards. The challenge

in such work was that both subjects were outside the traditional expertise of ECAs and met considerable institutional resistance, based primarily on a historical lack of experience and uncertainty as to how to merge these issues within traditional export financing mandates and procedures. The environment work may have posed the biggest policy challenge, and most ECAs eventually hired environmental experts. These experts became the pivotal variable as they then became environmental advocates within ECAs and actively consulted among themselves in addressing shared technical and operational issues. These experts also helped overcome many of the impediments and knowledge gaps and developed internal environmental processes for ECAs. New technical and project challenges continue to arise and these experts meet informally to devise solutions and advise policy makers.

The achievements in setting up environmental guidelines and processes for ECA financing have been substantial and this subject has attracted the largest number of authors. It is in this area that a stakeholder article expresses frustration. I can only leave it to the readers to draw their own conclusions from the articles by the various stakeholders, as well as articles by the other authors on this particular work, and on the progress and openness prevalent today.

It is worth emphasising that export financing policy necessarily addresses multiple national objectives simultaneously; not all meld smoothly together and compromises are required. ECAs were first instituted to support national exports and this remains their primary responsibility. Interestingly, the US Export-Import Bank was set up in the 1930s specifically to help the United States counter the economic effects of the Great Depression; it was not the first ECA, as the United Kingdom's Export Credits Guarantee Department (ECGD) gets that distinction. Other ECAs were similarly created to ensure the availability of competitive financing for national exporters. So policy work must, as a first priority, order and rationalise such financing competition among nations. And policy work must do so while minimising subsidies and protecting taxpayers from risk and loss, and it must also keep up with changes in market financing mechanisms and exporter needs. Then, political good governance issues, which are important competitive issues as well, add completely new dimensions to the co-operative landscape with special challenges for policymakers, as you will see from numerous authors.

But the financial crisis provided a strong reminder of perhaps the most important and fundamental role that can be played by official export financing – addressing market failure to protect export/import flows, jobs and economic well-being. Export financing proved to be a central policy tool used by G20 policymakers at the London Summit in April 2009 to help keep daily trade flowing and preserving jobs while they worked to repair broken and frozen financial markets in the worst financial crisis since the Great Depression. The bulk of the USD 250 billion of short-term financing raised by the G20 governments were from ECAs and multilateral financial institutions. In November 2008, shortly after the failure of Lehman Brothers, ECAs

from OECD and non-OECD countries gathered at the OECD and pledged to make extraordinary amounts of medium- and long-term export credits available to support ongoing infrastructure projects and larger capital goods flows to counter the building liquidity crisis; this pledge was renewed in April 2009 (the related Statements are reproduced in this publication). As part of the broadened trade finance initiative at the Pittsburgh Summit in September 2009, these medium- and long-term financing tools were added to the co-ordinated G20 initiative to complement support in place for daily trade flows and ensure a comprehensive approach to ensuring the adequacy of trade finance across all tenors.

Some have argued that markets never really fail and, therefore, ECAs are by definition subsidy vehicles. Few would make this larger argument now in the shadow of the worst financial crisis since the Great Depression. Markets can indeed fail, either structurally as was clearly seen during the financial crisis, or even situationally in excessive risk aversion in assessing and pricing risk, or in capacity constraints in lending to developing countries. In any event, there are two fundamental measurements of subsidies, the pure economic one which assumes that effectively markets never fail and the legal one used by the WTO that distinguishes between prohibited and actionable, and non-prohibited, subsidies. OECD export credit rules are recognised by the WTO as being non-prohibited subsidies whether or not they meet the pure economist's test. And OECD-led work in this regard seeks to ensure that any "subsidies" that exist in official export credit financing arise from the correction of market failure, not circumvention of efficient market behaviour.

I want to thank all the authors and the many hundreds of other policy officials and technical experts over the years whose hard work and dedication guided the evolution of the OECD export credit disciplines so as to allow them to remain an effective tool of multilateral co-operation within an environment of co-operative competition. "Smart" rules for fair trade in the area of export credits are those that: ensure that competition is based on price, quality, and service rather than financing terms; operate on a transparent and level playing field; eliminate subsidies; protect tax payers; and are flexible and practical so as to meet the real-time needs of governments and exporters. But "smart" is not a static concept. Therefore, addressing the emerging policy issues, highlighted in my article on "Future Challenges", is important to ensure that our rules remain "smart" – at least for the near future.

Note

1. OECD (1998), The Export Credit Arrangement, Achievements and Challenges 1978-1998, OECD, Paris.

Part II

EVOLUTION OF SMART RULES

1. *Export credits and the OECD*

2. *Guidance note on the scope and application of the Arrangement*

3. *Timeline of export credit agreements and events from 1961 to 2011*

4. *Chairpersons of the OECD export credit committees from 1963 to 2011*

5. *The early years: From OEEC to OECD, 1953 to 1962*

6. *OECD work on export credits: A legal and institutional laboratory*

EXPORT CREDITS AND THE OECD

Janet West

Janet West was Head of the OECD's Export Credits Division from 1993 to 2009, before which she was a Director of the Export Credits Guarantee Department (ECGD), the United Kingdom's official export credit agency, and the UK government's negotiator for OECD, EU and Berne Union export credit agreements. The author is the editor of this publication.

"*Smart rules for fair trade*", the title of this publication (which is part of a suite of publications to celebrate the OECD's 50th anniversary) is an apt *mantra* for export credits in the OECD where, for nearly 50 years, governments have negotiated effective rules to level the playing field for their exporters of capital goods and projects. This linkage of export credits and the OECD is set to continue with many challenges facing governments (about which Steve Tvardek writes in the final article of this publication). Here, I reprise the achievements and the one failure of export credits in the OECD – also illustrated in this publication by the "*Timeline of Achievements and Events*" and commented upon in the "*Forum of Views*" by many well-known export credit players, past and present – and why this work should remain in the OECD.

The first OECD export credit committee

Official export credits go back a long way, as François de Ricolfis (France) writes. The first export credit agencies (ECAs) were established in the post-World War I years. As government and private sector export credit activity grew, in 1934 the International Union of Credit and Investment Insurers (the Berne Union) was founded; its Secretary-General Kimberly Wiehl writes about the complementarity between the Union and the OECD. Post-World War II, ECAs were offering and guaranteeing longer-term loans and in 1955 a Council Decision of the OECD's predecessor organisation, the Organisation for European Economic Co-operation (OEEC), requested governments to discontinue artificial aids to exports, including export credits: "*… In respect of Government export credit guarantees, the charging of insurance premiums otherwise than in accordance with sound insurance principles* (i.e. *lower than is appropriate to the costs and extent of the risks covered*)". Jean Le Cocguic (OECD secretariat) details the early years of export credits under the auspices of the OEEC (1953 to 1962).

The OEEC became the OECD in 1961. OECD governments maintained their interest in export credits and in November 1963 the OECD Council agreed the formation of the "*Group on Export Credits and Credit Guarantees*" (known as the Export Credit Group - ECG),[1] a subsidiary body of the Trade Committee (TC), reporting directly to the OECD Council. Ken Ash (OECD Trade and Agriculture Director) writes about the TC's achievements in this its 50th year.[2]

Towards a consensus

With the overall objective of bringing more order and discipline to official export credits, the ECG initially focused on developing procedures for exchange of information; this task was completed in the early 1970s, including an *ex post* reporting system shared with the Berne Union (and the Bank for International Settlements) which later would be subsumed in the OECD's Creditor Reporting System. The ECG mandate also called for guiding principles for export credit policies and so members targeted the, then, problematic sectors of industry such as nuclear power and ground satellite stations. In 1974, sector understandings on nuclear fuel and on ground satellite communications were agreed.

Against the backdrop of the 1970s oil shocks and the related significant increase in levels of official export credits, some OECD countries began informal discussions about avoiding a credit race, limiting subsidies and developing disciplines through a "Gentlemen's agreement" covering all export credits. In the margins of the October 1974 International Monetary Fund (IMF) and World Bank (WB) Annual Meetings in Washington, DC, preliminary agreement was reached on a minimum interest rate (7.5%) for tenors of over five years and official support to oil exporting countries was prohibited.

In June 1975, at their Ministerial Council Meeting (MCM), OECD Ministers agreed that an export credit arrangement of a general nature between as many as possible of the industrialised countries of the OECD should be achieved. In consequence, the "*Rambouillet Declaration*" from the Economic Summit in November 1975 stated: "*The Heads of State and Government of France, the Federal Republic of Germany, Italy, Japan, the United Kingdom of Great Britain and Northern Ireland, and the United States of America met in the Chateau de Rambouillet from 15th to 17th November 1975, and agreed to declare as follows: … We will also intensify our efforts to achieve a prompt conclusion of the negotiations concerning export credits.*"

By early 1976, the six countries of the Rambouillet summit plus Canada reached agreement on a "*Consensus on Converging Export Credit Policies*", but could not agree on collective implementation and instead applied the agreement through unilateral undertakings; these were followed by similar undertakings from the other ECG members and all the undertakings came into effect in mid-1976. In June 1976, the OECD MCM Communiqué noted that "*The Ministers furthermore agreed to reinforce the Organisation's activities in the field of export credits.*" And in the same month, the Joint

Declaration of the Economic Summit in Puerto Rico welcomed "*... the adoption, by the participating countries, of converging guidelines with regard to export credits. We hope that these guidelines will be adopted as soon as possible by as many countries as possible*".

The Appendix to the Joint Declaration of the London Economic Summit in May 1977 stated "*We welcome the action taken by governments to reduce counterproductive competition in officially supported export credits and propose that substantial further efforts be made this year to improve and extend the present consensus in this area.*" A month later, OECD Ministers "*... welcomed the progress achieved in multilateral co-operation concerning export credits and underlined the need for further efforts to improve and extend the consensus on guidelines for the extension of officially-supported export credits*". And by the end of 1977, with the exception of Austria and New Zealand, all ECG members had made declarations that aligned their export credit policies with those of the *Consensus on Converging Export Credit Policies*.

In late 1977 to early 1978, the ECG formed a drafting group which included Canada, the European Community, Sweden and the United States with the aim of bringing ECG members' unilateral declarations into one document. These parties approved a text in February 1978, which became effective in April 1978 as "*The Arrangement on Guidelines for Officially Supported Export Credits*",[3] a "soft law" instrument that Nicola Bonucci (OECD Legal Affairs Director) explains, including its linkage with the Item (k) of the Illustrative List of the WTO Agreement on Subsidies and Countervailing Measures (ASCM) which provides a "safe haven" for export credits provided in conformity with the interest rate provisions of the Arrangement.

OECD Ministers, in their June 1978 MCM Communiqué, expressed satisfaction that the negotiations for an Arrangement had been successfully concluded and called for its regular review for reinforcing administration of the guidelines. To facilitate this process, a separate committee was established, "*The Participants to the Arrangement on Guidelines for Officially Supported Export Credits*" (the Participants) which, while not an OECD body, would meet in the OECD and be serviced by the OECD secretariat. The first Chairman of the Participants was Gilbert Morleghem (Belgium). A "*Guidance note on the scope and application of the Arrangement*" is set out later in this publication.

Developments, 1978 to 1998

The achievements of the OECD export credit community between 1978 and 1998 were in the main focused on the rules of the Arrangement; these are described fully in a book by the late John Ray[4] (my predecessor as Head of the export credit secretariat, 1982 to 1992) and in the OECD publication issued to celebrate 20 years of the Arrangement.[5] However, in the early to mid-1990s two good governance issues, bribery and environment, came under ECG scrutiny. This scrutiny would result in various informal ECG agreements in the period to 1998 (and

eventually in the adoption of OECD legal instruments) to deter bribery in the award of an export contract supported by official export credits, and to mitigate or remove negative environmental impacts of transactions which benefit from official export credits. Around the same time, non-governmental organisations (NGOs) sought a closer encounter with the ECG; concerns were raised at Ministerial levels about adding to the debt burden of Highly Indebted Poor Countries (HIPCs) through the injudicious use of official export credits; the Asian crisis prompted action by ECAs to maintain trade flows; and a couple of issues were examined at a technical level before being passed to the forum of the Participants to the Arrangement for negotiation of rules.

In parallel with the ECG work, the Participants concluded several negotiations leading to enhancements and adjustments of the rules of the 1978 Arrangement. These changes were, in the main, influenced by market realities, development of new financing techniques, push by governments to reduce the cost to taxpayers of export credit financing schemes and an imperative to redirect aid resources towards development and away from trade promotion and distortion. *Pour memoire*, here is a summary of these agreements and events, first in the ECG followed by the Participants.

Bribery: The ECG discussions began at the end of 1994 when members were informed by the OECD's Working Group on Bribery (WGB) that, in support of the OECD Convention on Combating Bribery of Foreign Public Officials in International Business Transactions, export credits would feature in the broader OECD survey on anti-bribery policies and practices. The Convention, a legally binding agreement, obliges its adherents (OECD countries plus others) to criminalise the offering, promising and giving of bribes to foreign public officials for the purpose of obtaining, retaining business or other improper advantage in the conduct of international business. A set of non-binding international recommendations and standards complement the Convention. In consequence of the WGB's advice and, importantly, in recognition that export credits was referenced in one of the Convention's ancillary documents, anti-bribery measures became a live issue in the ECG and in January 1998, ECG members agreed to exchange information through an ongoing survey of their procedures and practices to deter bribery, the results of which were expected to inform the review of countries' performance under the Convention.

Environment: Discussion on the environment also began in the ECG in 1994. In 1995, a survey showed that some ECG members considered environmental impacts when evaluating transactions for official export credit support; this prompted the United States to propose work to reach mutual agreement on environmental guidelines. By 1998, the ECG had in place a Statement of Intent about strengthening environmental considerations in ECAs' risk assessment practices and an agreement to exchange, informally, information on large multi-sourced infrastructure projects, such as the Three Gorges Dam in China (which had attracted much NGO opposition), in environmentally-sensitive sectors. NGOs wanted greater coherence between social and environmental policies of bilateral assistance agencies and ECAs than they considered existed

at that time.[6] The initial dialogue with NGOs was sometimes fraught, as mentioned by Birgitta Nygren (Sweden), but over the years it has evolved into a more positive exchange. Wiert Wiersama (Netherlands) writes on behalf of ECA Watch.

HIPCs: The June 1996 Summit Meeting of G7 countries held in Lyon called upon developed countries to support the efforts of developing countries, *inter alia*, to give priority to funding social and economic development and to avoid unproductive expenditure. The G7 Statement issued at the 1997 Denver Summit of Eight reaffirmed this commitment. As a result of all these encouragements, the United Kingdom sought a commitment from ECG members to refrain from providing official export credits for "unproductive expenditure"[7] to the HIPCs and eventually this was agreed in 1999 *via* an ECG Statement of Principles.

Premium fees: The first discussions on risk premium fees were held in the ECG between 1991 and 1993; these were initiated in the light of the extensive cash flow deficits of many members' export credit schemes and the perception that some fees were not matching risk and thus resulting in subsidies. In 1994, negotiation for risk-based premium fees was passed to the Participants' forum.

Project finance: In April 1996, the ECG began discussion, from a technical perspective, on project finance. ECAs were becoming more involved in project finance transactions (driven, *inter alia*, by privatisation and deregulation programmes and off-balance sheet accounting requirements) and the Arrangement requirements, *e.g.* semi-annual repayment tenors, were seen as a constraint to their involvement in such deals. The ECG made recommendations in 1997 to the Participants for rules to accommodate the specifics of project finance transactions.

The Asian crisis: In March 1998, the ECG held a special meeting, the first OECD-organised event on this crisis, at which ECG members confirmed their participation in an initiative announced in London by 20 ECAs. The aim of the initiative was continued trade flows that would benefit the economies and support employment of all involved countries: "*…ECAs have agreed to … continue provision of, and where appropriate expand, short-term insurance, guarantees and reinsurance to creditworthy buyers in the region,… exchange information on market developments and implementation of reform measures in the countries of interest recognising that the resumption of financial stability is crucial to all parties … remain open for medium- and long-term creditworthy business. …* ". A familiar message!

The milestones achieved by the Participants in the period to 1998 were many:

> **1978-1982**: With a view to reducing distortion in export competition, the levels of matrix minimum interest rates in the Arrangement were significantly increased to bring them closer to market rates (from between 7.25%-8% increased to 10%-12.4%).

1983: The Participants refined further the interest rate regime of the Arrangement by adapting this to changing and widely differing market conditions; the previous system of a matrix of fixed rates of interest had implied considerable subsidisation in certain cases. The new regime laid the groundwork for market-based interest rates that moved automatically for each currency used in the provision of official export credits, and were dubbed "commercial interest reference rates (CIRRs)". By regularly adjusting interest rates to inflation and government borrowing rates in the countries whose currencies were used to finance exports, the CIRR system significantly reduced the interest rate subsidy component in ECA financing that the inflationary experience of the 1970s had introduced in the fixed nominal interest rate system.

1984 and **1986**: Sector Understandings on nuclear power plants and civil aircraft respectively were concluded and annexed to the Arrangement.

1987: The Wallén Package,[8] *inter alia*, raised to 35% the minimum concessionality level for tied aid permitted under the Arrangement together with the application of a more market-reflective, and differentiated by currency, discount rate (DDR) – instead of the flat 10% used by the Development Assistance Committee (DAC) – for calculating the cost to donor governments of softening a transaction with aid. In this context, the term "grant element" was replaced by "concessionality level" for tied and partially untied aid purposes. These measures were intended to be a significant step towards eliminating subsidies in commercial export credits.

1991: The Helsinki Package[9] was concluded (for implementation from February 1992). Increasing the minimum concessionality level to 35% had failed to curtail the flow of trade-related aid to markets and industrial sectors where the Participants considered it had been misused – the so-called "spoiled" sectors and markets effect. As a result of this Package, tied and partially untied aid for richer developing countries and for projects that should be financed commercially was prohibited. Steve Tvardek writes about the Helsinki Package later in this publication

1994: The Schaerer Package[10] streamlined the classification of countries for maximum repayment terms, refined further the DDR and gave the green light to explore guidelines for minimum premium fees as well as to redraft the Arrangement, the latter *via* a Redrafting of the Arrangement Group (RAG). The premium experts group was set up and a first meeting was held in October 1994, with Pierre Knaepen (Belgium) as Chairman. Kurt Schaerer (Switzerland) writes about the success in negotiations; given his long tenure as Chairman of the export credit committees, he should know!

1996: The "*Ex Ante Guidance for Tied Aid*" was published; it was based on four years experience of implementing the Helsinki tied aid disciplines and aimed to assist aid donors and recipients, export credit and aid agencies and project planners to determine at an early stage whether projects would be eligible for tied aid.

1997: The Knaepen Package[11] was concluded and implemented from 1 April 1999; it set out guiding principles for premium fees through minimum premium benchmarks for country and sovereign risks. The agreement reflected two basic principles: (1) pricing should be risk-based so that the premium fees charged are not inadequate to cover long-term operating costs and losses (in accordance with the WTO obligation – Item (j) of the Illustrative List of the ASCM) and (2) pricing should converge and, from the exporter's perspective, reflect the differing quality of officially supported export credit products. In the same year, Korea became a Participant to the Arrangement (and an ECG member); the Permanent Delegation of Korea to the OECD writes about this association. Finally, on agricultural export credits – a left-over from the Uruguay Round[12] – a draft outline was tabled by the Participants' working group on agriculture, under the chairmanship of Takato Ojimi (Japan); this would lead to several years of negotiation and the singular failure to date of the Participants (the agriculture story continues into the 21st century – see below).

1998: Rules for project finance were agreed for a three-year trial period from 1 September 1998. This agreement permitted official support for non-standard repayment profiles and other flexibilities so that loan repayment terms matched the revenue-generating capacity of projects, the absence of which in the past had limited the involvement of ECAs in financing of private sector projects and/or increased the risk for the ECAs. Also in 1998, the RAG text of the Arrangement was implemented; it reflected a complete overhaul of the Arrangement's provisions and incorporated the decisions and interpretations and the numerous reforms and enhancements to the Arrangement that had been agreed since 1992.[13] The Chairman of the redrafting group, Bob Crick (United Kingdom), recalls those Rag days.

Into the 21st century

In this millennium, OECD export credit developments have been evolutionary, perhaps revolutionary, inevitably controversial, challenging (Denis Redonnet of the European Commission notes the challenges posed by negotiating as a block), innovative and fun!

Further ECG agreements have been concluded on bribery, on environment and on the HIPCs. We failed on agriculture but succeeded in setting new Arrangement rules for civil aircraft (with Brazil as a Participant), nuclear power plants, renewable energies and water projects and

premium fees. The Participants also, *inter alia*, radically redrafted the Arrangement in the wake of some WTO Dispute Panel outcomes and agreed enhanced transparency procedures for untied aid. And ensuring the integrity of the Arrangement has been and continues to be a priority, as Angus Armour (Australia) and Hans Janus (Germany) emphasise. New civil society stakeholders have come to the fore and the export credit committees have had closer involvement with the OECD's advisory committees of BIAC and TUAC (*c.f.* the articles by John Tyler and John Evans respectively) as well as the banking sector through the European Banking Federation (*c.f.* the article by Elena Letemendia). New OECD member countries have been welcomed into the export credit forums, as well as observers from many non-OECD countries. But the vexing issue of how to encourage participation in the export credit rules by major emerging economies that have highly competitive exporters of major capital goods and projects remains work in progress; Fumio Hoshi, Kohei Okada (Japan) and Wilhelm Jaggi (Switzerland), among many, think that this issue is vital to resolve. Finally, the global financial crisis and the concomitant G20 Trade Finance Initiative (about which Denis Stas de Richelle and John Ahearn of Société Générale and Citi respectively write) have assured an ongoing high profile for official export credits.

Bribery: An evolving story. Following conclusion of an Action Statement in 2000, the ECG reformulated the ongoing survey on members' procedures and practices to deter bribery; this was revised in 2006, taking into account not only ECG members' implementation experience of the Action Plan but also feedback from the WGB's Phase II reviews under the OECD Anti-Bribery Convention. Transparency International (TI) also provided input to these revisions about which Michael Wiehen writes. At the end of 2006, the Action Statement was further revised, made more robust and adopted by the OCD Council as a "Recommendation"[14] which became part of the wider OECD anti-corruption *acquis*. In the context of levelling the playing field among all providers of official export credits, the Recommendation has a provision which seeks to encourage non-OECD Members who are Parties to the Anti-Bribery Convention to adhere to the provisions of the Recommendation. It is now nearly five years since the inception of the 2006 Recommendation on export credits and anti-bribery measures; perhaps in the light of further experience, it may soon be time to review the Recommendation.

Environment: Another evolving story. The greening of export credits continued into the 21st century with the adoption of an OECD Recommendation in 2003 which was last revised in 2007. This green route is extensively described in the articles by Birgitta Nygren (Sweden), Patrick Crawford (United Kingdom), Pekka Karkovirta (Finland), Jim Mahoney and Isabel Galdiz (United States). A review of the 2007 Recommendation is now under way with climate change and human rights on the agenda – for the reasons explained by Julian Paisey (OECD secretariat) – and the expectation is a new, robust, relevant and responsible Recommendation by the end of 2011.

Sustainable lending: This proved to be a rather controversial issue, one which challenged the *raison d'être* of ECAs: should they be used as a tool for imposing good governance principles on developing countries. In 2000, OECD Ministers mandated the ECG "*... to strengthen measures towards ensuring that export credit support to HIPCs is not used for unproductive purposes*". Export credits and HIPCs were also mentioned in the 2000 G8 Communiqué, in the G7 Statement from Okinawa and in the G7 Finance Ministers Report "*Poverty Reduction and Economic Development*". Building on the 1999 Statement of Principles, the ECG agreed a revised Statement of Principles in 2001 which recognised the importance of the Debt Initiative for HIPCs. In order to assess the ECG Members' success towards meeting the goals of the Statement, transactions to these countries were to be *ex post* notified and made publicly available. In 2007, against the background of the IMF and WB Debt Sustainability Framework for Low-Income Countries (DSF), the aim of which is to support these countries in their efforts to achieve the Millennium Development Goals (MDGs), the ECG revised further its Statement of Principles and at the end of 2008 adopted "*Principles and Guidelines to Promote Sustainable Lending Practices in the Provision of Official Export Credits to Low-Income Countries*". Nicole Bollen (Netherlands) and Hervé Joly (IMF) write about the wider importance of this agreement.

Agriculture: This would have been a revolutionary agreement – had it been concluded! But, in 2002, the negotiations on agricultural export credits, which included Argentina as a participating party, failed (following which agriculture became the subject of WTO litigation). After very long and intense negotiations in the Participants' forum and OECD Ministerial intervention annually between 1996 and 2001 (*via* MCM Communiqués), a consensus minus one was the final position and perforce the issue was passed to the WTO which is where it now rests in the Doha Development Round – yet to be concluded. Mike Roberts (Australia) provides his take on why the negotiation failed. There certainly was a keen desire on the part of most participating parties to conclude an agreement that had eluded governments for many years. The final draft agreement tabled in the Participants' forum was passed to the WTO and this became the basis for Stuart Harbison's first draft agreement presented to the WTO Agriculture Committee in Geneva in 2002.

Arrangement text – post-WTO dispute findings: In the light of some WTO panel findings, mainly from civil aircraft disputes between Brazil and Canada dating from 1998, the Participants modernised the Arrangement and, at the end of 2003, adopted a new text, applicable as of 2004. The panel findings offered some jurisprudence from an ASCM perspective which was helpful in order to improve the Arrangement in terms of non-discrimination and greater transparency and coherence. Since 2004, regular updates of the Arrangement have been issued to reflect export credit developments and evolving financing practices – thus, the Arrangement continues as a "living document", the latest iteration of which was published in March 2011.[15]

Guidance for tied aid: In 2003 and 2005, revisions of the 1996 "*Ex Ante Guidance for Tied Aid*" were published to reflect further experience with the Helsinki tied aid disciplines. This Guidance has proved its worth insofar as the number of *ex ante* notifications of intent to provide tied aid that have been examined by the Participants has averaged less than two a year since 1996 and there have been none in the past three years.

Project finance and local costs: The project finance disciplines agreed on a trial basis in 1998 were integrated in the Arrangement in 2005 – without any sunset clause. As to local costs, in November 2007 the Participants agreed, for a trial period until the 31 December 2010, to increase the proportion of local costs that may be officially supported in an export contract from 15% to 30% of the contract value; this provision was cemented in the Arrangement from January 2011, with an obligation to notify *ex ante* whenever such costs exceed 15%.

Untied aid: Proposals were tabled in 2004 for disciplining the untied aid programmes of OECD countries participating in the Arrangement. The proposals were challenging: the aim was to eliminate trade distortions, avoid circumvention of the Helsinki tied aid rules and expand opportunities for market financings to developing countries. Challenging also because there were concerns that disciplines might adversely affect the amount of untied aid flows to developing countries and, anyway, untied aid was deemed to be fully accessible to all potential bidders. In subsequent discussions, a modified proposal was agreed for a two-year trial period from 1 January 2005 which focused on transparency through prior notification and *ex post* reporting of individual untied ODA credits. The agreement was a pragmatic compromise that assuaged the concerns of those who were negative towards disciplines while holding out the possibility, for those in favour of disciplines, of empirical study to prove or otherwise their case. Steve Tvardek in his article on aid and trade elaborates on this transparency agreement for untied ODA credits – extended until December 2012 when the question of "rules or no rules" may be resolved.

More recent and innovative developments in the Participants' forum have encompassed energy, civil aircraft and risk pricing.

Renewable energies and water projects: In response, *inter alia*, to the Johannesburg Summit on Sustainable Development in 2002 and the MDGs, the Participants agreed in 2005 to special terms and conditions for renewable energies and water projects (RE/W) to match those available for nuclear power plants, *e.g.* 15-year maximum repayment terms. The extended tenors were considered by the Participants to be commensurate with both the increased payback periods of such projects and the need to promote environmentally-friendly technology and sustainable energy. Insofar as water projects were concerned, in Johannesburg, Ministers reiterated their commitment to halve by 2015 the proportion of people who have no access to safe drinking water and the proportion of people without access to basic sanitation; transferring technology and

supporting capacity-building for water and sanitation infrastructure and services development were recognised as priority actions. The 2005 RE/W Sector Understanding was initially for a two-year trial period, extended until the end of June 2009 at which time it was renegotiated – in parallel with the revision of the 1984 nuclear power plants sector understanding – and a new Understanding was concluded with maximum repayment tenors increased from 15 to 18 years. In evolutionary mode, the Participants are currently negotiating to extend the scope of this Understanding to include climate change mitigation sectors and technologies to reflect other international agreements to combat climate change and reduce greenhouse gas emissions.

Nuclear power plants: In July 2009 a new Sector Understanding for Nuclear Power Plants (NSU) was concluded; this replaced the 1984 agreement; it permits, *inter alia*, maximum repayment terms of 18 years. The need for a revised NSU was driven by the expectation of increased demand for new nuclear power plant builds and the view that when providing official export credit support, repayment terms should correspond more closely to the expected life of the equipment – given the high capital costs of such an investment – and that the disciplines should be in line with those of the extant Arrangement, including the provisions for interest rates and increased local cost content. The view was also advanced that a longer repayment tenor would have a positive impact on energy prices. There was an expectation on the part of the negotiators that any changes made to the NSU would also apply, where appropriate, to renewable energies and water projects and, indeed, this was the case (see above). The new NSU has been welcomed by those involved in business of financing nuclear power plants (*c.f.* the article by Jean-Hugues Perreard and Anne Crépin of AREVA), although criticised recently by ECA Watch.

Risk pricing: A main highlight of 2010 was the conclusion of an innovative agreement on premium fees. Finally, after many years of discussion in the premium experts group, under the chairmanship first of Detlev Malkuhn (Germany) and latterly David Drysdale (United States), agreement was secured in 2010 to a common framework for the pricing of all risks. This agreement expanded the risk pricing rules of the Arrangement, building upon the long-established rules on minimum pricing for country credit risk, and introduced a common framework for the pricing of buyer credit risk along with new minimum premium rates for country credit risk – the latter had remained unchanged since the 1997 Knaepen Package. The need for a new pricing approach had grown in recent years as the focus of ECAs' activity continued to shift towards private buyers. Moreover, the recent sharp increase in the demand for official export credit support related to the global financial crisis emphasised the need to ensure a level playing field for exporters competing with official export credit support for overseas sales. The implementation date of the Malzkuhn-Drysdale Package is on or before 1 September 2011; David Drysdale (United States) and Michael Gonter (OECD Secretariat) write about this innovative Package.

Civil aircraft: The other main highlight of 2010; it proved to be challenging, revolutionary and fun! Two successive civil aircraft agreements were concluded by the Participants with Brazil as a participating party – that's the revolutionary part. The first agreement in July 2007 replaced the 1986 Aircraft Sector Understanding (ASU) which was no longer relevant to the aircraft market in the 21st century. The 2007 ASU aimed to secure a more efficient level playing field among the main providers of export credits for civil aircraft and to provide a framework for exchange of information and early resolution of export credit-related disputes – against the backdrop of the outcomes of WTO disputes between Brazil and Canada on regional aircraft. The second agreement in 2010, implemented from February 2011, updated the 2007 ASU, firstly because financial markets had fundamentally changed in the wake of the global financial crisis and secondly because Canada had introduced a new aircraft, the C-series, that overlapped the criteria set for regional/smaller aircraft versus large aircraft which prompted the view that a single set of terms and conditions would be more efficient and appropriate than the bifurcated approach in the 2007 ASU. In the 2010 negotiation, the stakeholder representation included airlines: David Berg of the Aviation Transport Association and Marc Verspyck of Air France question whether ECAs have a continuing role in aircraft financing. Peter Cameron (Canada) and Marcelo Della Nina (Brazil) welcome the results of the negotiations and Jean Le Cocguic explains why the OECD is the ideal forum for these aircraft financing rules. And how was all this fun? Marcelo's and Peter's accounts of the Rio de Janeiro signing in 2007 ASU and Nicole Bollen's mention of gorillas in the mist and angels on the ceiling provide some hints.

In welcoming the 2010 ASU, the OECD Secretary-General Angel Gurría noted that "… *The ability of the participants to design, negotiate and conclude such a thorough, market-driven agreement … is testimony to the power of the multilateral co-operation that continues to drive OECD work 50 years after its creation … [its participants] … designed and negotiated the agreement in the presence of official observers from Russia and China. … Russia is becoming a prominent commercial aircraft producer and China will begin commercial aircraft production in the next few years. I believe that they will find it in their longer term economic and financial interest to join this agreement; just as manufacturers, airlines, and their governments committed to the new Aircraft Sector Understanding today. We are ready to support Russia and China in joining the ASU and the offer also extends to the full range of OECD export credit disciplines.*"

Finally, there have been developments in overarching issues that affect both the ECG and the Participants; I recall four which are ongoing:

Civil society organisations (CSOs): Consultations with CSOs are now in their 14th year. Initially consultations were in the context of environment and export credits with a handful of NGOs, but these have developed in both scope and participation to the extent that annual consultations involve representatives of over 30 organisations whose input is sought by the OECD secretariat and members on the full export credit agenda. Moreover, a peer review procedure was developed

in November 2008 in relation to the anti-bribery and environment issues which equals many such processes adopted by other OECD committees. These consultations are expected to continue to be an important element in developing rules.

Data: For export credit purposes a new directive is in train in the light of the increasing number of agreements for which data is reported. This should enable a more robust and coherent data basis from which to launch empirical analysis for all export credit agreements and to inform future negotiations.

Global financial crisis: Statements on the global financial crisis and export credits were issued in November 2008 (the first to be issued by the OECD) and again in April 2009, both of which are reproduced later in this publication. Signatories to these were OECD countries, some non-OECD countries, including Brazil, China and India, and some international financial institutions. The latest of the two Statements reaffirmed the participating parties' commitment "…*to maintain their export credit support and ensure that sufficient capacity is available with the aim of supporting international trade flows*". Special measures were put in place by many of these parties to assure the capacity referred to in the Statement and the USD 250 million G20 package; perhaps exit strategies are the next stage.

Non-OECD competition: An achievement well documented in this publication is Brazil's participation in the civil aircraft agreements of 2007 and 2010. But there remain other non-OECD emerging economies, such as China, India, Russia and South Africa, who are not signed up to any of the OECD export credit rules, although some are WTO members and thus subject to the WTO ASCM. Since 1997, these governments have regularly been represented at OECD export credit meetings, including negotiations of agreements. The challenge ahead is to persuade such non-OECD competitors of the longer term economic and financial benefits of joining the OECD export credit agreements – Steve Tvardek expounds on this and other challenges in his concluding article.

Why the OECD?

Why should the export credit rules continue to be OECD-housed? To answer this question, I recall the remarks of the OECD Secretary-General Angel Gurría, which were made on the occasion of the launch of the latest export credit aircraft agreement but which, nevertheless, obtain to all our export credit work:

> *"The efficiency of this "soft law" mechanism also lies in the fact that it is built on WTO commitments, with respect to the design and operation of export credit programmes. In turn, the WTO has delegated the implementation of these commitments to the OECD, and they are embodied in OECD agreements through specific rules on the terms and conditions of official export credit financing.*

… This "soft law" mechanism provides an expedited ability to reach agreements on financing rules, as has been demonstrated … allows for a rapid response to the major changes in the market, such as shifts in the manufacturing and financing of commercial aircraft. … The benefits of multilateral co-operation are greatly magnified in the aviation sector … our multilateral soft law mechanism was a better and more practical way of resolving … real-time competitive transaction differences. This is "hard" evidence in favour of the efficiency of "soft law". No government has ever resigned from our export credit disciplines. Commitments are made by governments at the Ministerial level and compliance is excellent".

And more recently, some words from the Chair's Summary of the May 2011 OECD MCM[16] describes the OECD as the "*… unique setting where governments can come together to share policy experiences, identify good practices, find solutions to common problems and collaborate on addressing global challenges*"; I have been in the export credit business for over 40 years and I can think of no better advocacy for the continued linkage of the OECD and export credits – so as to ensure smart rules for fair and, importantly, responsible trade.

Notes:

1. Thirty-two of the 34 OECD countries are members of the ECG: Chile and Iceland are not.
2. In May 2008, the mandates of the Trade Committee (TC) and its subsidiary bodies, of which the ECG is one, were renewed until 31 December 2013. The ECG mandate was adjusted to reflect the importance of non-OECD countries with official export credit systems and the 1999 name change from "*Group …*" to "*Working Party …*".
3. The original Participants were Australia, Canada, the EEC, Finland, Greece, Japan, New Zealand, Norway, Portugal, Switzerland and the United States.
4. Institute for International Economics, Washington, D.C. (July 1995), "*Managing Official Export Credits, the Quest for a Global Regime*" by John E. Ray.
5. OECD (1998), "*The Export Credit Arrangement, Achievements and Challenges 1978-1998*", OECD, Paris.
6. The first NGOs contact were with the Environmental Defense Fund and Eurodad; these NGOs were joined by others over time who now collectively come together as ECA Watch.
7. Transactions that are not consistent with the HIPCs' poverty reduction and debt sustainability strategies and do not contribute to their social and/or economic development.
8. The Package was named after the then Chairman of the Participants, Axel Wallén (Sweden).
9. The Package proposals were drafted by the then export credit Bureau, chaired by Eero Timonen (Finland), at their meeting in Helsinki in July 1990.
10. The Package was named after the then Chairman of the Participants, Kurt Schaerer (Switzerland).
11. This Package was named after the late Pierre Knaepen (Belgium); he chaired 21 meetings of the premium experts group in a period of 30 months.
12. The Uruguay Round was conducted within the framework of the GATT; the Round transformed the GATT into the WTO and came into effect in 1995.

13. The Participants to the Arrangement currently number nine: Australia, Canada, European Community, Korea, Japan, New Zealand, Norway, Switzerland and the United States.

14. The Organisation's governing body, the Council, has the power to adopt legal instruments, usually referred to as "the OECD Acts"; these Acts are the result of the substantive work carried out in the Organisation's Committees. *Recommendations* are not legally binding, but practice accords them great moral force as representing the political will of Member countries and there is an expectation that Member countries will do their utmost to fully implement a Recommendation. Thus, Member countries which do not intend to implement a Recommendation usually abstain when it is adopted.

15. OECD document TAD/PG(2011)4.

16. US Secretary of State Hillary Rodham Clinton chaired the 2011 OECD MCM.

GUIDANCE NOTE ON THE SCOPE AND APPLICATION OF THE ARRANGEMENT

Legal status: The Arrangement is not an OECD legal instrument; it was always intended to be "soft law" (although adopted into EC Law) but with the commitment by its negotiators of strong political and practical adherence. In 1979 the Arrangement was acknowledged in the GATT Subsidy Code as the prevailing set of rules on export credits and again in 1995 in the ASCM. As Nicola Bonucci, Director of OECD Legal Affairs, puts it in his article, the "soft law" approach has proved successful, has advantages in being easily reviewed, modified and strengthened and, insofar as the Arrangement is concerned, has been hardened not only with a reference in the ASCM but also its inclusion in EU law and treatment in WTO panels on aircraft disputes between Brazil and Canada.

Purpose: To establish a framework for the provision of officially supported export credits for the sale of capital good and projects. The Arrangement was intended to encourage competition among exporters based on the quality and price of the goods and services provided rather than on the most favourable officially supported financial terms and conditions. Thus, the three main objectives pursued by the Arrangement's Participants over the years have been to curb export subsidies and trade distortions, level the playing field, and provide transparency, both programatic and transaction-based.

Application: The Arrangement applies to officially supported export credits with repayment terms of two years or more and

includes rules on how official support in the form of trade-related tied and partially untied aid may be given. Military equipment and agricultural commodities are excluded from the Arrangement, while specific disciplines apply to ships, nuclear power plants, civil aircraft and renewable energies and water projects. A negotiation on export credits for agriculture, undertaken in the late 1990s as a follow-up to the Uruguay Round outcomes, failed – the "singular failure" to date in the negotiating history of the Participants.

Scope: The Arrangement places limitations on the terms and conditions of export credits that benefit from official support; such limitations include maximum repayment terms, minimum cash payments to be made at or before the starting point of credit, maximum local costs content and minimum interest rates when a transaction benefits from official financing support. The disciplines have been expanded over time to encompass minimum premium rates, flexibilities for project finance-type transactions, extended tenors for renewable energy technologies and minimum concessionality levels and country eligibility for tied and partially untied aid.

The Participants: There are currently nine Participants to the Arrangement: Australia, Canada, the European Community (which includes all Member States), Japan, Korea, Norway, New Zealand, Switzerland and the United States. Brazil is a Participant in the Sector Understanding for Civil Aircraft.

Export credit: For the purpose of the Arrangement this is an insurance, guarantee or financing arrangement which allows a foreign buyer/borrower of exported goods and/or services to defer payment over a period of time.

Official support: This is government-backed support for an export credit. While no definition *per se* of " official support" is written into the Arrangement, the means by which it is provided is explicitly defined: it can take the form of direct credits/financing, refinancing, interest-rate support (where the government supports a fixed interest rate for the life of the credit), aid financing (credits and grants), export credit insurance and guarantees. Direct credits/financing (where the loan is extended by the government of the exporter), refinancing and interest-rate support are referred to as "official financing support". The provision of insurance and guarantees with no official financing support is termed "pure cover".

ECAs: These are the institutions which undertake official export credit activities for or on behalf of governments. There are many different types of ECA: they may, for instance, be government departments or agencies, or commercial institutions administering an account for or on behalf of government, separate from the commercial business of the institution.

ECAs provide a range of different products and services, including guaranteeing repayment of a loan by a financial institution to an overseas buyer (for example a buyer credit facility), insuring against non-payment of a credit extended by an exporter to an overseas buyer (for example a supplier credit facility) and providing direct loans or credits to overseas buyers.

Tied, partially tied and untied aid: This is aid which is in effect tied to the procurement of goods and/or services from the donor country and to a limited number of other countries. "Untied aid" is aid whose proceeds are fully and freely available for procurement of goods and/or services in all OECD countries and in substantially all other countries.

Timeline of Export Credit Agreements

1961	*Trade Committee* established
1963	*Group on Export Credits and Credit Guarantees (Export Credit Group – ECG)* established
1974	*Sector Understandings on Nuclear Fuel* and *on Ground Satellite Communications Stations* agreed
1975	*Rambouillet Declaration from the Economic Summit in November* "... intensify our efforts to achieve a prompt conclusion of the negotiations concerning export credits."
1976	*Consensus on Converging Export Credit Policies* agreed
1978	First *Arrangement on Guidelines for Officially Supported Export Credits* agreed Forum of the *Participants to the Arrangement* established
1983	*Uniform moving matrix of interest rates and CIRRs for low interest rate currencies* agreed
1984	*Sector Understanding on Export Credits for Nuclear Power Plants* agreed
1986	• *Standard formula for setting CIRRs* agreed • *Sector Understanding on Export Credits for Civil Aircraft* agreed
1987	*Wallén Package* concluded
1991	*Helsinki Package* concluded
1992	• *Tied aid rules of the Helsinki Package* implemented • *Post-Helsinki Arrangement* text implemented
1994	*Schaerer Package* concluded
1995	*Working Group on Agriculture* established
1996	*Ex Ante Guidance on Tied Aid* published
1997	*Knaepen Package* concluded
1998	• *20th Anniversary of the Arrangement* celebrated: *The Export Credit Arrangement – Achievements and Challenges – 1978-1998* published • *Project Finance Sector Understanding* agreed • *RAG* text of the *Arrangement* implemented • *Statement of Intent on the Environment and Export Credits* agreed • *Statement on the Asian Crisis* published
1999	• *Agreement on Environment Information Exchange for Larger Projects* agreed • *Knaepen Package* implemented • *Statement of Principles on Unproductive Expenditure to HIPCs* agreed • Title change of Arrangement to *Arrangement on Officially Supported Export Credits* • Title change of the ECG to *Working Party on Export Credits and Credit Guarantees*
2000	• *Action Statement on Bribery and Export Credits* agreed • NOT AGREED – *Sector Understanding on Export Credits for Agricultural Products*

and Events from 1961 to 2011

2001

- Voluntary *Common Approaches on the Environment and Export Credits (REV 6)* implemented
- *Revised Statement of Principles on Unproductive Expenditure to HIPCs* agreed

2002

Sector Understanding on Export Credits for Ships agreed

2003

- First revision of *Ex Ante Guidance on Tied Aid* published
- *OECD Recommendation on the Environment and Export Credits* agreed

2004

- *Post- Brazil/Canada WTO panels Arrangement* text implemented.
- *Untied Aid Transparency Agreement* implemented on a trial basis [continues to end-2012]

2005

- Updated *OECD Recommendation on Common Approaches* agreed
- *Project Finance Sector Understanding* agreed
- *Statement on Export Credits and Hydro-power Projects* published
- *Sector Understanding on Export Credits for Renewable Energies and Water Projects* agreed
- Second revision of *Ex Ante Guidance on Tied Aid* published

2006

- Revised *Action Statement on Bribery and Export Credits* agreed
- Adoption of *OECD Council Recommendation on Bribery and Export Credits*
- *ECG's Terms of Reference* adjusted

2007

- Revised *OECD Council Recommendation on Environment and Export Credits* adopted
- Revised *Sector Understanding on Export Credits for Ships* agreed
- New *Sector Understanding on Export Credits for Civil Aircraft* agreed and implemented with Brazil as a Participant

2008

- *30th anniversary of the Arrangement* celebrated: *Export Credit Arrangement 1978-2008 — Achievements and Challenges continued!* published
- *First Statement on the global financial crisis and export credits* published
- *Principles and Guidelines for Sustainable Lending to Low-Income Countries* agreed

2009

- *Second Statement on the global financial crisis and export credits* published
- Revised *Sector Understanding on Renewable Energies and Water Projects* agreed
- Revised *Sector Understanding on Nuclear Power Plants* agreed

2010

- *Malkhun-Drysdale Package* concluded
- Revised *Sector Understanding on Civil Aircraft* agreed with Brazil as a Participant

2011

- Latest *Arrangement* text issued – TAD/PG(2011)4 in March 2011
- *Malkhun-Drysdale Package* implemented
- Revised *Sector Understanding on Civil Aircraft* implemented
- *Smart Rules for Fair Trade* published to commemorate 50th OECD Anniversary

FUTURE CHALLENGES

- *To preserve the gains made to date within the existing boundaries and disciplines of the Arrangement and the ECG.*
- *To ensure these boundaries evolve and meet changes in financial markets, buyers' financing needs and governments' objectives.*
- *To widen the scope of multilateral co-operation by including major emerging economies in the building and operating of the multilateral export credit system.*

Chairpersons of the OECD Export Credit Committees from 1963 to 2011

Nicole BOLLEN
Netherlands
2005-2009

Birgitta NYGREN
Sweden
2000-2003

Eero TIMONEN
Finland
1989-1991

Axel WALLÉN
Sweden
1980-1987

Rolf GEBERTH
Germany
1973-1976

Sir Anthony PERCIVAL
United Kingdom
1967-1971

The Group on Export Credits and Credit Guarantees established in 1963

François de RICOLFIS
France
2009-

Mike ROBERTS
Australia
2004

Kurt SCHAERER
Switzerland
1992-1999

John COLEMAN
Canada
1988

The Participants to the Arrangement on Guidelines for Officially Supported Export Credits established in 1978

Gilbert MORLEGHEN
Belgium
1976-1979

Michel FREYCH
France
1971-1973

Hans BÜHLER
Switzerland
1964-1967

THE EARLY YEARS: FROM OEEC TO OECD, 1953 TO 1962

Jean Le Cocguic

Jean Le Cocguic is a Senior Policy Analyst in the OECD Export Credits Division and has made a special study of the origins of the export credits rules which were developed under the auspices of the Organisation for European Economic Co-operation.

In the reconstruction phase which followed World War II, most European countries set up specialised institutions (export credit agencies) which were tasked to support national exports through various financial mechanisms such as export credits or credit guarantees. By that time, these institutions were public and the modalities of official support that they offered were very soon considered as being artificial aid to exporters.

The first international efforts to regulate such export subsidies were undertaken from 1953 to 1959 in the framework of the Organisation for European Economic Co-operation (OEEC). At the same time, the young GATT was issuing its first general regulations on subsidy controls; subsequently, these regulations incorporated most of the prohibitions that had been issued by the OEEC, while the latter organisation became the OECD as of 1961[1]. From that moment, the GATT (and thereafter the WTO) and the OECD played complementary roles in the international regulation of export credits.

The OEEC issues the first guidelines on phasing out aid to exporters

The OEEC first began working to improve the liberalisation of trade as far back as 1950. Then, on 24 March 1953, the Council of the OEEC adopted a Resolution on the "future of the liberalisation of trade",[1] which requested the Steering Board for Trade – the predecessor of the OECD Trade Committee – to study, among other issues, "… means whereby artificial measures designed to aid exporters, which in the result tend to distort the normal pattern of competition, may be removed". The issue in those days was not export credits, but more generally "artificial aid" which could distort competition. In response to the Council's request, the Steering Board drafted a questionnaire which asked for factual information on the different

types of aid available to exporters at the time, including fiscal aid, supplies of raw materials on preferential terms, and direct and indirect subsidies. It also asked two questions on credit and credit guarantees:

> "3. What measures in the field of credit policy, with a view towards the granting of credit facilities on more favourable terms (volume, rates of interest, duration of credit, etc.) than would have been obtainable under normal commercial conditions, are being taken by your Government or governmental agencies to aid exporters?
>
> 4. What guarantee systems for export credits, financed or subsidised by your Government, are at present in force in your country? What kind of risks are covered by the system (political and currency risks, risks of increases in prices of raw materials, wages, etc.)? How large a guarantee fund is available for the purposes of this scheme? What proportion of total exports have in recent years been covered by such guarantees?"

On 24 July 1953, the OEEC Council adopted a Recommendation on "measures designed to aid exporters"[2] in which it recommended that Member countries "… refrain, while the work of the Steering Board for Trade is in progress, from taking measures which might result in complicating still further any action which the Organisation may decide to take after the Board has terminated its work". This standstill clause could be considered limited in impact since it appears in a non-binding Recommendation and because its wording is moderate, *e.g.* "refrain… from taking measures which might… any action which the Organisation may decide to take…".[2] In addition, the standstill clause applied only to measures that Member countries might take in the future, not to existing measures that had already been implemented.

OEEC Council Decision of 14 January 1955, measures designed to aid exporters

In the light of the replies to the OEEC questionnaire, on 14 January 1954 the Council adopted a Decision on "Measures Designed to Aid Exporters"[3] which is recorded as the first international text establishing disciplines on export credits practices. In this Decision, the Council requested that Member countries discontinue, by 31 December 1955, artificial aid to exporters in the form of measures listed in Annex I. Until such discontinuation, the Decision included standstill clauses (Member countries should not further extend the application of existing measures of artificial aid to exporters or introduce further measures of the kind); paragraph (e) of Annex I of the Decision read as follows:

> "In respect of Government export credit guarantees, the charging of insurance premiums otherwise than in accordance with sound insurance principles (*i.e.* lower than is appropriate to the costs and extent of the risks covered)".

The 1955 Council Decision was legally binding: for the first time, member countries undertook to discontinue aid measures and to stop introducing new measures. In addition, the 1955 Decision marks the start of the OEEC's role as a supervisory body for international regulations in the export aid field: the text provided for an effective monitoring of the ban established. Measures deemed to be incompatible with the principles outlined in the Decision could be referred to the OEEC, which could then request the member country concerned to discontinue or modify the measure in question. In practice, the deadline for phasing out the listed artificial measures, initially 31 December 1955, was extended by successive Council Decisions until 30 June 1959. However, the Decision only mentioned credit guarantees. The Council asked that more work be carried out, in particular, "… the export incentives in the field of government credit for the financing of exports". This work resulted in two major new Council Decisions, adopted on 22 July 1958: the first to establish a consultation procedure and the second specifically focusing on export credits.

OEEC Council Decision of 22 July 1958 establishing a consultation procedure on aids to exports[4]

This Decision supplemented the January 1955 Decision and covered aid not prohibited under the first Decision and, in particular, aid or subsidies operating directly or indirectly to increase the exports of a member country. The Decision established a consultation procedure on request by any Member country which deemed that its interests were being seriously prejudiced or threatened by such aid; the purpose of the procedure, which was compulsory in this case, was to consult on the possibility of limiting such measures or their effects. The OEEC henceforward classified aid to exports into two categories: (1) "artificial" aid, prohibited under the 1955 Decision and (2) other aid which may be subject to consultation. In effect, this was the first version of a distinction between "prohibited" aid and "actionable" aid which would later appear in the GATT disciplines and in the WTO Agreement on Subsidies and Countervailing Measures (ASCM).

OEEC Council Decision of 12 July 1958 on measures to aid exporters in the field of export credits and export credit guarantees[5]

This important milestone extended the scope of application of the 14 January 1955 Decision in two ways: firstly, by extending prohibited aid to the export credit area and, secondly, by inviting Member countries to communicate the financial results of covering export risks for government export credit support programmes. The salient points of the Decision were:

- Paragraph (e) in the list of artificial aids to exporters was amended to "… In respect of Government export credit guarantees the charging of premiums at rates which are manifestly inadequate to cover the long-term operating costs and losses of the credit insurance institutions."

- The following measures were added to the list: "g) The grant by Governments (or special institutions controlled by Governments) of export credits at rates below those which they have to pay in order to obtain the funds so employed." and "h) The Government bearing all or part of the costs incurred by exporters in obtaining credit".

- The Council also recommended that Governments of Member countries communicate, confidentially and subject to reciprocal treatment, on request, the financial results of covering export risks (either by the Government or be institutions controlled by it).

The Council requested the Steering Board to continue its studies to determine which practices in the financing of export credits were likely to distort competition among exporters. In effect, the scope and types of discipline applicable to export credit systems were considerably extended by the Decision of 22 July 1958: the scope of application of prohibited measures included direct credit for exports at rates below the rates that Governments had paid to obtain the funds [paragraph g)], together with other subsidies where the costs to exporters of obtaining credit were borne by the Government [paragraph h)].[6]

In fact, two fundamental changes were made in respect of export credit guarantees. The first was that the criterion for benchmarking risk premiums was no longer "sound insurance principles"; instead, the prohibition was made more specific, applying to rates that "are manifestly inadequate to cover long term operating costs and losses of the credit insurance institutions". The wording of the 1958 text clearly opted for a "long term", "cost-based" approach. Furthermore, the introduction of the term "manifestly" allowed Governments a degree of discretion in setting premium rates; accordingly, only rates that were "manifestly" inadequate would be categorised as a prohibited subsidy (the word "manifestly" was subsequently deleted during the Uruguay Round). Thus, this fundamental OEEC Council Decision established two basic prohibitions in the export credit field, applying to credit guarantees and to direct financing, which are the origin of the prevailing (1995) ASCM, Items (j) and (k)-1 of the Illustrative List of Export Subsidies.

OEEC Council Decision of 17 February 1959 on measures designed to aid exports[7] (including export credits and export credit guarantees)

Although the deadline for discontinuing certain aids to exporters set in the OEEC 1955 Decision was extended year-by-year until 1959, it became clear that not all OEEC Members complied with the Decision within this timeframe. The Council, therefore, decided to consolidate and strengthen OEEC regulations on aid for exports. Thus, this 1959 Decision reiterated the prohibition on granting artificial aid as defined in the list in the Annex (the list reprises the provisions of the Decision of 22 July 1958 concerning export credits and export credit guarantees), reaffirmed the compulsory standstill on other measures of artificial aid to exporters which distorted competition among

exporters and recapitulated the two consultation procedures open to Member countries. The consultations could also cover export credits and credit guarantees.

While not contrary to the prohibitions under paragraphs (f) – adequate risk premiums, (g) – loan rates higher than the cost of obtaining the funds and (h) – governments not to bear the costs incurred in obtaining credit, export credits and credit guarantees could, nonetheless, be prejudicial to the interests of another member country or directly or indirectly increase exports of a given product. However, the 1959 Decision also allowed Member countries to apply temporarily appropriate solutions to aid granted for agricultural and food products, provided that they complied with the appropriate OEEC Resolutions on the subject.

In addition, the Council also decided that every member country should communicate, confidentially and subject to reciprocal treatment, to any other member country which so requested, the financial results of its covering export risks (previously this was only a recommendation). Lastly, more work was mandated to determine which practices in the financing of export credits and the insurance of export risks were likely to distort competition.

OEEC Council Decision of 17 July 1959 on strengthening the consultation procedures on measures designed to aid exports

This Decision specified the scope of the consultation procedures, approved on 17 February 1959, and the methods for implementing them, including the extension of compulsory consultation to member countries that were importers of products benefiting from the aid in question. Previously the consultation procedure only applied to the member country granting the aid and the Member country referring the complaint. This last Council Decision closed the first, legally binding and intensive rule-making phase at the OEEC. In parallel, the GATT established in 1947, had started its work on export subsidies.

The first GATT ban on export subsidies

The first, 1947, GATT rules on subsidies (Article XVI) did not incorporate any particular provisions on export subsidies, still less on export credits. The first bans on export subsidies appeared in Article XVI-B (3 and 4) of the GATT, which were added in April 1955. According to Article XVI-B, the GATT Contracting Parties were asked:

- To seek to avoid the use of subsidies on the export of primary products. (XVI-3).
- As from 1 January 1958, to cease to grant either directly or indirectly any form of subsidy on the export of any product other than a primary product which subsidy results in the sale of such product for export at a price lower than the comparable price charged for the like product to buyers in the domestic market. (XVI-4).

A standstill clause was added to the GATT so that the scope of application of the subsidies referred to in Article XV1-4 could not be extended beyond that existing on 1 January 1955. This standstill arrangement, initially intended to apply until 31 December 1957 – the date on which the restrictions under Article XVI-4 were to come into effect – was extended until 1967, when it expired. However, the 1 January 1958 deadline to implement the ban on subsidies for the export of products other than primary products was not met, and the implementation of Article XVI-4 was referred to a GATT Working Party which, on 19 November 1960, adopted a Declaration with a view to bringing Article XVI-4 into force.

In fact, the Declaration only became effective on 14 November 1962 for 16 out of the 43 Contracting Parties at that time (OECD members except Greece, Iceland, Ireland, Portugal, Spain and Turkey), plus New Zealand and Rhodesia. The GATT Article XVI-4 process was run in parallel with the extension until 1959 of deadlines for the prohibition of aid for exporters set out in the January 1955 OEEC Decision. This parallelism in both sets of disciplines is not surprising considering that a large proportion of the Contracting Parties to the 1947 and 1955 GATT were also Member countries of the OEEC and, from September 1961, of the OECD.

Export subsidy ban by the GATT and transition of rules to the OECD

The 1960 to 1962 period was transitional in respect of the OEEC Decisions. In December 1960, the OECD Preparatory Committee for Trade Issues examined the future of trade legal instruments adopted by the OEEC. It recommended that certain Acts, including the Decision of 17 July 1959 on aids to exporters, should not be maintained by the new OECD. In parallel, the negotiators in both the OECD and the GATT did not wish to lose the List in the Annex to the Decision of 17 July 1959, which contained concrete examples of prohibited export subsidies. During the discussions of the GATT Working Party on the implementation of Article XVI-4, it was noted that the list should not be considered exhaustive and that for governments which approved the Declaration, the practices described in the List should generally be considered as subsidies within the meaning of Article XVI-4.

The List was finally included in the November 1960 which entered into force in November 1962. The status and content of the List remained unchanged until 1979, when it was incorporated into an annex of the Agreement on Interpretation and Application of Articles VI, XVI and XXIII of the GATT, a plurilateral agreement also known as the "Subsidies Code". Article XVI-3 of the GATT on export subsidies for certain primary products was maintained and its provisions were transferred into Article 10 of the Code. Article XVI-4 was inserted into the Code as a new Article 9, and the three paragraphs (f), (g) and (h) in the initial List of export subsidies that related to export credits and credit guarantees became paragraphs (j) and (k) of the annex called the "Illustrative List of Export Subsidies".

In 1979, paragraph (k)-2 was also added to the List of Export Subsidies, to take account of the fact that the Arrangement on Guidelines for Officially Supported Export Credits had been agreed in 1978 under the auspices of the OECD, with the implied reference of "…is a party to the international undertaking on official export credits to which at least twelve original signatories to this Agreement are parties as of 1 January 1979". Excerpts of the GATT Subsidies Code concerning export credits are shown in the box below.

The OECD Arrangement came into effect in April 1978 and over 30 years later it continues to be the internationally recognised set of rules governing the provision of official export credits.

Article 9 and Items (j) and (k) of the Illustrative List – 1979 GATT Subsidies Code

Article 9

1. Signatories shall not grant export subsidies on products other than certain primary products.
2. The practices listed in points (a) to (l) in the Annex are illustrative of export subsidies.

Annex: Illustrative List of Export Subsidies [Excerpts]

(j) The provision by governments (or special institutions controlled by governments) of export credit guarantee or insurance programmes, of insurance or guarantee programmes against increases in the costs of exported products or of exchange risk programmes, at premium rates which are manifestly inadequate to cover the long-term operating costs and losses of the programmes (5).

(k) The grant by governments (or special institutions controlled by and/or acting under the authority of governments) of export credits at rates below those which they actually have to pay for the funds so employed (or would have to pay if they borrowed on international capital markets in order to obtain funds of the same maturity and denominated in the same currency as the export credit), or the payment by them of all or part of the costs incurred by exporters or financial institutions in obtaining credits, in so far as they are used to secure a material advantage in the field of export credit terms.

Provided, however, that if a signatory is a party to an international undertaking on official export credits to which at least twelve original signatories (6) to this Agreement are parties as of 1 January 1979 (or a successor undertaking which has been adopted by those original signatories), or if in practice a signatory applies the interest rates provisions of the relevant undertaking, an export credit practice which is in conformity with those provisions shall not be considered an export subsidy prohibited by this Agreement.

Notes

1. Document C(53)90 of 24 March 1953.
2. Document C(53)156(Final) of 24 July 1953.
3. Document C(55)6 of 14 January 1955.
4. C(58)16 Final of 22 July 1958.
5. Document C(58)138(Final) of 22 July 1958.
6. Paragraphs g) and h) of the Decision would later be merged in the Illustrative list.
7. Document C(58)271 (Final).

OECD WORK ON EXPORT CREDITS: A LEGAL AND INSTITUTIONAL LABORATORY

Nicola Bonucci

Nicola Bonucci is Director of the OECD 's Legal Directorate. Legal Affairs, inter alia, provides advice and information on the legal, institutional and procedural aspects of the Organisation's activities, including the negotiation, interpretation and application of the Legal Instruments of the Organisation.

A Gentlemen's agreement

Not long after I joined the Legal Office of the OECD, in 1995, I was invited by Janet West (then Head of OECD's Export Credits Division) to attend a meeting of the Redrafting of the Arrangement Group (RAG). The RAG was in charge of the revision of an international legal instrument that was completely unknown to me, the "Arrangement on Officially Supported Export Credits" (hereafter the Arrangement), and I was most welcome to come and get acquainted with this part of my new portfolio.

As a young and dedicated public international lawyer, I decided to prepare myself well and started to read with care the Arrangement, but the more I read the less I understood – not only because I was not at all familiar with the substantive issues at stake but, more importantly, because I could not figure out the legal status and nature of the document I was reading.

The document was presented as a "Gentlemen's agreement" but looked, in a number of respects, like a legally binding treaty. It contained a "best endevours" clause but also provided for derogations to its provisions. It was not considered an OECD legal instrument but had been negotiated within the OECD and supported by a secretariat composed of OECD staff.

I was quite excited about my findings and arrived in the meeting room with clear ideas and concrete proposals on how we should work in order to improve the legal coherence of this unusual legal

instrument. My enthusiasm was, however, soon chilled by the reaction of the then Chairman of the RAG (Bob Crick, a fellow contributor to this publication) who, after a few interventions on my side, looked at me and said (by memory) "Dear young fellow, thank you very much for your interventions but this Arrangement has been functioning perfectly well since its establishment in 1978…". While at the time I felt annoyed and even unhappy by his comment, I have to admit that if I had been the Chairman of the RAG I would have reacted exactly in the same manner. The reality is that the Arrangement is a *sui generis* document which delivers what its participants expect and there are not many international documents that meet this test!

More broadly one can say that in terms of cost-benefit, the OECD work on export credits is one of the best bargains for OECD members and even beyond. It is pioneering work in a number of respects but first and foremost, with respect to the substantive area it covers, is the establishment of self-disciplines on export credits almost 20 years before the setting up of the WTO. This was certainly forward looking.

But the OECD export credit work also presents a number of other interesting features, in particular from a legal and institutional angle, and those are the two aspects I would like to cover in the present brief article.

The legal creativity of the OECD work on export credits

Bismarck used to say that "… the war is too important to be left to generals". In looking at the OECD work on export credits we may conclude that the law is too important to be left to lawyers! The fact is that the various instruments developed in the last 30 years, both in the context of the Participants to the Arrangement (the Participants) but also within the OECD Working Party on Export Credit and Credit Guarantees (Export Credit Group – ECG), have been largely developed by practitioners and have resulted in legal instruments which are operationally sound and used by these same practitioners. It also means that the famous "legal coherence" mentioned in my introduction may suffer here and there (even though a lot has been done in the last few years to remedy this), but this does not affect the general direction of the instruments in question.

From a legal point of view all the instruments, be it the ones developed by the ECG or the ones established by the Participants to the Arrangement, have a common feature: they are not legally binding, they are what international lawyers call, after Lord McNair invented these terms, "soft law". What is soft law? There is no universally agreed definition of what exactly these terms are supposed to mean or cover: recommendations, guidance, principles, arrangements, guidelines, action plans are all different tools used in the international community to produce "soft law". While the terms are different they are all intended to define a "non-legally binding instrument", *i.e.* an instrument that does not commit legally those who have subscribed to it. But does this mean, therefore, that the Arrangement or the various OECD Recommendations agreed by the

ECG and adopted by the OECD Council are meaningless pieces of paper? It suffices to see the history of the Arrangement to understand that this is not the case. This "Gentlemen's agreement" has been by and large respected by all its Participants who feel politically, if not legally, bound by it.

Furthermore, it is a fact that the Arrangement has been "hardened" by three different actions:

- A reference to it in the WTO Agreement on Subsidies and Countervailing Measures (ASCM).[1]
- Its inclusion in EU law.[2]
- Its treatment in the WTO panels dealing with the aircraft disputes between Canada and Brazil.[3]

In particular, the inclusion of the Arrangement as item (k) of the Annex to the ASCM has not only made the Arrangement an instrument of reference in a legally binding treaty, but it has also "multilateralised" its scope of application. Any WTO member who acts in the framework of the Arrangement, even without being a formal Participant to it, would be deemed to comply with WTO obligations. In this respect, the Arrangement has become a worldwide standard.

The work carried out in the ECG, while being more classical and taking the form of OECD Recommendations, cannot be underestimated either. The Recommendation on export credit and bribery is the benchmark for the evaluation carried out by the OECD Working Group on Bribery in International Business Transactions; here again one can see that the border between soft law and harder instruments is not as wide as one could imagine.

It is the case that because instruments in the export credit field are not legally binding they can more easily be reviewed, modified, amended and strengthened. Thus, the first instrument on export credit and bribery was a mere Action Statement issued by the ECG in 2000.[4] This Statement was enhanced once before being converted into a full-fledged OECD Recommendation. Indeed, similar stages led to the OECD Recommendation on export credits and the environment. These are perfect examples of the merits of a gradual approach and one that ensures that there is ownership of the instrument once it is developed. The bottom-up approach of the OECD and the fact that OECD members take OECD legal instruments, even non-legally binding ones, quite seriously means that soft law developed in the OECD context is more effective than one developed by a number of other international institutions.

The institutional setting of the OECD work on export credits: A way for the future?

Maybe the less well-known point and specificity to understand, as an outsider, is the articulation and the relationship between the Participants to the Arrangement and the ECG. The forum of the Participants is not considered to be an OECD body as it groups the countries and institutions that participate in the Arrangement; this means that the forum is not legally bound by the OECD rules of procedure on issues such as participation of non-members, classification of documents or elections of the bureau. It also means that, formally speaking, the European Commission may represent all the EU Member States as one Participant. This particular setting gives the Participants certain latitude; while they usually work following the OECD procedural framework they can always depart from it and the Participants can also approach countries which are not in the Arrangement in a more informal and, one may argue, more effective way. Thus, Brazil joined a few years ago the sector understanding on aircraft without becoming a Participant to the overall Arrangement. As a sort of permanent conference of the parties, the Participants to the Arrangement may also decide to revise the Arrangement or parts of it at anytime and within the calendar that they deem most appropriate. It is through this pragmatic approach that the Arrangement remains a legal instrument connected with the reality of a rapidly evolving sector. However, the Arrangement would not have been able to respond by itself to the challenges faced by export credits if its work had not been complemented by the ECG. Contrary to the Participants, the ECG is an OECD body in which European Union members participate with their own vote and voice. The ECG has a peculiar place in the OECD hierarchy as, while being established by the Trade Committee, it reports directly to the OECD Council[5]. Thanks to its broader mandate, the ECG has been able to tackle issues that would have been difficult to handle in the context of the Arrangement, such as export credits and environment or export credits and bribery. The ECG also allows the Export Credit Agencies (ECAs) of the OECD members to share experiences and learn from each other, including from implementation of agreed Recommendations and guidelines (such as those established for sustainable lending to low-income countries).

Insofar as the relationship between the two bodies is concerned, it is one of full complementarity which is facilitated by the fact that countries are usually represented in the two bodies by the same people, as well as by virtue of an atypical institutional setting in which both bodies are served by the same secretariat composed of OECD staff.

The role of the OECD secretariat both as an institutional memory and a go-between, as well as honest broker, cannot be underestimated. In this context it is crucial to have a single secretariat which serves two institutionally and substantively different, but at the same time highly interlinked and interdependent, instruments and bodies. In fact, if looked at from a broader perspective, one could argue that this particular configuration could be a template of what the OECD should aspire to become.

My conclusion

The OECD work on export credits is a perfect illustration of the added value of the OECD in the international context. It is a cutting edge issue, highly technical and at the same time extremely concrete and politically sensitive. The OECD has built an expertise that everybody recognises and seeks to put this to the benefit of a better, and stronger, global governance.

Both in terms of legal instruments and of institutional setting, the OECD work on export credits could be seen as a sort of laboratory for the future of the OECD: open to major players, whether OECD members or not, both serving its membership but also able to bring its skills and technical expertise into a wider context and agenda, offering a high quality of service thanks to a motivated and qualified secretariat, managing to fulfill its ambitious 50th anniversary motto of promoting "better policies for better lives".

Notes

1. *www.wto.org/english/docs_e/legal_e/24-scm_03_e.htm.*
2. *ec.europa.eu/trade/creating-opportunities/trade-topics/export-credits/.*
3. *www.worldtradelaw.net/reports/wtoab/brazil-aircraft(ab)(21.5).pdf* and *www.worldtradelaw.net/reports/wtoab/canada-aircraft(ab)(21.5).pdf.*
4. *www.transparency.org/global_priorities/public_contracting/instruments/export_credit_agencies* for a full history.
5. Point 5 of the ECG mandate "… when the reports of the Working Party call for action by the Organisation as such, they shall be forwarded *in toto* to the council, with any comments the Trade Committee may wish to make".

Part III

FORUM OF VIEWS

1. *Challenges going forward…*

2. *Building bridges: From aircraft to sustainable lending*

3. *Reflections on export credits in the OECD*

4. *Human rights and labour standards: The duty of export credit agencies*

5. *Past achievements of the Arrangement and future challenges*

6. *OECD's achievements on export credits: A mirror of its strength*

7. *A German perspective of export credits in the OECD*

8. *Export credits and Korea*

9. *The European Banking Federation and OECD export credits*

10. *Towards the next 50 years: A view on outreach*

11. *Financing nuclear power plants*

12. *Negotiating as a block: The EU and export credits*

13. *A long history in facing challenges*

14. *OECD and agricultural export credits: A singular failure*

15. *Negotiations and export credits in the OECD: A never-ending story*

16. *The business view*

17. *The OECD and civil society in the fight against corruption*

18. *Strength in co-operation: The Berne Union and the OECD*

19. *Export credit agencies at the OECD: Any role left?*

CHALLENGES GOING FORWARD...

Angus Armour

Angus Armour is Managing Director and Chief Executive Officer of the Export Finance and Insurance Corporation (EFIC) of Australia; EFIC is Australia's official export credit agency which provides finance and insurance solutions to help Australian companies export and invest offshore to overcome financial barriers. The author was elected President of the International Union of Credit and Investment Insurers (the Berne Union) in 2009 and his term continues through 2011.

An Australian colleague retired recently to a farm in the outback, in rolling hills that shield from sight the nearest village 20 minutes away which consists of four houses and a general store that becomes a pub after 5.00 pm. The weatherboard farmhouse is wrapped by a timber porch that overlooks the hills and is surrounded by a high fence that encloses a flock of sheep.

Our colleague removed the fence first thing; it would improve the view and let the sheep roam. He visited the pub that evening to celebrate his triumph of city-ingenuity over the inertia of the country. "Oh yes", said the locals, "removed the fence, eh? Let the sheep roam away from the house then? You'll have snakes in the house now. When the sheep are grouped close to the house, the snakes don't like it and stay away. Remove the fence, the sheep roam, and the snakes come into the house." The next day the fence was reinstated and the sheep were penned!

Achieving policy consensus in dynamic markets

Without taking the allegory too literally, there is an echo of our efforts as guardians and public agencies to impose disciplines on export credits; to create a framework that is commercially responsive but without the volatility of commercial markets. We would not be the wolves in any narrative, but we do gather to exercise some authority in maintaining a fence of market discipline. We protect the house behind the guidelines developed in the OECD Arrangement on Officially Supported Export Credits. Any fence needs maintenance though, and sometimes a new fence is required to satisfy new neighbours.

There have been significant changes over the years in the disciplines of the Arrangement (*e.g.* project finance rules, special terms under sector understandings, adjusted local cost rules and, recently, buyer risk pricing

rules). At every stage of fundamental change, there has been broad agreement on the need for progress. My personal history in export credits began in 1987 when I joined the Canadian Export Development Corporation (EDC), the Canadian export credit agency (ECA) as a freshly minted MBA with a background in finance theory. I recall confronting the matrix of lending rates that governed our work, which had no relationship to finance theory whatsoever; however, it was a starting point, a basis on which authorities could agree to extend export credits. Dedicated work by successive colleagues continues to adapt that framework to the demands of our diverse stakeholders.

These changes to the Arrangement have transformed it to a more market reflective instrument, but not to the degree that export credit activity precisely and immediately mirrors the movements in commercial markets. I recall the comment of a former global head of export finance of a major European bank that "… sticky ECA pricing and conditions sometimes help us to avoid rushing into mistakes." Our shareholders now are confronting the challenge that financial markets can systematically misprice risk and the consequences for governments in fiscal and regulatory terms. "Behavioural economics" as a discipline is attracting more attention, particularly in application to financial markets and the tendency of these markets to herd behaviour. Despite these challenges, there is a remark that I have heard attributed to Edward Demming, the American quality management guru, that "… all models are wrong, but some models are useful" and from our perspective, the market interplay of supply and demand for capital is the appropriate basis for the decisions we take about risk and pricing in export credits, as a business that itself uses capital.

From the perspective of our clients, the transformation of the Arrangement has been welcomed but there is concern with the pace at which changes have been adopted. We have been seen as slow to adopt new tools in the market, which in some cases has been our good fortune, but we have lost opportunities as well. Inevitably, the cycle will turn and we will be called to embrace new tools and approaches. We must be prepared to respond responsibly drawing on the successes and lessons in our industry and in the financial sector generally.

Maintaining the integrity of the Arrangement

One challenge will be to maintain the integrity of the Arrangement as we adapt to the legitimate concerns of new members welcomed into the OECD export credit community. It is a significant challenge also to "socialise" the OECD disciplines by drawing in non-OECD countries, and in particular Brazil, Russia, India and China, who have become major providers of export credit support, but this challenge must be met for the Arrangement to remain relevant. Otherwise, matching terms may become more prevalent and in turn render the disciplines of the Arrangement less relevant, which would undermine the collective benefit of the group.

So how should we continue our engagement with the non-member economies? We could tap into the G20 as a forum through ministerial discussions on international economic policy initiatives; or possibly elevate capacity building as part of our outreach programme, in line with ongoing work in monitoring implementation of guidelines on the environment, anti-bribery/corruption and sustainable lending measures. A consensus on the best approach to answering this question will develop over time.

Other developments may potentially influence the development of the Arrangement. A current topic of discussion is ECA support that falls outside the Arrangement, such as untied loan/guarantee programmes and a push for transparency of these programmes *via* the OECD Working Party on Export Credits and Credit Guarantees. Currently, transparency is confined to untied aid transactions but there is a reasonable basis to consider expanding such transparency to untied loan programmes.

ECAs also must adapt to the strategic initiatives of international financial institutions (IFIs) and multilateral agencies (MLAs) in trade finance. MLAs appear to be re-inventing themselves with changes to their offerings or existing conventions. This is desirable if it creates a more responsive and market-oriented product but it also may represent a more attractive alternative for banks than ECA backing (*e.g.* through participation in MLA "B" loans and the advantage of preferred creditor status afforded to MLAs). IFIs and MLAs are not subject to the disciplines of the Arrangement; from a borrower's perspective, the attraction could be lower funding costs, albeit some MLAs are mandated to support only projects with a developmental impact.

Finally, as new normal market conditions return, how will the role of the ECA evolve? Increasingly, as institutions we talk about the globalisation of our clients, not just their exports. In the world of integrated supply chains, what role will we play in mobilising global trade and investment? How will we complement the private market, given the landscape created by the financial crisis and the regulatory changes we anticipate? How will the essential element of collaboration continue to be achieved in the field of medium- and long-term official export credit support?

The energy and diligence shown by our colleagues in the OECD, our guardian authorities and the practitioners who have devoted their time to the framework issues confronting our industry, are an inspiration for us to pursue the answers to these questions and more. Those of us who work in this field, or those who have benefitted from export credits, are grateful for their continued dedication.

BUILDING BRIDGES: FROM AIRCRAFT TO SUSTAINABLE LENDING

Nicole P.F. Bollen

Nicole Bollen is the chief Paris Club negotiator for the Netherlands on behalf of the Ministry of Finance and was the Chairwoman of the OECD export credit committees from 2005 to 2009, prior to which she was a Vice-Chairwoman in 2004. From 2000 to 2003, the author was Head of the Dutch Delegation to OECD export credit meetings and from 1996 to 2000 was Agricultural Attaché in the Delegation of the Netherlands to the OECD.

Little did I know what I had let myself in for when Mike Roberts (Australia, and then Chairman of the OECD export credit committees) asked me, once I had joined the Bureau in 2004, to take the export credit Aircraft Group under my wing. Mike, in his convincing down-under way, said "… there is not an awful lot happening … other than to explore whether or not Brazil would be interested in joining the discussions on a possible update of the rules for aircraft financing".

The notion of Brazil, a non-OECD country, participating in an OECD negotiation followed from the WTO disputes between Canada and Brazil on aircraft financing. If Brazil were to be interested in participating in the revision of the 1986 Aircraft Sector Understanding (ASU) – which was and remains annexed to the Arrangement on Officially Supported Export Credits – this would mean more work for the Aircraft Group; if not then the Group would remain in sleeping mode. A nice Group with which to start my Bureau responsibilities!

Aircraft and gorillas in the mist!

So I agreed to Mike's proposition and the rest is history. Before we knew it, we were in full flight of aircraft negotiations, with Brazil's participation, from 2005 to 2007 and all together we managed to land the new ASU safely in Rio de Janeiro in July 2007, with OECD Secretary-General Angel Gurría as a witness. Cheers Mike, no regrets, it was a fascinating experience and until now, one of the more challenging but also more rewarding of my professional career.

We made it, despite the fact that I sometimes had the impression that I was watching "Gorilla's in the mist" and that some of us came out looking like Saint Sebastian – shot with arrows! I will never forget the angels on the ceiling of the meeting room in the Maison de Benelux (the Embassy of the Benelux countries to the OECD) encouraging us to find compromises.

The personal courage and great skills of the negotiators and their teams, a great Vice-Chairman and a very skilful professional secretariat, helped us manage to fly just in the nick of time through the ever-faster closing window of opportunity. This episode shows that there is, indeed, life after a WTO dispute. In this case, it was the OECD offering a unique platform to formulate commonly agreed rules to ensure a level playing field at the lowest possible expense for the tax-payer. Coming from the Ministry of Finance, the Treasury, I have always found it of paramount importance that export financing terms, as such, should not be used as a means of competition to win business. After all, it is tax-payers' money that can be spent only once. Competition should be based on the quality of the goods and services rendered. May the best bid win – and not the most favourable financing package!

Time was ripe for improved (good) governance

Apart from the typical Treasury perspective, sustainability and good governance were also of keen interest to me in the work we managed to do during my chairmanship of the OECD export credit committees. I have no pretension whatsoever that there is any originality in following these principles other than good sense. My life was, in that respect, made much easier by the work already done by my predecessors; the foundation was there and time was in our favour as well. So, substantial progress was made in the area of anti-bribery measures, common approaches to the environment, special terms for renewable energy and sustainable lending to low-income countries: OECD Recommendations were concluded on the issues of environment and of bribery, a Sector Understanding on renewable energies and water projects was agreed and annexed to the Arrangement, and the ECG took on board the International Monetary Fund (IMF)/World Bank (WB) Debt Sustainability Framework (DSF).

The work on the DSF was, and is, very close to my heart. Having experienced in the Paris Club what havoc is created by the incapability of countries to pay off their debts, not only for the country in question and its population but also for the world economy as a whole, I found it important to help break the vicious circle of lending, over-lending and restructuring. With the *adagio* in mind that lending, as such, is not a bad thing but one should not lend more than one can repay, we started work in the OECD's Working Party on Export Credits and Credit Guarantees (ECG), in close co-operation with the IMF and the WB, on sustainable lending. The Paris Club, as a staunch supporter, followed the issue with great interest.

As to the ECG, I think I may say that we made our fair contribution to debt sustainability in low-income countries. In translating the joint DSF of the IMF and the WB into the OECD Principles and Guidelines to Promote Sustainable Lending Practices in the Provision of Official Export Credits to Low-Income Countries, we now have the tools in hand to avoid those great "business opportunities" ending up in a Paris Club rescheduling. Ownership by the borrower also plays an important role as well as proper data sharing. By now, many countries and institutions

implement the DSF in their lending practices; I am convinced that those that have not done so will follow suit, if only from the perspective of sound risk management.

Outreach: Extending the hand of export credits

And so to outreach. The OECD offers a platform not only to agree upon common rules but also to meet and exchange views, co-operate, consult and have policy dialogue with non-OECD countries, other international organisations and institutions (such as the Berne Union), civil society organisations and industry (*e.g.* the European Banking Federation and the Aviation Working Group). The export credit committees held regular consultations with all these interested parties; such meetings had their own dynamics and were unique. I will not forget the frank exchange we had with the President of the China Export Import Bank, including a discussion on the colour of cats catching mice!

These consultations with stakeholders kept us sharp, that is not to say that we always followed the advice on offer, but we did realise that we cannot work in splendid isolation either; we profited from such expertise and fed it into the decision-making process. I have always tried to keep in the back of my mind that the OECD is there for its members. It is the members that determine when, where and how far one can reach. So it is thanks to the members that we achieved what we did.

Weathering the storm of the global financial crisis

I found it of great value to benefit from the knowledge and advice of the other bodies within the OECD; this put our work in context and placed it more within a whole-of-government view. Export credits remain a very specialist issue, technical and sometimes hard to explain, but when it attracts attention, it really does. The amount of export business involved, approximately USD 66 billion annually, is quite impressive - that is to say before we were confronted during the financial crisis with figures that no one had dreamt of!

But even during the crisis, we managed to do the right thing by working together to maintain the flow of export financing. Joining forces to weather the storm, a storm that only few of us had experienced before, with OECD and non-OECD countries, the WTO, IMF, WB, other parts of the OECD and the G20, resulted in a unique combination which made it possible to deliver tailor-made measures, restore confidence and avoid trade distortions. This joint force also allowed governments to keep interventions measured – in time and in money. In other words, once more, the OECD offered a unique platform from which to address global trade and finance issues.

Happy anniversary OECD and many more to come!

REFLECTIONS ON EXPORT CREDITS IN THE OECD

Bob Crick

Bob Crick was Vice-Chairman of the OECD export credit committees from 1995 to 2000 and Head of International Relations in the Export Credits Guarantee Department (ECGD), the United Kingdom's official export credit agency.

Where did it all start? I joined ECGD in 1964. I would like to portray this as a deliberate career choice but in reality, like many of my peers, my arrival in ECGD was a result of an application to join Her Majesty's Government Home Civil Service. Looking back, this was a most fortunate outcome. My first 20 or more years were spent at the ECGD coal-face working in various areas, including underwriting export business. This was to stand me in good stead when in 1987 I moved into the world of international relations, representing ECGD and the United Kingdom on export credit related matters in the European Union (EU), the OECD and the Berne Union.

First radical overhaul of the Arrangement

In 1995 I was asked, by the then Chairman of the OECD export credit committees, Kurt Schaerer (Switzerland), who was later to foster several groundbreaking OECD export credit agreements, to join the Bureau as a Vice-Chairman and assume the mantle of the respected figure of Gerb Ledeboer (Netherlands). My initial involvement was as Chairman of the Nuclear Sector Group, which was not particularly onerous, but the pace of work soon picked up when I was asked by the erstwhile Head of the OECD export credit secretariat, Janet West, to chair the Redrafting of the Arrangement Group (RAG) in order to bring some cohesion to the Arrangement on Officially Supported Export Credits. This work, over a two-year period, involved a dedicated group of volunteers from several countries (not forgetting the hard working secretariat) in numerous informal drafting meetings, as well as subsequent formal discussions in Brussels in the EU Council Working Group on export credits and, eventually, in the forum of the Participants to the Arrangement. Finally, in 1997 the Participants to the Arrangement adopted the RAG text and its attendant suite of sector understandings (for implementation from the beginning of 1998), the general format of which survives to this day, albeit adapted to include successive new procedures and disciplines.

Rules for tied aid

Although the Helsinki Package of tied aid disciplines was agreed in 1991, the ensuing discussions in the Tied Aid Consultations Group (to decide which projects were commercially viable and thus should not benefit from trade-related tied aid) ground remorselessly on – despite the agreement in 1996 to the published "*Ex Ante Guidance for Tied Aid*" which was intended to bring greater uniformity and understanding of the application of the rules to individual projects. I still look back in admiration at the early complex project-related discussions chaired by Birgitta Nygren (Sweden), which often lasted for several days; I was later to follow in her footsteps. One interesting by-product of the Helsinki Package was the evolution of the rather novel and mysterious format of co-ordination to decide the EU's position on the commercial viability of individual projects. This unique and relatively informal process was agreed by the unanimous vote of all EU Member States (an infrequent event in my experience) outside the scope of the normal EU co-ordination edict known as "Comitology" (the committee system which oversees the delegated acts implemented by the European Commission).

Behind the scenes

I will not attempt a chronological outline of the various international agreements secured in the export credits committees since these are already a matter of record. Instead, I will try to give some insight to behind the scenes, not only as a national delegate but also as a Vice-Chairman and Bureau member. This latter responsibility became a more and more time consuming enterprise as the agendas and working sessions of the committees grew at an exponential rate.

As a national delegate, the first imperative is to secure a foothold on the agenda of the meeting of the appropriate committee. While from a UK perspective this is an easy task when dealing with the more technical subjects within the remit of the OECD Working Party on Export Credits and Credit Guarantees (ECG), it is more difficult when dealing with the policy areas under the umbrella of the Participants to the Arrangement where EU competence applies. One effective solution was to have the matter raised by relevant national Ministers, either through the process of the annual OECD Ministerial meetings and – if the matter was considered a real priority – through the G7 and G20 processes. I became quite familiar with the work undertaken by the Sherpas in the run up to these Summit meetings whose aim was to draft a framework communiqué to be agreed and issued by Heads of State or Ministers, recording areas of agreement, aims and objectives in various political, economic and environmental spheres. It was largely by these means that important issues such as the standardisation of export credit premium rates for political risk, assessing the environmental impact of infrastructural projects and limiting official export credit support for, so-called, "unproductive expenditure" were prioritised, eventually leading to ground breaking agreements. Only one such target, rules for agricultural commodities, eluded our grasp

– albeit with only one dissenting voice – about which my friend Mike Roberts writes elsewhere in this publication.

How did the work of a Bureau member dovetail with discussions in formal meetings? I suppose the first thing is the recognition that the working day during the span of the meeting was extended by at least one hour before the scheduled start, often continuing throughout the lunch break and beyond the afternoon session and finishing well into the evening over dinner. While these Bureau meetings may sometimes have been an informal review of the progress made during the day's discussion and how matters should be progressed, during the final stages of the formal negotiation of important agreements, the *tempo* was much greater. In particular, I recall the final drafting effort made by the whole of the Bureau and the secretariat on the eve of the agreement on export credit premium rates for political risk, which extended until nearly 5.00am the day of the agreement – this on a diet of bread and water without the bread! Little did we know at the time that even after the agreement was secured in April 1997, the Participants to the Arrangement would engage in a further twelve months of discussion to decide upon so-called Permitted Exceptions to accommodate risk mitigation techniques!

While the efforts and motives of the Bureau may at times have been treated with suspicion in some quarters, I can honestly say that directional meetings and informal drafting sessions, always in the company of the secretariat, were invariably conducted in a non-partisan environment.

The new issues of bribery, environment, unproductive expenditure

I referred earlier to the growing *tempo* of discussions and the range of subjects covered by the committees Perhaps the most remarkable shift occurred when the ongoing discussions in the Participants' forum, on refining and extending the rules of the Arrangement, were supplemented by the work in the ECG embracing entirely new civil society issues. These issues included discussions on combating bribery (as part of a wider discussions of the OECD Anti-Bribery Convention), environmental review of business benefitting from official export credits, as well as limiting support for what was termed "unproductive expenditure" to Heavily Indebted Poor Countries (HIPCs). The HIPCs issue was a particular imperative for UK Ministers and I worked long and hard as a national delegate to gain support for the initiative and the eventual Statement of Principles agreed by the ECG in 2001.

However, perhaps the most fundamental shift in the export credit agenda was the development of the whole new area of environmental appraisal of projects. The eventual agreement had its humble roots in an initial framework drafted by Birgitta Nygren (then Chairwoman of the ECG), Janet West and myself during a *lacuna* in the agricultural export credits negotiations. Employing our considerable experience and drafting skills, perhaps not matched by specialist knowledge of the subject matter, a first draft of a framework agreement on environment and export credits

was circulated which, while initially being greeted with some scepticism, was later to evolve into the 2003 OECD Recommendation on Common Approaches on the Environment and Export Credits. It has to be said that agreement in the ECG might have been hastened had there been a greater degree of co-ordination between ministries at the national level!

The onset of discussions in the ECG on civil society issues also focused minds (and sharpened swords) of various non-governmental organisations (NGOs); for the first time, delegates to export credit meetings faced a crowd of angry demonstrators on entering the OECD building. Members of the Bureau and secretariat also faced a very determined band of lobbyists, often involving a new stream of informal meetings in various capitals. While this lobbying force certainly helped to concentrate minds, and thus probably aided the process, in certain instances the tendency by NGOs to focus on projects underwritten up to ten years previously, arguably did little to help their cause.

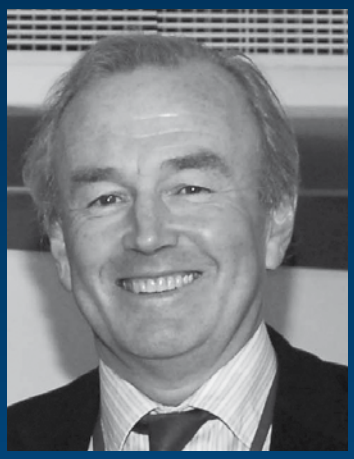
The road show

Members of the Bureau were also called upon at certain times to help spread the gospel of the OECD export credit work. This was particularly so when Poland, Hungary and the Czech Republic joined the OECD and their ECAs had, virtually overnight, to embrace a whole new set of OECD disciplines and procedures which had evolved since 1978. So together with our great friend and colleague the late Pierre Knaepen (Belgium) who was the architect of the risk premium agreement, Janet West and I travelled to Warsaw, Budapest and Prague giving several presentations each day to Finance Ministries, ECA staff, banks and exporters, to explain the work, rules and processes of the OECD export credit regime.

My conclusion

I look back with some pride on the achievements of both the ECG and the Participants to the Arrangement, with the support of my Bureau colleagues, as well as the tireless assistance of the secretariat. During my term of office I acted as Chairman of virtually every export credit committee, *i.e.* the Participants to the Arrangement, the ECG, the RAG, the Nuclear and the Aircraft Groups, the Tied Aid Group and the Premium Experts Group (the exception being the Country Risk Experts Group) and I fully enjoyed most of it. I also pay credit to the generosity of ECGD, my then employer, in allowing me the time and facility to contribute to the work of the OECD for the perceived greater good.

HUMAN RIGHTS AND LABOUR STANDARDS: THE DUTY OF EXPORT CREDIT AGENCIES



John Evans

John Evans is General Secretary of the Trade Union Advisory Committee (TUAC), which is the official voice of the labour movement at the OECD. TUAC has played an important role in OECD work for more than 40 years, bringing the voice of more than 60 million workers in 31 countries to the international policy debate. TUAC was founded in 1948 as a trade union advisory committee for the Marshall Plan. When the OECD was created in 1961 TUAC continued its work in the new organisation. As the OECD's role has changed to take in new members and become a leading forum for policy making to shape globalisation, TUAC has worked with the OECD to help ensure that global markets are balanced by an effective social dimension.

Just as export credit agencies (ECAs) played a vital role in keeping trade and investment flowing throughout the global financial crisis, so the crisis has changed the economic landscape for ECAs. Buoyed by the G20's injection of a massive USD 250 billion for trade finance, ECAs have stepped into the gap left by the retreat of private sector investors, launching new products and entering into new co-financing arrangements. In November 2010, the International Union of Credit and Investment Insurers (the Berne Union) reported that "… members are anticipating their support for global trade and investment to reach pre-crisis levels or beyond this year".[1] In short, the crisis appears to have given ECAs a new lease of life which promises to make then more relevant than before.

A stronger future, making it fairer

TUAC strongly welcomes the co-ordinated and innovative measures undertaken by ECAs to support the recovery in trade flows, thereby helping to build a recovery and maintain and create jobs. However, if indeed ECAs are poised to play a greater role in global trade and investment, then it is vital that they also exercise greater responsibility. As the economic and financial crisis continues to wreak havoc on the lives of citizens and workers, millions of whom have lost their livelihoods, jobs, incomes and rights in the face of companies closing or scaling back operations, there is a real danger that hard won gains in social standards will be lost.

Given their significant role in supporting international business, ECAs must show leadership in supporting responsible business conduct and building fairer global trade and investment. Meeting common responsibilities depends on adopting a collective approach that involves all ECAs. The pressure on public budgets and the need for accountability requires the same. TUAC considers that the OECD Working Party on Export Credits and Credit Guarantees (ECG) is ideally placed to carry this agenda forward.

Progress so far

Over the past decade, the ECG has made progress in moving forward the collective agenda of responsible business conduct and fairer trade and investment.

Engaging with civil society

The ECG has increased its engagement with non-governmental actors, not only TUAC and BIAC as institutional partners, but wider civil society and in particular anti-corruption and environmental non-governmental organisations (NGOs). This has traditionally taken the form of annual consultations, although since 2008 the ECG has sought to engage civil society more substantively in its assessment of the progress made by members in deterring international bribery and reviewing social and environmental impacts. This engagement represents an important step towards building transparency and the trust necessary for ECAs to succeed in delivering a fairer future.

Deterring international bribery

The ECG has also undertaken measures to co-ordinate approaches to tackle international bribery, reflecting the priority given by the OECD to the OECD Anti-bribery Convention. Efforts to date have culminated in the 2006 OECD Council Recommendation on Bribery and Officially Supported Export Credits which includes measures that require exporters to provide no-bribery guarantees, verify that they have not been debarred, charged, or convicted as a result of corruption offences and disclose agents and commission payments on demand. Importantly, given the growing concerns of business surrounding the "level playing field", parties to the OECD Anti-bribery Convention that are not members of the ECG can also adhere to the Recommendation.

Preventing negative impacts

The ECG has also developed common procedures on social and environmental issues. Under the 2007 Revised Council Recommendation on Common Approaches on the Environment and Officially Supported Export Credits (Common Approaches) – which is currently under review – ECAs should screen projects for their potential social and environmental impacts and benchmark

them against international standards, including the ten World Bank Safeguard Policies and the eight International Finance Corporation (IFC) Performance Standards, which covers labour and working conditions.

Promoting the OECD MNE Guidelines

ECAs have also taken steps to support responsible business conduct in trade and investment by promoting the OECD Guidelines for Multinational Enterprises (Guidelines). Action includes: publishing the Guidelines on ECAs' websites (Australia, Finland, Japan and Korea); providing applicants/exporters with copies of the Guidelines (Portugal); translating the Guidelines into local languages (Slovenia); referencing the Guidelines in export credit and investment guarantees (Belgium); encouraging applicants/exporters to act in accordance with the Guidelines (Denmark); requiring applicants/exporters to sign a letter stating that they are aware of the Guidelines (France) and requiring applicants/exporters to state that they are aware of the Guidelines and that they will comply with them to the best of their ability (Austria and the Netherlands).

The Austrian ECA, Oesterreichische Kontrollbank (OeKB), provides a good practice example of promoting the Guidelines. Following a campaign by, *inter alia*, the Austrian Chamber of Labour, the OeKB requires applicants to declare in writing that they have taken note of the Guidelines and will do their best to comply with them in their international business activities. If the Austrian National Contact Point (NCP) determines that there has been a breach of the Guidelines, then this will be considered negatively by the Ministry of Finance and the OeKB in the context of any application for official export credits.

Existing gaps

Yet, despite progress, the procedures of the Common Approaches still lag behind other standards in key areas, including human rights and labour standards (*e.g.* development banks, the IFC and some of the individual ECA's policies and practices).

Protecting human rights

> "… no one expects ECAs – or business, for that matter – to solve all the world's problems. But both are expected to not make them worse" (United Nations Special Representative for Business and Human Rights, Professor John Ruggie).

Professor Ruggie has singled out ECAs for their failure to address human rights, underlining their duty to ensure that public funds are not used to fund business activities that contribute to human rights abuses in other countries:

> "ECAs may be State agencies or privatised, but all are mandated by the State and perform a public function" and "… relatively few ECAs explicitly consider human rights at any stage of their involvement or require their clients to undertake due diligence on their potential human rights impacts".[2]

Professor Ruggie has called on the ECG to upgrade the Common Approaches by incorporating references to all internationally-recognised human rights, including the eight International Labour Organisation's core labour Conventions and requiring ECAs and applicants/exporters to undertake human rights due diligence. Professor Ruggie has also called on ECAs to introduce consequences and withhold public advantage from companies that have "… engaged in egregious human rights abuses".

Supporting labour standards

A debate in the United Kingdom on labour standards has also exposed weaknesses in the Common Approaches. The question of the observance of international labour standards in supply chains was first raised by NGOs following a change in the rules of ECAs on foreign content. As the Common Approaches only impose discretionary and partial obligations on ECAs in relation to reviewing the social and environmental impacts of projects, the NGOs were concerned that – in the absence of comprehensive screening – the increase in sourcing overseas would increase the risk of negative environmental and social impacts.

Next steps

The ECG has already taken steps to meet some of these challenges in the context of its ongoing review of the Common Approaches: it has created an informal group on human rights to take forward the recommendations of Professor Ruggie. In addition, the UK Government has taken up the call for consequences, proposing that the revised Common Approaches require ECAs to take account of any negative final statement of a NCP under the Guidelines.

TUAC considers that the ECG must go much further; it must show leadership and ambition in the review of the Common Approaches and upgrade its procedures on labour standards in line with best practice. The ECG should also improve its anti-bribery measures and introduce peer review across all its agreements, which goes beyond the current system of self-assessment and uses tried and tested methods practiced successfully by the OECD in other policy areas.

Finally, TUAC recommends that the revised Common Approaches be re-named Recommendation on Common Approaches on Human Rights, Labour Standards and the Environment in order to reflect better its full scope.

Notes

1. *www.berneunion.org.uk/pdf/Press%20Release%20November%202010.pdf.*
2. *Protect, Respect and Remedy: a Framework for Business and Human Rights*, Report of the Special Representative of the Secretary-General on the issue of human rights and transnational corporations and other business enterprises, Professor John Ruggie, 7 April 2008.

PAST ACHIEVEMENTS OF THE ARRANGEMENT AND FUTURE CHALLENGES

Fumio Hoshi

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The OECD Working Party on Export Credits and Credit Guarantees (ECG) was, in the early and mid-1970s, the unique forum for discussing and setting out the original rules limiting individual government supported export credits. The OECD Arrangement on Officially Supported Export Credits, established in 1978, focused on rules for levelling the playing field among OECD members in order to avoid trade distortions. From the mid-1980s to the 1990s, I participated in OECD meetings on behalf of JBIC (then the Export-Import Bank of Japan), working with other export credit agencies (ECAs) to establish the basic structure of the Arrangement framework – from the Wallén Package on interest rates to the Knaepen Package on risk premium.

The pricing system of the Arrangement

During the 1970s, just before the birth of the Arrangement, intensive competitions developed among exporting countries, *i.e.* the Member States of the European Union, the United States and Japan. Under the different national export credit systems, each country provided subsidies to support lower interest rates for financing its exports resulting in increased budget burdens. In the early 1980s, the world economy suffered from inflation caused by the second oil crisis and some OECD countries adopted high interest rate policies to restrain inflation. Moreover, one recalls that world politics were still dominated by the cold war between the Western and Eastern Blocs and the United States was confronted with a serious financial problem caused by the expansion of its military budget. Inevitably, this environment was reflected in the negotiations of provisions in

the Arrangement for the pricing of official export credit support which focused on two elements, interest rates and risk premium fees.

Birth of the fixed interest rate regime

With regard to the current interest rate system, the first discussions focused on the fixed interest rate to be applied to financing supported by ECAs. The concept of setting a common interest rate among the competing ECAs originated from the Agreed Minutes on Export Credit Support signed by six countries in Washington in 1974. After establishing the Arrangement in 1978, discussion on a common fixed interest rate heated up. Some countries suggested higher interest rates for export credits in order to eliminate subsidy elements from official export credit support; subsidy meant lower interest rate assistance with taxpayers' money and the intention was to avoid allowing official financing support to exacerbate the serious budget deficits of governments. At that time, political compromise took precedence over consistency with market practice and as a result, an unusual situation developed: the interest rate applied to official support under the Arrangement exceeded that of the market in some countries, like Japan, where commercial credit was available at relatively low interest rates. Due to the politically-motivated high interest rates imposed by the Arrangement, in addition to the heavy burden of accumulating government debts in Eastern Europe and developing countries, the volume of export credits supported by JBIC in 1984 decreased to a level of 40% of the peak recorded in 1981.

Throughout 1986, there were some long and hard discussions on the minimum interest rate to be applied under the Arrangement. In the early stages, several methods were proposed, such as a uniform moving matrix system and a differentiated rate system. Another proposal was made by the then Chairman of the Participants to the Arrangement, Axel Wallén (Sweden), who suggested that the applied interest rate should be tied to the market rate in each currency; this proposal defined the applied interest rate as the commercial interest reference rate (CIRR) which consisted of a base rate, a global margin, a fee and a premium fee. Further discussions on the CIRR proposal followed and, after eight years, it was developed under the auspices of Chairman Kurt Schaerer (Switzerland), and became part of the Schaerer Package agreed by the Participants to the Arrangement in 1994. Under the Schaerer Package, the CIRR system generally applied to all countries, whereby CIRR was set at a fixed margin of 100 basis points above each currency's base rate and adjusted monthly.

Birth of the risk premium regime

In the meantime, the discussions on the second element of the pricing system commenced. In 1986 the GATT started to strengthen its regulations on subsidies by governments. Fuelled by this trend in international trade policy, as well as concerns about serious budget deficits due

to the export credit activities of several export insurance institutions, the OECD discussions moved towards requiring a risk premium which would cover long-term operating costs and loses and foster a convergence on risk premium charged by the ECAs. Intensive negotiations were undertaken, beginning in 1994, when the Participants to the Arrangement set up a group of their premium experts, chaired by Pierre Knaepen (Belgium). What made the discussions particularly difficult for the negotiators was the absence of a common practice for charging premium by ECAs and their different financing tools: *e.g.* insurance, guarantees and direct lending. However, in 1997, the Participants to the Arrangement agreed the Knaepen Package (named after the Chairman of the premium experts) which established the guiding principles for charging risk-based premium for official support for export credits. To facilitate wider acceptance of the Knaepen Package, the guiding principles focused on setting premium for sovereign and country credit risk.

The Schaerer and the Knaepen Packages marked the establishment of the current pricing system of official support for export credits. Throughout the processes outlined above, the Participants to the Arrangement consistently worked to level the playing field under the slogan of avoiding trade distortions and reducing subsidies. Thirty years have passed since the inception of the Arrangement in 1978 and although the pricing system has worked well for many years it may now be the time to take a step to the next stage.

Changes needed in ECA practices

Over the past 30 years, the Participants to the Arrangement have had to tackle two big issues at the same time: the first, to continue to exclude subsidy elements from the official support system for export credits in line with WTO regulations and the second, to promote the export credit system while maintaining a level playing field. As a result, a system was established which removed subsidy elements from officially supported export credits. In the meantime, reflecting the amazingly rapid changes in the world economy, some new and unexpected developments were introduced, such as "market window" operations and project finance activities. The Arrangement faces the never-ending challenge of coping with new developments affecting the business of ECAs. This challenge cannot be avoided, as everyone knows that the current economic and political circumstances are far different from those prevailing 30 years ago.

Financial institution of last resort

In recent years, ECAs have reconfirmed and expanded their role in international trade and business. The global financial crisis originating with the shock of the collapse of Lehman Brothers in 2008 proved to all that private markets alone cannot ensure steady flows of credit to support international business. In order to ease the adverse effect of such global financial turmoil, ECAs have provided medium- to long-term trade finance to developing as well as

developed countries, have monitored the macro-economies of those countries carefully and have exchanged information with international financial institutions. Even in times of economic boom, private banks and multilateral development banks may face pressure to decrease their loans to developing countries; for private banks this pressure may arise from the BIS (Bank for International Settlements) capital adequacy requirements and for multilateral banks it may arise from concerns about the level of indebtedness of developing countries. With the object of ensuring sources of sustainable financial support for international trade and business, ECAs must be the "financial institution of last resort".

Considering that the world economy and the political situation have changed drastically since the 1980s, ECAs may no longer be able to perform the functions currently required of them based on a system constituted 30 years ago; a level playing field among the Participants to the Arrangement is now almost established. Over several decades, ECAs have been excessively absorbed in combating subsidies and competition among the Participants and somewhat less careful about adapting to the changes occurring in the outside world.

Can the current pricing system last forever?

Now that the subsidy element has been almost eliminated from the pricing system for officially supported export credits, it is time to reconsider the appropriateness of the strict regulations on the terms and conditions imposed under the Arrangement. The CIRR and risk premium systems may require change.

Observations on the CIRR regime

As an initial step, a wider array of options should be allowed in determining the CIRR rates quoted to borrowers. Some argue that the additional 100 basis points margin included in the calculation of the CIRR is intended to take account of both the spread between the borrowing costs incurred by domestic first-class borrowers, plus the warehousing costs for the period from the commitment of the financing to disbursement. Considering the development of new financial techniques, such as the option and swap markets, which had not matured at the time the CIRR regime was agreed in the 1990s, as well as the low interest rates prevailing in developed countries like OECD members, the spread of 100 bps may in some cases be regarded as unduly high and rigid compared to current market practice. It may not bode well for the ability of ECAs to meet current needs and fulfil their changing roles that the CIRR conditions imposed under the Arrangement have remained more or less the same over a quarter century, while the financial markets have experienced, and may continue to experience, drastic and rapid changes in response to short-term economic developments.

In addition, a further issue should be considered with regard to the current CIRR regime. The discussion on the appropriate CIRR has so far been limited to the fixed interest rate regime; the status of floating rate loans has been left open. No subsidy element is contained in a floating rate loan when the rate covers the fund-raising cost of the ECA or other lending institution. A key point to keep in mind is that warehousing costs would be almost negligible in a floating rate loan, as the funds are always available in the market at an interest rate based on LIBOR (the London Inter Bank Offered Rate) and there is, therefore, no need to impose a spread or premium to reflect such warehousing costs.

Observations on the risk premium regime

With regard to the risk premium system introduced in April 1999, in my personal view, the overall level of the risk premium is too high in various ways. The level of the minimum risk fee (minimum premium rate) is based on the arithmetic average of the premium imposed by all ECAs at the time the system was developed; this is somewhat inflexible and arbitrary. Under the current procedure, in the event that a country is downgraded (decided by consensus of the participating ECAs in the Arrangement in the context of a borrowing country's ability to service its external debt), it takes too long to restore its previous rating. Therefore, the risk premium required to be charged by an ECA tends to be higher than the market level. In order to minimise such distortions, it may be necessary to examine a new flexible method which enables ECAs to make suitable adjustments to the risk premium level.

Early in 2010, remarkable progress was achieved in respect of the current premium regime. After accepting the Knaepen Package, in 1997, and cementing this in the Arrangement, the Participants discussed for over a decade an alternative risk premium system based on the credit risk of the buyer. This finally bore fruit in the form of a compromise on buyer risk premium (*i.e.* the Malzkuhn-Drysdale Package); what should be appreciated is that this regime was constituted on the basis of the experience of ECAs as well as market trends. I look forward to watching carefully the implementation of this newly agreed risk premium system which will be put into practice in the autumn of 2011 and which responds to my concerns about aligning better the Arrangement's rules to the market and global developments.

The role of the Arrangement in the 21st century

Over the past decades, JBIC has engaged in negotiating and implementing the Arrangement rules as an active ECA operating in Japan. The Arrangement must continue to evolve to reflect the development of the world economy, but recently its rules have become somewhat complex and inflexible in light of current conditions. Consequently, ECAs have been gradually forced to become customer-unfriendly institutions, in contrast to their originally intended role. Further, such troublesome and rigid procedures for official support also have the unfortunate effect

of discouraging non-member countries from participating in the Arrangement. The current tendency of negotiations for the Arrangement seems to go far beyond its original objective of not using taxpayers' money to support exports through ECAs. Labelling as a "subsidy" an ECA interest rate that is lower than the market rate is a misinterpretation of the word; this is an issue which the Participants to the Arrangement need to address. As a result of applying over adjusted CIRRs and premium fees, all ECAs have earned considerable profit lately. It is time for the Participants to examine seriously what a public financial institution should be. The highest priority for a financial institution of last resort is to provide steady flows of credit; break-even profit may be sufficient for such institutions.

In order to support private business through export credit finance, sensitivity to market trends and flexibility in providing financing packages for export industries will be an important future theme for the Arrangement. Now, in the 21st century, the world economy is characterised by emerging markets outside OECD member countries which are not regulated by the Arrangement. The Participants cannot allow themselves to be stuck in their own world, admiring the achievements of the past and ignoring the present. The Arrangement must continue to accommodate new and flexible frameworks in order to remain abreast of the ever-changing business of ECAs. This is a new challenge which the Participants should now address with the same dedication and spirit of co-operation that they have demonstrated in the past.

OECD'S ACHIEVEMENTS ON EXPORT CREDITS: A MIRROR OF ITS STRENGTH

Wilhelm B. Jaggi

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Among the many important fields of co-operation within the OECD, the work on export credits does not make the headlines daily but is well anchored in the core of its mandate. This work contributes to the expansion of world trade on the basis of non-subsidised, undistorted competition in accordance with international obligations. In addition, over the last two decades another aim embodied in the mandate of the Organisation has gained in importance in the export credit context: the contribution to sustainable development and good governance through the observation of appropriate disciplines on tied aid, the establishment of common approaches on the environment, the agreement on anti-bribery measures and the agreed principles for sustainable lending.

My first experience with the work of the OECD on export credits goes back to the 1991 Helsinki Package on tied aid. As Head of Switzerland's Economic Development Co-operation, I followed these negotiations from the angle of foreign aid. And, I had just defended successfully Switzerland's programme of mixed credits before a parliamentarian commission when the new rules on tied aid obliged us to alter and reduce our activities in this field. I had then the opportunity to participate actively in the negotiations of the Schaerer Package as Head of Switzerland's Department for Export Credit Guarantees and Export Promotion. Later, during my tenure as Swiss Ambassador to the OECD, I quite naturally kept a special interest in the work of the Organisation on export credits.

The achievements in the co-operation on export credits are among the most remarkable negotiation successes of the OECD. Although the members agreed on the common aim to eliminate trade distortion or to further sustainable development and good governance, their mandates, specific interests, institutional approaches and sensibilities varied. Thus, the challenges faced during the four decades of continuous improvement of the OECD Arrangement on Officially Supported Export Credits and of the complementary policies were considerable. The successful completion of the work on politically difficult and technically complex issues is an outstanding example for the strength of the OECD in consensus building, based on the creation of mutual confidence, transparency and peer pressure. In addition, the efficient, innovative support by the secretariat, which can draw on the multidisciplinary skills and experience of the organisation in areas like environmental protection, development co-operation and anti-bribery policies, has been and continues to be an important ingredient of success and represents another specific strength of the OECD. Last but not least, I admired the skills of the respective Chairmen of the OECD's export credit committees – the Participants to the Arrangement and the Working Party on Export Credits and Credits Guarantees (ECG) – in furthering balanced compromises and packages.

In the course of the almost five decades of OECD work on export credits, the political priorities and public sensitivities evolved and the Participants to the Arrangement and the ECG did not only react to these changes but also influenced and shaped them. Today, most export credit agencies (ECAs) – at least in the OECD – are confined to non-marketable risks and, at the same time, are required to be self-financing and to offer competitive terms in comparison to other ECAs. These divergent requirements would amount to squaring the circle without the export credit disciplines and, in particular, the minimum premium system for sovereign risks established by the 1997 Knaepen Package - which will be enhanced in 2011 thanks to the important breakthrough on minimum premiums for commercial risks. These disciplines on premiums established within the OECD prevent premium undercuts and are an important safeguard against the provision of export subsidies outlawed by the WTO.

With the growing public awareness of environmental and corruption issues, the need for a level playing field did not remain confined to premium and other underwriting conditions. The common approaches on the environment and the agreed anti-bribery measures responded to that need and both instruments are periodically reviewed. An important and welcome aspect of this process is the improvement of the dialogue with non-governmental organisations and the building of mutual trust based on increased transparency.

The challenge ahead of the OECD is now to induce important trading nations outside the Organisation to adhere to the export credit disciplines. The participation of these countries as observers in the work of the Participants to the Arrangement and the ECG is an important, but not yet sufficient, step in this direction.

The work on export credit is based on the strong conviction embodied in the mandate of the OECD that trade is an important motor for economic growth and development. Export credits that are based on sound and sustainable policies are an essential tool to facilitate and promote that beneficial effect. The high appreciation of the co-operation within the OECD by guardian authorities and ECAs is rooted in this common understanding and trust.

A GERMAN PERSPECTIVE OF EXPORT CREDITS IN THE OECD

Hans Janus

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To contribute to growth in world trade is an essential part of the mission of the OECD; looking back at 50 years of history, export credits are a vital part of this mission. The OECD Working Party on Export Credits and Credit Guarantees (ECG) was established in 1963 and the Arrangement on Officially Supported Export Credits came into force in 1978. Germany has contributed to the work of these two committees since their inception.

As one of the main providers of medium- and long-term export credits, Germany attaches great importance to a well functioning international legal framework for officially supported export credits and the adaption of this framework in the light of political and economic developments.

The work done by the Participants to the Arrangement and the ECG, as well as the reforms agreed in these bodies, reflect the changing priorities and concerns in the world of export credits. The emergence and growing relevance of civil society issues, such as environment, bribery and sustainable lending, mark important shifts of paradigm in our approach (and that of our stakeholders) to officially supported export credits. I will not, however, dwell on past successes and highlight the developments which have taken place in the history of both the Arrangement and the ECG. I would rather look ahead and explore some avenues that the regulatory framework of export credits could possibly take in the future.

Global standards

The future of the Arrangement, as well as the integrity of the whole OECD regulatory framework, will depend largely on our ability to adapt the rules to the challenges that lie ahead. We will have to develop, and possibly change, the rules in a way that reflects ideally the requirements of the exporting community and the aspirations of other stakeholders.

Doing this, we have to keep in mind that officially supported export credits are only a small (and sometimes perceived as esoteric) part of global trade policy and that everything we do in the OECD has to stand a litmus test in a broader trade policy context.

Concentrating on what we could achieve within the remit of the OECD, I see some building blocks which merit and require further work. Looking ahead, establishing global standards in export finance is the essential challenge. All OECD members align their policy to the Arrangement and this creates a level playing field for financing conditions. In addition, the OECD Recommendations and Principles agreed in the ECG provide a framework for environmental assessment on the basis of international environmental and social standards, the prevention of bribery and the promotion of sustainable lending.

OECD exporters are increasingly faced with competition from non-OECD countries. While competition itself is a normal and positive process, exporters and ECAs increasingly observe that some non-member countries provide their exporters with very favourable financing conditions which are often not in line with the rules of the Arrangement. Sometimes these conditions are even in combination with lower environmental standards which would not meet the requirements of the OECD Recommendation on export credits and the environment.

In view of the intensified competitive situation in world markets, and with the aim of avoiding competitive disadvantages for OECD exporters, we support the efforts of the OECD to reach out to non-member countries with the intention of establishing global standards. The outreach strategy of the OECD led to a remarkable first success: conclusion of the Sector Understanding on export credits for civil aircraft in 2007 with the participation of Brazil. Outreach activities *vis-à-vis* other countries – in particular China – have, so far, been less successful. The objective should be to convince those non-OECD countries who provide official export credits that adherence to the international regulatory framework of the Arrangement is in their long-term interest. On the other hand, I think that outreach should not be the exclusive policy tool; the OECD work is embedded in broader policy frameworks such as the G20 which covers more trade related issues and which could possibly provide more leverage in establishing global standards for export credits.

Future role of the Arrangement

Another issue (no less important) is the future role of the Arrangement. The main purpose of the Arrangement is to provide a level playing field for officially supported export credits and "… to encourage competition among exporters based on quality and price of goods and services exported rather than on the most favourable officially supported financial terms and conditions". The Arrangement is also anchored in the WTO's Agreement of Subsidies and Countervailing Measures (ASCM): officially supported export credits in conformity with the interest rates

provisions of the Arrangement benefit from the "safe haven" of the ASCM and are not considered a subsidy. Hence, the Arrangement is widely seen as a blueprint for subsidy-free export support. This important role of the Arrangement should be preserved by all means.

In the recent past, there were some tendencies to incentivise a particular industry through generous export credit terms. With the adoption of the Sector Understanding for renewable energies and water projects, the focus of the Arrangement changed slightly, *i.e.* the purpose of the Understanding was explicitly to encourage "… renewable energy in preference to traditional energy projects using carbon fossil fuel", as a press release of the OECD secretariat put it. The reverse side of the coin would inevitably be an attempt to discourage, by less generous terms (or ban completely), project types which are considered to be less environmentally friendly.

While I appreciate that the Arrangement also becomes visible as an instrument that contributes to climate change mitigation, I would like to warn against using the Arrangement as a policy tool. Over emphasising this role of the Arrangement (in contrast to its traditional purpose) would, in my view, seriously threaten its function as a model for subsidy-free support. A policy tool which provides incentives or disincentives for specific project types could hardly be considered as a neutral safe haven.

In my view, the complex, multilayered regulatory framework for export credits is a major asset of the OECD. This framework should be further developed and refined to ensure tailor made solutions for our exporters, provide a level playing field among ECAs and give assurance that officially supported export credits are a subsidy-free instrument. Representing an ECA that is a main provider of medium- and long-term credits and is active in nearly all industry sectors, I hope that this aim will be pursued – without additional bureaucracy which would complicate or delay our internal processes.

Looking ahead, I wish that OECD members, with the support of the secretariat, strike the balance between sometimes diverging interests and continue to develop the Arrangement and other OECD instruments in the field of export credits in a reasonable and responsible way.

EXPORT CREDITS AND KOREA

This article is authored by the Permanent Delegation of the Republic of Korea to the OECD, Paris

We offer our congratulations to the OECD on the celebration of its 50th anniversary and recognise its continuous efforts to lay the foundation for global economic order and growth. The OECD is committed to promoting the economic prosperity of its member countries, assisting developing countries and expanding multilateral cross-border trade.

Korea was one of the most impoverished countries in the world only some 60 years ago. Korea's export volume was less than 1/100 000 of the current volume at USD 3.5 million. In fact, China and Japan only became trade partners around 1946, the year after Korea gained independence from Japan.

Korea's rise, and a need for export credits

Even back in the early 1960s, no one expected or even imagined the possibility of this nation making any economic progress; its export volume was smaller than that of African countries such as Cameroon, Sudan, Tunisia and Uganda. In its October 1960 issue, "*Foreign Affairs*", an American magazine on international relations, described Korea as "hopeless", citing a 25% unemployment rate, a GNP *per capita* at less than USD 100, USD 20 million in exports and USD 200 million in imports. This is why, today, the international community often uses the term "miracle" to describe Korea's rise as an economic powerhouse, citing Korea as an important example in the history of global economic development.

But this growth did not come naturally; the Korean government and its people undertook many initiatives and endured painful efforts to live better lives. The major initiative designed to develop its economy was implemented in 1962 when the government adopted the first "five-year plan for economic development". These five-year plans continued through to the 1990s.

The need for export credits came about as the government expanded support for business under the national growth platform, *i.e.* export driven economic development. Currently, the Korean government operates the Export-Import Bank of Korea (KEXIM) to extend export finance and the Korea Trade Insurance Corporation (K-sure) for credit insurance and guarantees.

The ramifications of Korea joining the OECD export credit forums

Korea became the 29th member of the OECD in 1996 and it was also at that time that Korea became aware of a number of new issues being addressed in the OECD's two export credit committees, *i.e.* the Participants to the Arrangement on Officially Supported Export Credits and the Working Party on export Credits and Credit Guarantees (ECG).

One of the most important issues for Korea, in the context of the Arrangement, was the adoption of new premium rules in 1997 (the Knaepen Package), which included minimum premium benchmarks (MPBs) for sovereign and country credit risks. MPBs aimed to seek convergence on the pricing of officially supported export credits so as to ensure a level playing field and were to be incorporated in the Arrangement. The Participants to the Arrangement were expected to apply 100% of the MPBs to all officially supported export credits as from April 1999. But for Korea, a relative newcomer to the Organisation, it was difficult to comply with the MPBs due to lack of knowledge of the Arrangement and, in particular, the new premium rules. Fortunately, thanks to the understanding of OECD members and the secretariat, Korea was permitted to phase-in gradually its compliance with the MPBs.

The Participants to the Arrangement then agreed in 1998 to add more flexibility to repayment periods in an effort to support project finance transactions; this agreement (which was initially for a trial period but it is now cemented in the Arrangement) was welcomed by Korea as demand for project finance was increasing among its exporters.

The Participants to the Arrangement later began discussion on renewable energies and ultimately, in 2007, established a new sector agreement with favourable financing terms and conditions to encourage the use of such technologies. The agreement on renewable energy has had significant policy implications for Korea, a country with little natural resources and for which renewable energy development is a key policy agenda.

In the ECG, new issues such as environment and bribery were being addressed; these were welcomed by Korea. The ECG adopted a Statement to address environmental issues when providing export credits and which eventually evolved into an OECD Council Recommendation in 2003 (later revised in 2007). Similarly, the ECG agreed a set of measures to deter bribery in export credit transactions and this too evolved into an OECD Recommendation in 2006.

A better understanding of the Arrangement

Korea gained a deeper understanding of export credits and the Arrangement through the WTO Korea/EU shipbuilding subsidy dispute and a similar dispute between Canada and Brazil on regional aircraft. These two cases forced Korea to pay more attention to the interpretation of the so-called "safe haven" clauses in Annex I paragraphs (k) and (j) of the WTO Agreement on Subsidies and Countervailing Measures. These disputes also underlined the importance and complementarities of the OECD Arrangement and the WTO agreement in providing official export credits.

Regrettably, however, the Agreement Respecting Normal Competitive Conditions in the Commercial Shipbuilding and Repair Industry was not adopted by the OECD Council Working Party on Shipbuilding, despite having been concluded in December 1994. But, the Sector Understanding on Export Credits for Ships, annexed to the Arrangement, was revised and implemented as from April 2002.

The Arrangement, which applies to official export credits with a two-year or longer tenor, has proved to be an effective tool for Korea because of its capacity to create a level playing field among OECD members' export credit policies. The Arrangement not only establishes a global platform for industrial development but also fosters an environment that enables Korea to compete with other advanced countries in major industries, including semi-conductors, automobiles and vessels, thus boosting its exports in these vital sectors.

Korea has, since becoming a member of the OECD, continued its unceasing efforts to gain a deeper knowledge of all the export credit agreements through attendance at meetings such as those of the Premium and the Country Risk Experts in the context of the Arrangement and of the Environmental Practitioners in relation to the OECD Recommendation on export credits and the environment, in order to share our experience with our partners around the world.

The global financial crisis and Korea

In April 2009 at the London Summit Meeting, leaders of the G20 countries agreed to establish the G20 Trade Finance Initiative, which entailed providing USD 250 billion in trade financing over the following two years to overcome the global financial crisis.

Subsequently, the United Kingdom and the United States, co-hosts of the G20 Trade Finance Experts Meeting, emphasised the importance of international co-operation for the successful resolution of the issues discussed during the G20 Summit Meeting. The OECD's ECG, as well as some non-member economies, including Brazil and China, decided to adopt a Statement on the global financial crisis and export credits; in accordance with this Statement, Korea, as

a responsible member of the international community, took the initiative to provide better support for trade finance. Indeed, the Korean government concluded currency rate swaps of USD 30 billion with the US Federal Reserve Board and USD 22 billion with the International Monetary Fund as a proactive measure and to ease concerns on insufficient foreign liquidity, despite strong economic fundamentals in the country.

Thanks to the knowledge and wisdom gained from accession to the OECD and a painful IMF bailout in 1998, Korea was able to recover from the global financial turmoil faster than other countries.

The future of the OECD

The future of the OECD would seem unquestionably promising, largely because of its openness to the outside world and its willingness to adapt according to the changing world around it. The OECD continues to welcome new members and observer countries on a regular basis and looks forward to integrating developing countries into the OECD family.

We would like to take this opportunity to express our deep appreciation to OECD member countries and to the OECD secretariat for their continued co-operation and assistance. To the OECD and its working parties, we wish you continued success!

THE EUROPEAN BANKING FEDERATION AND OECD EXPORT CREDITS

Elena Letemendia

Elena Letemendia is Senior Adviser to the European Banking Federation (EBF) based in Belgium. Set up in 1960, the EBF represents the banking sector of the European Union and European Free Trade Association countries and comprises some 5 000 institutions. The EBF represents, defends and promotes the interests of its members and aims to ensure that the experience and the views of banks are taken into consideration in shaping relevant policies.

When I moved from the UK Treasury to the EBF in Brussels in early 1994, I was not surprised to be given charge of the export credit file. I had some familiarity with the business from my days as a banker in the 1980s, and more recently as a civil servant: I was the Treasury representative in the UK delegation to the export credit meetings of the European Union (EU) and the OECD. But, as for many others who touch on the export credit field, this acquaintance convinced me of how much I did not know about the business. Many years on, I am still full of respect for the real experts.

Recognising the complexity of the subject, the EBF decided in 1993 to assemble a group of practitioners to prepare policy advice for our members. Thus, the Working Group on Medium- and Long-Term Export Credit Insurance was formed, for which I acted – and still act – as Secretariat. This group is the source of initial EBF positions on all export and trade finance policy initiatives which may affect European banks' business. The experts are drawn from the EBF's member banking associations and their member banks.

Special status of export credit work

From the start, the EBF's export credit work has had a special status among its working groups and committees. Unlike most of our files, the work is not defined by a broad policy theme of the kind normally handled by European representative bodies; it is concentrated on a single banking product with a specific purpose, albeit one that has other banking services associated with it. Because the export financing loans cross frontiers, they may carry country as well as corporate risk; and putting them together requires international co-ordination and special skills on the part of loan providers. Export credits also give rise to unusually close relations between lenders and borrowers, product suppliers and buyers. Apart from these

features of the product, export credits are of economic and political importance as a foundation of the multilateral trading system. The global perspective requires the business to be subject to international guidelines that are beyond the scope of individual or EU government authority. This makes policy discussion, and the work of an industry representative such as the EBF, unusually challenging.

Over recent years, we have had to come to grips with a wide range of types of financial intermediation and institutional relationships. While the banks' main service in export credits is to provide finance over medium to long periods, an export transaction may require other services, such as the issue of performance bonds, local intelligence, the facilitation of local processes through their networks and shorter term financing in the country of the recipient of the goods and services. The nature of the contract may vary from the sale of industrial goods such as turbine generators, to ships, nuclear power and renewable energy facilities, rail transportation networks and aircraft. The purchaser may be situated in any country of the globe, and our member banks may be collaborating with other financial institutions, from other countries, in syndications or multi-sourcing transactions.

These diverse elements mean that when we are developing positions for the industry at EU level we need a broad range of expertise. Having said this, banks are used to working together and see at close hand the different approaches of the export credit agencies (ECAs), as well as the different relations between ECAs and their domestic banking constituencies. Individual banks that are internationally active may have a panoramic view of what is happening in the market. As well as making use of the knowledge available within our own constituency, we have benefited from close relations with the European Commission, which has helped us to keep abreast of developments and give policy input at the right time.

Over the past 16 years, I have seen important changes in our export credit work and institutional relationships. Our focus has broadened, the scale of our activity has increased and our involvement with the OECD export credit committees has grown to an extent that we could not have imagined.

Back in the early 1990s, the OECD's Arrangement on Officially Supported Export Credits was already a longstanding and successful part of the export credit policy landscape. At that time, in Brussels, our attention was mainly drawn to the EU's initiative to harmonise conditions for the different export credit schemes run at national level. Our members supported the EU's steps to level the playing field for government export credit support. At the same time, we wanted to ensure that the rules would not disadvantage European businesses and banks in relation to their counterparts outside the area. This concern about the need to take account of international competition was, we felt, addressed in the EU Directive that was adopted in mid-1997.

A deepening involvement with the OECD

By the late 1990s, our members were also following with interest the development of the work on premium issues under the Arrangement. We entered a new phase, as we became increasingly drawn to the OECD context, with the evolution of the Arrangement and the developing discussions on establishing common approaches for taking environmental concerns into account when providing official export credit cover. Since then, our involvement has increased, and we have had the privilege of being invited to contribute to the main fields of OECD export credit work.

In the OECD, as in the European context, our approach has been pragmatic. In broad terms, our experts have recommended that the conditions governing medium- and long-term credit schemes should fit the nature of the business being covered and that the guidelines should be clear and keep competitive distortions to a minimum. In some cases, we have advised that proposed guidelines could cause unnecessary bureaucracy and significantly impede the ability to do business. We pressed the point of unnecessary bureaucracy during the discussions over the 2007 OECD Council Recommendation on Common Approaches on the Environment and Officially Supported Export Credits, as well as suggesting a change in procedure to enable ECAs participating in the same transaction to co-ordinate documentary requirements for environmental reviews. Because the banks are in the front line of the competition for export business, a continuing concern for us has been the risk of agreeing significantly tighter or more cumbersome guidelines within the OECD than elsewhere. This level playing field concern really comes to the fore where environmental standards are concerned because the outcome may ultimately work against environmental objectives, allowing countries with lower standards to win the business.

Our input to the OECD process has not been limited to lobbying in its strict sense. We have appreciated the opportunity to report on market conditions, giving advice on the extent to which the rules reflect the sometimes changing market realities. Since the global financial crisis, the EBF has reported regularly at the annual stakeholder consultations with the OECD export credit committees about the market's ability to meet the need for financing, in terms of volume, tenor and pricing. At the stakeholder consultation in November 2008, we pointed to the problems of risk-sensitivity, scarce liquidity and higher cost of funding and the consequences for the availability of affordable export financing. We welcomed the subsequent decision of the Participants to the Arrangement in January 2009 to introduce changes to the rules to facilitate export credit support in the face of the global financial crisis and the April 2009 commitment of OECD and other countries, set out in the Statement on The Global Crisis and Export Credits (reproduced in Part IV of this publication), to co-ordinate export credit support to help boost international trade and investment during the crisis.

Alongside our fundamental pragmatism, is the recognition that rules should be guided by broad principles of public policy, particularly evident in the OECD's work to minimise adverse environmental effects from export credits, to promote renewable energies and to combat bribery. The ability of the OECD guidelines to accommodate these broader objectives and set export credit in its social and economic context is clearly vital. On our side, policy contributions have broadened to include consideration of the global social and economic importance of support for trade – a step beyond the technical focus of the early years. This approach rightly reflects the development of banks' business strategies, in which corporate social responsibility is being given increasing weight. Similarly, our recent lobbying on the potential effects of the latest bank regulatory proposals of the Basel Committee focuses on the unintended consequences for international trade and ultimately global growth, a subject that remains at the top of the EBF's agenda.

In parallel to our changing policy involvement, a striking development over the past decade has been a deepening in the EBF's contact with the OECD's export credit committees, through the development of their approach to consultation with civil society organisations. The greater frequency and regularity of dedicated stakeholder consultations have given us a solid platform to offer views and learn about those of other stakeholders. Echoing this development, our own group of experts has increased the frequency of its meetings and our members make an effort to gear their discussion more closely to the OECD priorities. We continue to benefit from close relations with BIAC, the OECD's Business and Industry Advisory Council, which allow banks and industry to explore their common ground in the exporting business.

Continuing collaboration with the OECD

Writing at a time when the effects of the financial crisis are still being felt, it seems clear that export credits will play an important part in spurring the economic recovery over the coming months. Perhaps the crisis has altered perceptions: the contribution of officially supported export credits to trade, and indirectly to global growth and development, may be better recognised outside the business than before and the quality of ECA-backed loans has been confirmed. There is a greater awareness of the sensitivity of international markets and the trading system to falls in confidence; this may, in turn, bring a clearer appreciation of the role that public authorities can play in assuring continuity of financial flows and providing support on a scale that may be unobtainable elsewhere.

Within the banking community, we look forward to future collaboration with the OECD, public authorities and other stakeholders, to ensure that private and public sectors can complement one another as effectively and productively as possible.

TOWARDS THE NEXT 50 YEARS: A VIEW ON OUTREACH

Kohei Okada

Kohei Okada is the Chief Executive Director of Nippon Export and Investment Insurance (NEXI), one of Japan's official export credit agencies. NEXI was formed in 2001, as an affiliate of the Ministry of Economy, Trade and Industry, to administer trade and investment insurance for international transactions that cannot be adequately covered by conventional insurance. Since 2004, Kohei Okada has been a Vice-Chairman of the OECD export credit committees, with particular focus, on outreach to non-member countries.

The OECD may now be at a crossroads in its history of 50 years. In the late 1970s, when the Arrangement on Officially Supported Export Credits was conceived in the OECD, exports from OECD members accounted for about 70% of total world exports; this figure has fallen to the current level of around 60%. Although it depends on one's viewpoint as to whether this level is large or small, there will be no argument that it will, in the face of the increase of exports from non-OECD countries, continue to decrease in the coming years.

To put it the other way around, non-OECD countries already account for 40% of world exports and this will continue to grow. It is a matter only of time before more than half of the world's exports will be from non-OECD countries; then our favourite word "outreach" may start to sound more or less ironic – questioning which side is "out"!

A parable with a kernel of truth

The other day a friend of mine, a banker who loves golf, gave me a rather caustic allegory when I asked him his opinion on the outreach issue: "… from what you tell me, the OECD is like a prestigious golf club with its established traditions but the members who were in their prime thirty years ago are now of considerable age and unless younger players join, the club will soon have fewer members who really play golf. But you will find that young players are not willing to join the club, saying that the playing etiquette is too strict and the rules unnecessarily complex, although for you, the extant membership, these are the heritage of the club and so cannot be relaxed so easily. Sometimes, you tighten the rules in order to be more respected in the neighbouring communities, as you strongly believe that this will bring the club more prestige, which is the price to pay for the pride and honour you can enjoy as a member. But whether you recognise it or not, you, the older members, play much

less often than before so the etiquette and tightened rules are not obstacles to your enjoyment of the game; however, for potential younger members these become a hindrance …" As is the case with most parables, it seems to me that this story holds a kernel of truth, with a dose of oversimplification!

To my regret, and without recourse to parables, it seems that the discussion on outreach in the OECD is not making very rapid progress, at least as far as the field of export credits is concerned. Maybe it is not so easy to move forward; after all, nobody will voluntarily place themselves under restrictions and the idea of integrating new members by requiring them to adapt their policies and practices to those of the membership, while the existing members need not change their habits at all, may not be a very attractive proposition to possible newcomers. On the other hand, I think that there is a sign of change which tells us that we should not be too pessimistic. Why? Because it is now more than ever, in the context of today's global financial and economic environment, that the Arrangement is a necessity.

At this moment, it seems that almost every country is trying to introduce new support measures to promote exports in order to keep its economy afloat. However, most countries also consider that there should be limits to the support measures on offer. Firstly, the financial burden arising from such measures is a concern which has emerged rapidly; even the nations that currently provide official export credits that almost defy the market economy would find such burden financially unsustainable in the near future. Secondly, we have no room for trade distortion in today's global economy and we can no longer revert to the times of *laissez-faire* and *beggar-thy-neighbour* policies in our deeply mutually-dependent global economy. Therefore, I believe that every exporting country, in the not so very long run, will come to recognise the importance of maintaining order in the field of export credits.

The question is how that order should be achieved. High expectation is placed on the OECD export credit committees and the secretariat in such a process, since their continuous dialogue spanning over 30 years and their accumulated expertise could be considered an asset to be shared with the global society. To this end, I expect the export credit rules, guidelines and principles established in the OECD to continue and to be enhanced and adapted to the changing global environment. To facilitate this transition, I believe that it is essential for OECD members to focus fully and urgently on the issue of outreach.

From OEEC to OECD – an outreach evolution

We can find in the history of the OECD a classic example of handling the outreach issue. The forerunner of the OECD was the Organisation for European Economic Co-operation (OEEC), which was established to administer the Marshall Plan for the reconstruction of Europe after World War II.

The OEEC might have ceased to exist after it had attained its original purpose but it underwent a great transformation 50 years ago to become the OECD, now a highly successful, and one of the most influential, international organisations. That transformation, by extending the OEEC's wings to countries outside Europe, was a revolutionary redefinition of identity which could be described as a leap over the traditional border into "outreach". There must have been reformists and conservatives both with their own views, and there must have been long and numerous discussions and many compromises before the decisive transformation step was taken. I imagine also that those concerned finally came to the united conclusion that, other than by transforming itself, there would be no other way to survive as an influential international organisation.

With non-member countries holding increasingly greater positions and responsibilities in the global economy, today might be the time to make a leap across the border again. And we could be bold, having in mind the decisive step taken by our great ancestors who created the OECD 50 years ago!

The views expressed in this article are personal to the author.

FINANCING NUCLEAR POWER PLANTS

Jean Hugues Perreard and Anne Crépin

Jean-Hugues Perreard is Vice-President and Anne Crépin is Deputy Vice-President, Project & Export Finance, the AREVA Group, France. AREVA is a state-controlled company involved in nuclear power production and building and servicing nuclear reactors. AREVA also treats and recycles used fuel and is developing a portfolio of clean energy plants (using wind energy, bio energy, solar power and hydrogen power) to complement its nuclear energy activities.

Historically, financing nuclear power plants has benefited from strong state support, in particular in the frame of launching a campaign. This support has materialised through government organisations, government-owned or government-dominated companies and through guarantees of debt provided by government to private entities for the financing of new nuclear power plants.

Lenders (private investors and banks) are interested in stable cash flows and high probability of return of their investment within a reasonable and specified time frame; this applies to nearly all investments and across all sectors. As a consequence, financing packages are focused on quantifying and allocating risks, liabilities and costs in such a manner as to ensure that repayment occurs at the expected due date.

When bidding or making a commercial proposal to their clients, all major infrastructure suppliers and industrial companies include in their offer various forms of financial engineering assistance. The aim is to support the commercial offer and the success of the transaction by helping the client to secure access to relevant financing at a competitive/acceptable cost. In some cases, the proposal for such assistance is a key differentiator; in others it is a critical factor of success and is particularly crucial in the nuclear sector, as the magnitude and length of the project make project financing difficult in any economic environment. It is a fact that all nuclear power plant projects undertaken abroad so far, whether or not successful, have given rise to the financing provided by an export credit agency (ECA).

Two components of financing new nuclear power plants: equity and debt

Equity, as reported by the Nuclear Energy Agency (NEA) in 2009[1], raises capital by selling a share of ownership in the venture; it can be

internal equity – put up by the sponsors in kind or in cash – or external, which raises money by selling shares of stock in financial markets. Equity is more expensive than debt because the investment is more at risk: lenders have priority over owners in access to cash flows of the project during operation and, typically, have a first secured interest in the project's assets in case of project failure. The return on equity expected to be required is linked to the risk perceived by investors. Equity is generally available on capital markets (at some price), but right now most equity investors have no experience with nuclear projects and most nuclear projects cannot pay the yield needed to attract them until experience is gained. One remedy could be for the equity partners to provide equity in kind, or for principal customers to become strategic equity investors. A high equity share can significantly and negatively impact a project's expected return, but this may be needed to establish project credibility. Accordingly, most nuclear power plant projects are driven by industrial and utility producers who have nuclear experience and may derive additional (non-economic) benefits from the development of nuclear power, rather than financial investors purely focused on a project's return profile.

Debt financing basically deals with three issues, risk, liquidity and cost.

- *Risk* is the ability and willingness of lenders to bear the non-payment risk associated with the loan granted to the buyer. As mentioned in an article by Peter Atherton, Citigroup Global Market (New Nuclear Economics & Politics, May 2010), the five risks that nuclear power plant developers face are planning (delays), construction (cost overrun), power price, operational and decommissioning, three of which (construction, power price and operational) are so large and difficult to manage that individually they could bring even the largest utility company to its knees financially; this makes a new nuclear plant a unique investment proposition for utility companies. However, lenders in nuclear power plant projects also face other risks: creditworthiness of the borrower, country risk (political and sovereign) and specific nuclear risks. In determining whether these risks are acceptable to the lenders, liquidity and cost have to be considered.

- *Liquidity* is the capacity of the market to finance a significant portion of the new-build transaction with a long tenor of credit (at least eight years), taking account of the risk conditions and the cash flow profile associated with a nuclear power plant project (long construction period during which there is no cash revenue).

- *Cost* refers to the remuneration required by the lenders on the liquidity and risk conditions; when these perceived risks are too high, an excessively high financing cost can obviously jeopardise the economics of the project.

Corporate and sovereign financing structures for new-build nuclear power plants

Financing for the building of new nuclear power plants has evolved over time but two structures represent the bulk of what is observed today: corporate funding on balance sheet and sovereign financing/involvement.

Corporate funding on balance sheet: this source of funds is limited to a very few number of major European utilities that, given their tremendous scale advantages, have access to capital markets and bank funding in quantities sufficiently large to support nuclear new-build. Most US utilities cannot self-finance new-builds due to their small size.

Sovereign financing/involvement: in many cases, and in particular in emerging counties, the government of the nuclear power plant purchaser bears all or a significant portion of the financing or the associated risks, to the benefit of the utility. It could be that the government directly invests in equity or provides a guarantee to the lenders. Should the sovereign risk be perceived by the lenders as high in a long-term perspective, which is the case for most emerging countries, the market would face difficulties to provide sufficient funding at a satisfactory cost; financing could in this context require a different kind of support.

While many professionals are brainstorming on alternative debt financing schemes, *e.g.* pure project financing, structured financings, BOT (build own transfer), BOOT (build operate own transfer), it is AREVA's understanding that such structures may be implemented for nuclear power plants in low-risk countries or within the frame of a government-to-government agreement (such as the Turkey Akkuyu contract with the Russian Federation). This kind of agreement reinforces the involvement of the host State and the impact of the project on its budget; this type of financial scheme could only be envisaged when the nuclear power plant new-build is standardised and the constructor is able to demonstrate a significant experience.

Future financing of new-build nuclear power plants

As a conclusion, it must be stressed that in the coming years the market will not debt-finance on a large scale and at an acceptable cost; most nuclear power plant new-builds will be financed with the benefit of local State support and, as a consequence of the nuclear power plant specifics in the medium- to long-run, ECA-backed financing will remain the cornerstone of such new-builds.

Indeed, ECA-financing, under the umbrella of the OECD Arrangement on Officially Supported Export Credits, is the reliable, funding source widely available thanks to its member governments' support that provides capacity and reliability on a long-term basis.

More generally, we thank the OECD and its capacity to adapt its rules to take into account the evolution of the market, as was the case in June 2009 with the adoption of the revised Sector Understanding on Export Credits for Nuclear Power Plants.

Note

1. OECD (2009), *The Financing of Nuclear Power Plants*, OECD, NEA, Paris.

NEGOTIATING AS A BLOCK: THE EU AND EXPORT CREDITS

Denis Redonnet

Dennis Redonnet is Head of Unit in the Directorate General for Trade of the European Commission which is in charge of implementing the common trade policy of the European Union. The author is the chief negotiator for the EU Member States in the OECD forum of the Participants to the Arrangement on Officially Supported Export Credits.

The European Union (EU) has a single market for its 27 Member States; it is the largest trading block in the world and accounts for more than 16% of world exports. Not surprisingly, the 27 are a heterogeneous group of countries – Member States differ in size, resources, industrial base, exported goods and services and, therefore, in trade policy objectives and needs. Olive oil exports from Greece have a different trade pattern than exported luxury cruise liners from Finland.

The competence issue

As laid down in the founding Treaties of the European Union, the EU has exclusive competence in the area of common commercial policy – and that includes international export credit disciplines. This competence requires the Commission first, to obtain a negotiating mandate from all EU Member States and then, to negotiate with the other Participants to the Arrangement.

The provision of export credit insurance and guarantees is a national (Member State) competence. After all, there is no such thing as a "European" export product – as opposed to a German or Dutch export product – apart, perhaps, for an Airbus aeroplane. And there is no "European" export credit agency (ECA). But when it comes to setting the rules and disciplines applicable to export credit insurance and guarantee practices, the competence is a European one: thus, the EU negotiates with other countries as a block.

Member States, as members of the OECD, are represented directly in the OECD Working Party on Export Credits and Credit Guarantees (ECG). However, the Commission has a role to play here as well: to contribute, co-ordinate and facilitate information exchange between Member States in order to have a more coherent European view. Environment, for example, is a shared competence between the Member States and

the EU and when it is linked to export credits there is a need for the Commission to act as a co-ordinator, especially when the issues covered are subject to an EU *acquis*.

Finally, the Lisbon Treaty has given the European Parliament (EP) a new say in the legislative process on trade policy. The Arrangement must be transposed into EU law, through an ordinary legislative procedure involving both the EU Council and Parliament, on the basis of a Commission proposal. The EP has shown a great interest in this legislative process, beyond mere adoption of the OECD Arrangement, and has sought to engage the other EU institutions in a larger reporting and policy coherence exercise on export credits. With the financial crisis and its impact on real trade flows, export credits have played such a positive role in the recovery process that this has led to a greater awareness within a broader political audience.

The policy orientations

Beyond the issue of institutional competence, Member States and the Commission are also wedded by a shared philosophy: we hold dear the basic principles of the Arrangement, *i.e.* the orderly use of export credits and the level playing field principle.

Bearing in mind the single, domestic market of the EU – there are no exports within the EU, only intra-EU trade - the Commission has initiated strong disciplines for export credit activities inside the EU itself. In the area of short-term credit insurance, the Commission has provided guidelines to EU Treaty rules in its Short Term Export Credit Communication – the Commission's interpretation of the areas where official ECAs cannot compete with the private market. During the recent financial crisis, a temporary framework to support access to finance was established and official European ECAs entered the "marketable risks" area from which the private markets had withdrawn. This decision is in line with the mandate to complement the private market capacity in difficult times.

On the other hand, the medium- and long-term EU harmonisation Directive governs some aspects of longer-term credit activities. As for other typical ECA products such as guarantees and bonds where the risk is on the exporter, there are State Aid rules to ensure that government intervention through ECAs does not distort competition and trade inside the EU. Furthermore, the OECD Arrangement is part of the *acquis communautaire* as it has been adopted into EU legislation by Council Decisions. The EU legal system makes the disciplines of the Arrangement legally binding and, thus, from this standpoint, there are stricter rules inside and for the EU than for other Participants to the Arrangement. This is the reason why the EU will continue to push other Participants to raise their ambition in terms of the level playing field and the scale of our shared OECD disciplines.

Negotiating as the EU in the OECD

How does the EU create negotiating positions for the OECD? The EU Council Working Group on export credits meets once a month in Brussels to review all policy issues and, if necessary, to formulate common EU positions for OECD negotiations in Paris. Usually, discussions are pursued until common ground has been achieved in support of an EU position. Should an issue be very political or divisive, appropriate Council decision-making bodies would be involved. In Paris, it is only in tied aid consultation procedures, when determining a project's financial viability and appropriateness for tied aid, that a voting procedure of qualified majority is exercised during negotiations. Additionally, on the spot co-ordination meetings are held regularly in Paris: normally, these co-ordination meetings are held in the early and late hours (mornings and evenings) or during lunch time – keeping the Europeans hard at work when other Participants have ended their working day!

Export credits are being discussed in many forums, varying from intra-ECA meetings to the WTO and, recently, also in the G20; in the latter forum, the Commission has a double role – not only providing its own expertise and political weight but also ensuring a representation and channel for the Member States that are not members of the G20.

And finally, international and EU internal export credit agreements and disciplines are living documents. *i.e.* they are being revised or updated as needs arise to reflect better the economic situation and export finance or industry requirements. This reality check makes coherence and unity of EU positions all the more necessary in what is, increasingly, a faster moving environment than in past decades.

A LONG HISTORY IN FACING CHALLENGES

François de Ricolfis

François de Ricolfis has been Chairman of the OECD export credit committees since mid-2009 and is Director General of the SGFGAS (a French agency dealing with housing-loan subsidies). The author was, until 2007, Head of the Delegation of France to the OECD export credit committee meetings in his capacity as Deputy Assistant Secretary for export finance in the French Ministry of Finance. From 1999 to 2006, the author was Head of the Medium and Long Term Department in COFACE, the official export credit agency of France.

Export credits supported by national governments have a long history. In 1919, in the aftermath of the First World War, the United Kingdom established the Export Credits Guarantee Department (ECGD), the first public export credit agency (ECA) of its kind. This was a landmark innovation as over the years all exporting countries followed suit and ECAs, including ECGD, are now established globally –in more than 60 countries including practically all OECD countries. A further innovation was the establishment of the International Union of Credit and Investment Insurers (known as the Berne Union) in 1934; through this forum, ECAs started co-operating at a technical level by exchanging information – and still do so today.

Another major step in the export credit world was in 1978 with the first OECD Arrangement on Officially Supported Export Credits which established a set of agreed disciplines on financing terms and conditions for export transactions with a repayment term of two years or more. These disciplines were consequent upon the 1973 oil shock and subsequent trade imbalances when countries were fiercely competing for market shares and providing overgenerous export financing terms, whether through too low interest rates or risk premium fees.

Crises or not, export credit systems have persisted

Since then, the world of public export credit support has gone through several economic and financial crises (from the 1980s debt crisis to the current global financial crisis), witnessed radical changes in financing techniques as well as in industry structures and has seen dramatic changes in the landscape of exporting powers. The rise of China as a major exporter of capital goods, in such sectors as high-speed trains which directly compete with established producers, is the latest challenge to face the export credit industry.

Despite these crises and changes, national export credit schemes are still in place and so is the Arrangement, thus showing a continuing robustness and adaptability, in line with the spirit of the negotiators of the Arrangement and its rules. While sometimes criticised, exporters and bankers remain enthusiastic users of ECAs' facilities as well as keen adherents to the Arrangement's rules, as witnessed by the surge in activity after the 2008 banking crisis.

I have been active in export credits for more than 20 years; allowing for a very partial overview of all that has been achieved by OECD member countries in the field of export credits during that time, I focus here on two sets of thinking. My first thought concerns the reasons why the OECD work on export credits has been so successful; my second is to look at one of the most difficult tasks facing the export credit committees, *i.e.* building a lasting rapport with emerging economies.

Why the OECD platform works for export credit

Beginning with the success of the OECD work, a striking long-term development alongside the constant deepening and expansion of the rules (as described by other authors in this book) is the co-operative working environment between the two export credit committees, *i.e.* the Participants to the Arrangement and the OECD Working Party on Export Credits and Credit Guarantees (ECG), notwithstanding the real differences in OECD member countries' objectives. We should remember that, still in the 1990s, member countries had severe disagreements over policy issues, some of which were brought to annual OECD Ministerial meetings, *e.g.* the level of export financing interest rates in 1990.

Another widely contested issue among member countries was the appropriateness of tied aid for individual projects in developing countries in the context of the Helsinki Package of tied aid disciplines embedded in the Arrangement in 1992. In the beginning, many of the intended tied aid transactions were challenged, leading to disputes being brought to the OECD Secretary-General. Today, thanks to many years of work and building a body of experience, disagreements on tied aid projects are rare; when these do happen they are quickly resolved in real time. This co-operative atmosphere has certainly helped to secure a series of agreements over the years, among which are the guiding principles on risk premium, rules for aircraft financing, common approaches on the environment and anti-bribery measures.

Another reason for the enduring strength of the OECD export credit agreements, including the Arrangement, is the ability of the two export credit committees to accommodate opposite viewpoints and perspectives on their way to solutions. Let me illustrate with some examples:

- Often, sensitive stakes are at issue, yet agreements are concluded: the fight against bribery in international transactions, safeguarding the environment, sustainable lending to developing countries, encouraging the use of renewable energies.

- The ability to reconcile the very short-term (and sometimes politically sensitive) policy of export promotion with the very long-term consequences of decisions taken: an export credit insurance commits the ECA and its guardian authority for, in some cases, more than 20 years.

- A very discrete, and usually media shy, domain but with high economic stakes: it is not a widely known fact that more than 30% of civil aircraft exports received official export credit support in 2009, countering the fall in lending capacity by private lenders in the wake of the 2008 banking crisis.

This ability to accommodate diverse policies and perspectives may, in turn, be related to the structure of the export work within the OECD. First, and as explained by Nicolas Bonucci (Director of OECD Legal Affairs) in his article herein, the Arrangement is not an OECD act but a Gentlemen's agreement benefitting from OECD secretariat support. Despite this special status of "soft law", all the Arrangement's Participants comply with its rules and it is recognised by the WTO as a source of international regulation. One could also argue that since its inception, the soft law dimension of the Arrangement has contributed to making it more acceptable to its Participants. Today, practice makes it not very different in implementation to a traditional treaty, but it remains an instrument for which heavy acceptance procedures are unnecessary (except in the European Union where it is part of EU law and thus legally enforceable).

A further strength of the OECD export credit work is due to the very close relationship between ECA practitioners and government ministries' representatives. ECA officials are represented in member countries' delegations to OECD export credit meetings and often express themselves within these meetings and in technical groups, such as the one formed to examine risk-based premium fees. In effect, debates are able to deal with legal and financial techniques and to range from broad policy issues to practical problems in pursuit of solutions. As a result, the export credit rules established in the OECD, by either of the two committees, are always agreed by consensus, based on experience and implemented by practitioners of the trade, without any intermediate step such as national regulation. Consequently, a high level of comparability is established among ECAs. Over the years, we have so far avoided a pure top to bottom approach for a negotiation, thus allowing the views of the practitioners to be a part of the process; this has produced creditable and durable results.

The challenges facing the OECD export credit community

What then are the challenges for the OECD export credit work? The most immediate is for all members to keep its rule book relevant and to continue improving the services it brings to the members. This is why work is ongoing on a number of issues such as implementing the new aircraft financing agreement, further developing the rules for renewable energy projects and enhancing the common approaches on environment to reflect latest concerns on climate change and sustainability.

Beyond, and linked to, the quite substantial export credit workload is a more general objective of improving the engagement with external partners This is not to say that the OECD committees live in a vacuum, far from it; their sessions are open to a variety of observers, from non-member economies to international institutions such as the International Monetary Fund and World Bank, and consultations have been held on a regular basis since 1997 with stakeholders, including non-governmental organisations.

In fact, the export credit committees actively seek to widen their expertise and engage with other players in the world of export finance and there are several reasons why we should continue our efforts in this direction:

- First and foremost, in order to succeed in the broad agenda it has set to itself, the OECD must continue to combine an ever wider field of competences and expertise, *e.g.* by looking at the new innovative financial techniques drawn from the banking and insurance industries, by drawing on more industry expertise and by greater understanding of topics such as environment and social regulations. These efforts all require a substantial investment of time and energy by member countries and the secretariat – and this is sometimes difficult to achieve.

- Engaging with other players also requires a better overall understanding of the market, its functioning, requirements, needs and techniques. This has been underway but needs to be continued and deepened. The first version of the Arrangement was agreed in 1978 as a way of eliminating a credit race by reducing subsidies (what we call in our own jargon pricing to risk) and avoiding export credits being used as a competitive tool. There was no need, at that time, to refer to market terms since markets for export finance were substantially less developed than today – over 30 years later.

Over recent years, the OECD work has had to take into account market conditions and developments; a number of WTO rulings have stressed this approach. Markets are mature and able to cover all transactions in most countries; they price all types of risk and are ready to take

on risks that were previously deemed too large or too exotic. However, there remain areas where the market is not overly present and for which ECA support, *via* government schemes, can fill the gap. So, in order to be relevant and/or to avoid undesirable trade distortions, we have to pay heed to the constantly evolving market. This continuing look to market practices has led to changes in the operation of the Arrangement, as two examples show:

- ECAs and member governments usually prefer a regime of stable rules and prices, which are best suited to their operational modes and which, in theory, provide a counterweight to market swings. But this preference for stability, if taken too far, could lead to unsound divergences from market conditions: either ECA support could be priced far above market or too much below market. The 2007 aircraft financing agreement found a way to accommodate these two opposites by introducing a link between ECA pricing and market prices, leading to regular adjustment of the former.

- ECAs are, quite logically, working on a national interest basis and supporting, in principle, goods and services produced in their own country. This basic tenet of officially supported export credits has to be reconciled with constant shifts in production patterns linked with economic globalisation. The OECD has recognised the trend by allowing a more generous element of local content in transactions with official export credit support and leaving to each country the choice of whether to cover or not such third country content. However, national rules can be quite different from one country to another; lately the trend has been for a general relaxation of national content rules, thus allowing for greater flexibility and recognition that this traditional policy tool is now less relevant to business than in the past.

OECD export credits and the WTO

The relationship between the OECD and the WTO in the export credit field is important. The Arrangement benefits from specific treatment in the Subsidy Code of the WTO (inherited from the GATT texts): the latter grants the former protected status in law as compliance with the terms of the Arrangement is deemed to be compliant with WTO rules. That, at least, was our assumption for many years. But a series of WTO panel rulings (on Brazilian, Canadian and US' programmes) at the end of the 1990s showed that the reality was more complicated. The panels looked at interest rate support and insurance programmes, the setting of limits on the use of such programmes and the rules of the Arrangement. As a result, in 2004, changes were made to the Arrangement text to clarify some of its provisions and, thereafter, WTO texts and case law have been and continue to be factors that are taken into account when considering adjustment to the rules of the Arrangement.

The interplay between the Arrangement and the WTO is a complex one (not the same membership, nor the same way of looking at issues and the WTO, perforce, has a more legalistic approach to the interpretation of text). The Arrangement's Participants were sometimes unwilling to accept that another body could limit their freedom of action but soon came to accept – maybe reluctantly – that compliance with WTO principles is not a given. This is an ongoing issue of awareness and adds an extra dimension to our work.

Outreach to emerging economies

Lastly, the OECD export credit committees have to continue work on attracting new members to their forums, especially important exporters of capital goods and projects. While a number of non-member economies (*e.g.* Brazil, China, India, Indonesia, Russia, and South Africa) and their ECAs have participated in the deliberations of the OECD export credit committees since the mid-1990s, we would like to see them as full members sitting alongside their OECD peers. However, with one exception (Brazil for the aircraft financing agreement), these major exporting countries have not yet taken their seat; this should (in both meanings of the tense – future and obligation) be a key issue for the export credit committees.

The 1978 Arrangement encompassed the vast majority of capital goods exporters and thus its rules were efficacious for obtaining a level playing field among industries and this has lasted through to very recent years. However, as non-member economies develop substantial exporting capabilities, we need to find ways of bringing them into the same set of rules so as to maintain and extend such a level playing field. We succeeded in doing so for the specific field of civil airlines with the participation of Brazil, but since then progress has been limited. To be fair, the issue goes well beyond the realm of export credits as it is linked, *de jure* or *de facto*, to wider issues such as successful entry to the WTO and joining the OECD. The new OECD members of Chile, Estonia, Israel and Slovenia have or are being integrated in our work; but the continued absence of some major competitors remains a challenge.

OECD AND AGRICULTURAL EXPORT CREDITS: A SINGULAR FAILURE

Mike Roberts

Mike Roberts was Vice-Chairman of the OECD export credit committees from 1998 to 2003 and Chairman in 2004. The author was also Deputy Permanent Representative for Australia to the OECD from 2002 to 2004.

Sitting half a world and six years away from my involvement with the OECD and export credits, my immediate reaction, when asked to contribute this agricultural story, was "what was all the fuss about"? Having moved on in life and career, the issues inevitably lost relevance and clarity for me. So my first step was to idly Google agricultural export credits to see what websites have contemporary relevance in this somewhat esoteric field.

The result was an eye-opener and immediately took me back to my default negotiating stance of many years; what could have caused this? Simply a routine US Department of Agriculture (USDA) announcement of the availability of GSM-102 credit guarantees for fiscal year 2010 export sales. Sounds innocuous until a close examination revealed the usual mix of rich countries, including three OECD members, being given GSM credits for the purchase of US agricultural commodities on terms of up to two years. Incredible that in this day and age, a dinosaur such as the Commodity Credit Corporation (CCC)/GSM[1] still exists and that the world trading system has not yet been able to shut it down – but I am getting ahead of myself!

Trade liberalisation matters – including for agriculture

Best if I go back to the beginning. Australia is a young nation which has had to fight for a position in the world. Having had to stand on our own two feet reasonably quickly has led us to the view that as, perhaps, the world's most efficient producer of agricultural products

we should be able to sell such products where we wish for a fair return. We get quite upset at restrictions on our doing just that or subsidies which restrict our markets or penalise our returns. For this reason, we have been vociferous promoters of the liberalisation of international trade along with, we imagined, the interests of other developed countries of the world. Of course, the reality has turned out to be quite different and trade liberalisation has proved to be a tortuous path to tread. However, for many years the exception was the success of the OECD's involvement in export credits.

When I first started in the field of export credits my induction included exposure to an "export credits guide for dummies" which included a series of motherhood statements/laws which sought to make sense of a complicated field. One of these laws concerned the natural repayment period of an export credit being directly related to the useful economic life of the good concerned. So, for instance, while an agricultural export product would have a shelf life of only weeks, a capital good used as an input into a production process or forming part of a large project could have a useful life of many years. There were oddities of interest to those with a perverse mind (such as myself), like counting a stud sheep/goat/bull as a capital good with an appropriately adjusted credit period. Some may say that this is another example of the male of the species being over valued! Of course there were other laws such as co-insurance and pricing for risk which were also to feature in future OECD negotiations, again for the wrong reasons.

I actually had two careers in export credits, having had an initial stint as a bag carrier for my boss in the late 1970s/early 1980s at several OECD export credit meetings. Then, the issues all revolved around interest rates and aid distortions and Australia's interests were largely aligned with most other member countries. There was a natural order to negotiations. It was safe to bet that if we had a doubt concerning a proposal it was always acceptable to go along with the United States. The United States was a champion of reining in subsidies in export credits and the results, in terms of levelling the playing field and the elimination of interest rate subsidies, spoke for themselves. However, when I eventually took over responsibility for Australia's export credit policy the situation had changed dramatically. Now the main issue concerned agricultural export credits and blinkered self-interest was revealing itself in the US approach to negotiations.

Subsidies for agricultural export credit shown to be unhelpful

One of the joys of negotiating in the OECD is that impartial in-depth analysis would always be available to flesh out the *pro et contra* of the topic concerned. This was demonstrated to the highest degree in the negotiations on agricultural export credits and was a credit to the professionalism of the OECD and the intellectual rigor of the export credit secretariat. The analysis demonstrated that while the use of export credits in agricultural trade was not a major problem (only 4.4% of world trade between 1995 and 1998), trade distortions were occurring as the terms of commonly utilised credits constituted export subsidies. The total subsidy element

was estimated to be USD 300 million in 1998; of this, the United States provided 86%, the European Union 7%, Canada 5% and Australia 2%. The United States was clearly identified as the largest user of export credits and its export credits had at, 6.6%, the highest subsidy component.

On the back of its in-depth data analysis, the OECD secretariat made two damming observations, observations which should logically have signalled the death knell for agricultural export credit subsidies. The first observation was that a possible justification for officially supported export credit programmes was that they may help developing countries overcome liquidity constraints in order to purchase necessary food which otherwise would not have been affordable. However, statistically and inconveniently for subsidisers, the bulk of officially supported export credits was provided for trade between OECD countries, where liquidity constraints are unlikely (as noted earlier, this is still the situation today). The second of the secretariat's observations was that the estimated benefits of officially supported export credit programmes to importers were small – "… perhaps only sufficient to gain a competitive advantage for the exporter" – and unlikely to help needy countries. In other words, the export credits were purely aimed at securing a competitive position *vis-à-vis* other suppliers.

The result of years of having to offer non-commercial repayment terms, particularly for wheat exports, led Australia to loose hundreds of millions of dollars as Egypt and Iraq defaulted and received extensive debt relief through Paris Club rescheduling. While repayment terms were undoubtedly out of touch with reality, Australia endeavoured to keep to market rigour in other areas. Thus, there was no attempt to offer a concessional interest rate or to provide an extraordinarily low co-insurance element, let alone to engage in a laughable "attempt" at pricing for risk – all elements of the GSM credit packages. While difficult issues were involved for Australia surrounding funding these trading losses, the real losers were the developing countries forced to come cap-in-hand to the Paris Club and often to bear the cost of IMF-imposed structural adjustment treatments. This is the thing about credit terms – regular and sustained usage leads to a build-up of debt; agricultural export credits is the worst kind of debt as the goods involved are consumer-oriented with no beneficial infrastructural or industrial development effects to service the debt.

Failure rears its head – just the once

Being green in those days (actually now as a Sustainability Manager I still am - but of a different hue), I approached the negotiations in good faith as I imagined everyone was doing. All the interdepartmental committee meetings putting together negotiating positions, submissions to ministers seeking political coverage, long but always interesting OECD meetings (including a particularly frustrating negotiating session where the United States said sorry but it was not in a position to negotiate), raging discussions over dinners in Paris, all seemed worthwhile, at least at the time. Negotiations inched forward over several years with the positions of the

protagonists becoming clearer, although motives were still obscured. Our wonderful Chairwoman (Birgitta Nygren, Sweden) gave her all towards securing an agreement, ably assisted by a committed secretariat. But ultimately this was all for nothing.

The US' insistence on including a non-export credit issue in the negotiations, State Trading Enterprises (STEs), was the major factor in the eventual failure of the negotiations. A brave eleventh-hour attempt at compromise wording by Birgitta Nygren enabled Australia to accept the proposed package. I was fortunate that the Australian Wheat Board (AWB) Limited was on its way towards its eventual privatisation and Australian government involvement was being reduced and eventually removed. I was able to cobble together some words which interpreted Birgitta's suggested wording to facilitate Australia's acceptance. However, this was never going to be acceptable to, or possible for, my Canadian colleagues. Leaving Canada isolated on the STE issue was one of the hardest decisions I have been required to make in my career and troubles me to this day. This was a major part of my motivation in agreeing to contribute this article – to set the record straight.

At the least, the United States move can be viewed as cynical and/or opportunistic; cynical, because the chances of a successful negotiation were dramatically reduced by the STE issue and this effectively drove the negotiation into the WTO Doha Round where it would be used as a bargaining chip. In addition, the United States would be comforted by trade negotiations history – that the negotiations were most likely to be protracted, thereby prolonging the life of the GSM programmes. And opportunistic because in the unlikely event of an OECD agreement, the United States would have achieved an offsetting gain to put against a toothless GSM.

All in all, a disappointing and unnecessary stain on the OECD's proud record in the export credits field, but that is international negotiations.

I started this article by observing the contemporaneous usage of GSM credits. GSM marches on albeit with several "teeth" removed (GSM 103, pricing for risk) courtesy of our Brazilian friends, while all around the world is changing – the world financial system has been torn down and is being rebuilt; Canada now looks likely to own AWB Ltd in the light of an Australian government decision not to block a takeover; the Australian dollar has recently (and briefly) reached parity with the Greenback, etc.

Reading through this article has given me concerns at it being labelled an anti-US rant. This was never my motivation or my inclination. I have tried to make it clear that the US' negotiating history regarding export credits in the OECD was second to none; this is one reason that the failure on agriculture was so galling.

I have headed this article "A Singular Failure" in order to emphasise that the breakdown in negotiations was the exception not the rule within the OECD's export credit family. Perhaps one day soon we will see a result out of the Doha Round: extended terms for agricultural export credits will be restricted to genuine cases of need arising from liquidity shortages in developing countries rather than as competitive advantages for exporters. I live in hope but with few expectations.

Cheers from the underside of the world to all my OECD friends!

The views expressed in this article are personal to the author.

Note

1. Commodity Credit Corporation (CCC): US Department of Agriculture administers export credit guarantees for commercial financing of US agricultural exports. The guarantees encourage exports to buyers in countries where credit is necessary to maintain or increase US sales, but where financing may not be available without CCC guarantees. The Export Credit Guarantee Program (GSM-102) covers credit terms up to three years.

NEGOTIATIONS AND EXPORT CREDITS IN THE OECD: A NEVER-ENDING STORY

Kurt Schaerer

Kurt Schaerer was Chairman of the OECD export credit committees from 1992 to 1999, prior to which he was Vice-Chairman from 1987 to 1991. The author was also responsible for export credit policies in the Ministry of Economic Affairs from 1988 to 2004.

The evolution of the export credit framework shaped under the roof of the OECD is documented elsewhere in this publication. I will therefore point to some aspects which, in my view and from my perspective, contributed to achieving successes in the negotiations on various and very different issues over many years.

Understanding cultures, making issues transparent

Official export credits are a complex area. Export credits, guarantees and insurance are issued in many different forms and on different levels of technical sophistication, reflecting the underlying culture and role of government in the context of national economic policy. Such differences in support must be accepted as long as they bring about equivalent results in the appreciation of the beneficiary; a precondition for equivalence is transparency. Therefore, transparency has always been one of the keywords when preparing the ground for new rules on any export credit issue.

At the outset, it is worth spending time and effort on establishing a high degree of transparency. Bringing, from the beginning, all partners in the discussion to the same level of understanding of the issues will spare many rounds of time-consuming fact-finding at later stages. Moreover, eliminating personal suspicion in the late stages of negotiation may cost more in time and goodwill than early, objective fact-finding.

Closed systems are bound to die

No system that negates the compulsion to adapt to the changing environment will survive for long. What is true for the biosphere is just as valid for human beings and their highly developed constructions, be they technical or intellectual. Those responsible for the regulatory framework for export credits must constantly observe and take account of relevant changes of the economic, financial and political determinants. Failure to detect and accept the need for timely adaptation will inevitably result in high repair costs, including loss of political goodwill.

Towards a joint objective among the like-minded

Based on new requirements from a changing environment and a transparent picture of existing rules, a new objective for changed rules can be defined. At first, such objectives will be abstract. Abstract objectives make it easier for many to reach agreement. Compared to many other international organisations, the OECD's export credit bodies represent a group of relatively like-minded countries. It can be helpful to obtain support towards achieving success in the negotiation through a mandate from the appropriate OECD Ministerial meeting. But it also happened that we had to inform Ministers on insufficient progress, which provoked their call for increasing efforts in our negotiations.

Because we all have different backgrounds, the Bureau, the secretariat, as well as all participating parties in the negotiations have their individually tainted views on the joint objective of the negotiation. This is even truer when it comes to ways and means to achieve such goals. Expecting others with differing views to change their position implies that I too could be wrong and that others have the same right to expect me to change my position. To be ready to have one's position questioned and argued by others may be the beginning of a process leading to a joint understanding.

Windows of opportunity

Maybe this near-end paragraph should better stand at the very beginning of my reflections! I think that "windows of opportunity" is the key phrase of successful negotiations. Windows of opportunity can be offered from a changing outside environment. Windows of opportunity can also be created from the inside by appealing, through good arguments, to a sensitive attitude of the outside. Systems like the OECD export credit bodies should always be open and equipped to seize actively and reactively appropriate opportunities for adaptation within their political and financial finality. Throughout my association with the export credit bodies of the OECD, the ever important issue was the appropriate timing in creating, and reacting to, windows of opportunity. To cite but a few random examples: when through public discussions social responsibility in official support to exports became a recognised issue for governments and

their national and international reputation, explicit rules on corruption and environment were written into the OECD export credit rule books. When governments recognised that exporters should compete on price and quality of their goods rather than on the price of official support, minimum premium and repayment terms for official support were agreed. When governments accepted that the grant element of aid credits should, among others, be determined by the difference between a concessional aid-credit interest rate and a market interest rate for a given currency and thus reflect the real financial effort by the donor country, differentiated discount rates were introduced.

Collective efforts and achievements

It is this unique blend of social and financial issues which made participating in and chairing negotiations in the OECD export credit bodies so fascinating for me. I must admit that these achievements would not have been possible without the loyal support from my Bureau colleagues, the intellectually priceless contributions from the secretariat and the friendly and human understanding from the delegates.

Negotiations: A never-ending story

Negotiations will be the only constant in the OECD rules on officially supported export credits because:

- For historical reasons, official export credit systems show structural and operational differences which have withstood many rounds of negotiation.
- The internal and external determining environment for export credit agencies (ECAs) is constantly changing under the pressure of national and international political and economic evolutions.
- The successful long time survival of systems, including ECAs, depends on timely adaptations.
- Many different stakeholders wish their, sometimes narrowly defined, interests adequately reflected in official export credit support.
- It is in the interest of governments to run official ECAs on social and financial sound principles.
- Such sound principles do not lend themselves to a once-and-for-all hard definition.

- Export credit disciplines enshrined in the OECD rule books have been proved successful throughout many years.

- Globalisation of production will, over time, convince additional emerging economies that it is also in their interest to join accepted sound rules for official export credits.

I wish all those who, on various levels, are involved in future drafting, negotiating and accepting modified and new export credit rules, the wisdom for decisions that are appropriate in time and substance.

THE BUSINESS VIEW

John Tyler

John Tyler was the Chairman of the Export Credit Task Force, of the Business and Industry Advisory Committee (BIAC) to the OECD from 2004 to January 2011. Since 1962, BIAC has brought together the advice and counsel of the business communities of the OECD member countries; BIAC participates in the OECD committee work of the 34 OECD member governments. The private sector represented by BIAC supports the OECD's efforts to combine analytical thinking and business experience to formulate an integrated set of public policy recommendations, including on export credits, based on facts and analysis.

In addition to my paid job as UK Director of Treasury and Insurance at Alstom, it has been my privilege for the last six years to chair the Export Credit Task Force of BIAC. I have enjoyed involvement in the work of the OECD export credit committees from a business perspective, and I have been able to draw on the experience I gained from attending meetings of these committees in the 1980s while representing ECGD – the export credit agency (ECA) of the United Kingdom – as part of the UK delegation. This latter experience was particularly valuable to me when I first took on my BIAC role because it meant I had a good prior knowledge of how the OECD committee process works: I knew some of the long-standing players and I was able understand most of the jargon, acronyms and abbreviations that are in common use in these forums.

The OECD's export credit committees have always had a reputation for being responsive to market changes and able to take quick decisions (well, relatively quick compared to the work of some other OECD committees!). As a result, the OECD Arrangement on Officially Supported Export Credits has evolved from a slim document in the early years to the complex set of guidelines that exists today. It is also encouraging that the rules of the Arrangement have, generally, been followed by all its Participants – overt breaches have been rare but, of course, there have occasionally been some interesting interpretations of the rules (One amusing example that I remember was when one country's notification of the sale of thousands of containers to a small island state in the South Pacific was challenged on the grounds that the containers would have needed to be permanently stacked three high if they had all been delivered to the island in question).

Subsidies and incentives

From a business perspective, the exporting of capital goods must have been very exciting in the late 1960s. OECD governments were desperate

to increase the volume of exports from their countries in order to boost their balance of payments and preserve manufacturing jobs – many of which were under threat as a result of a shrinking domestic market. To achieve this, governments became willing to intervene in the export market place by providing subsidies and other incentives. In order to remain competitive, large companies in each country actively lobbied their Governments to support their export efforts in this way, which meant that there was a real danger of a credit race developing. Based on very good commercial reasons, the International Union of Credit and Investment Insurers (the Berne Union) had already achieved much progress in discouraging its members from agreeing long credit terms that were out of scale with the useful life of the products that were being exported. But Governments were increasingly willing to flout the Berne Union's guidelines to win particularly large and prestigious projects, and they discovered new ways of providing support through their ECAs, *e.g.* by making available subsidised financing packages.

In the early 1970s it became clear that the OECD was well placed to achieve an international consensus among member governments through the introduction of guidelines aimed at limiting the credit terms that could be supported by official ECAs. The inception of the OECD Arrangement in 1978 provided member governments – and their ECAs – with a solid reason to rebut pressure from exporters for unreasonably long credit terms and highly subsidised financing packages.

At the time, some countries (such as Germany and Japan) had particularly low interest rates, and so companies in those countries were able to offer their customers long-term export credit loans at extremely low fixed interest rates, whereas exporters in other countries struggled to offer long-term fixed rate financing at all – and when they did the interest rates available in their own currencies seemed uncompetitive. Amazingly, the ECAs in high interest rate countries almost felt obliged to subsidise the cost of export finance loans so that their exporters could offer long-term export finance that was more competitive with those offered by companies based in low interest rate countries. The potential cost of these interest rate subsidies was, of course, immense and some further controls clearly needed to be introduced.

Moving closer to market

The OECD export credit committees' initial, and rather half-hearted, attempts at controlling the spread of interest rate subsidies involved the introduction of a regime of minimum fixed interest rates (based on the average yield of medium-term government bonds issued by the main OECD countries – the so-called SDR (Special Drawing Rights) based rate for loans in currencies with high interest rates, while allowing countries with low interest rates to continue providing export credits at commercial interest rates. This effectively institutionalised a regime of interest rate subsidies on loans denominated in high interest rate currencies – and exporters became very good at taking full advantage of these state subsidies. In those heady days, the long-term

commercial swap market was still in its infancy, so most of these interest rate subsidies could not be hedged. In some countries, such as the United Kingdom, this resulted in a huge legacy of subsidy costs that was financially unsustainable and which attracted the close attention of the Treasury.

Meanwhile, businesses in the low interest rate countries became increasingly frustrated at being unable to match the subsidised offers being made by their competitors, and so they demanded other forms of subsidy from their governments so that they could offer increasingly softer credit/financing terms to their customers. To solve the problem, several countries started offering trade-related soft loans, subsidised from their overseas development assistance budgets as a means of sweetening the overall price of projects and/or the cost of financing of those projects; this was seen to be a very cost-effective way of winning export contracts.

As a consequence of these developments, the OECD export credit community eventually introduced two new rules that revolutionised the practice of heavily subsidised export credits by setting minimum interest rates for each currency, based on long-term government bond yields in those currencies (the Commercial Interest Reference Rate or CIRR), while still allowing ECAs to continue supporting loans with totally unsubsidised interest rates (pure cover loans). At the same time, the injection of relatively small amounts of development assistance aid to sweeten the price of export contracts was banned.

The Arrangement has significantly changed since those times, for instance by the addition of rules governing risk based minimum premium rates and by introducing requirements for ECAs to make searching enquiries about the environmental and social effects of the projects that they are proposing to support, as well as the business ethics of companies involved. However, exporters and banks do their own due diligence on such matters, so these enquiries by ECAs tend to be more of an aggravation factor rather than making any real difference to the political correctness of ECA-supported projects.

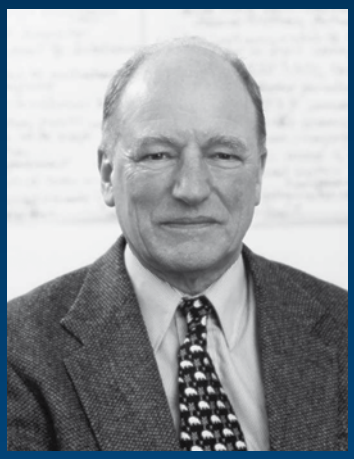
Non-OECD competition cannot be ignored

The OECD export credit regime that is in existence today puts all export credits on a commercial footing and OECD based exporters are no longer able to gain access to state subsidies to make their bids more attractive. Until the global financial crisis, this level playing field resulted in a much diminished role for ECAs. Although there has been a resurgence of activity in the last couple of years, it is difficult to envisage a long-term need for ECAs once the commercial banks again have the capacity to meet fully the demand for attractive long-term financing without the need for state guarantees – although the extent to which this will be achievable depends, somewhat, on the effects of Basel III and other economic factors.

But one of the biggest challenges currently faced by OECD based exporters of capital goods is the growing competition from companies in countries that are not (yet) members of the OECD and do not apply the rules of the Arrangement. Much is written about the activities of companies based in China and the way that they are able to offer their exports at cheap prices and/or with cheap financing. It is my view that if this activity is not controlled in some way, it could quickly lead to protectionism and a resurgence of the credit race that the Arrangement has so far succeeded in preventing.

The OECD's outreach programme is a step in the right direction towards integrating the emerging industrial economies in its rules and principles. The programme encourages the OECD export credit community to increase its efforts to persuade relevant governments to adhere to the Arrangement and the other export credit Principles, Guidelines and Recommendations; this could take a long time – but I will follow developments with great interest.

THE OECD AND CIVIL SOCIETY IN THE FIGHT AGAINST CORRUPTION



Michael H. Wiehen

Michael H. Wiehen is a Member of the Advisory Council of Transparency International (TI), having served previously on the Boards of both the international organisation and the German national chapter. TI is a global civil society organisation, whose mission is to create change towards a world free of corruption. Since its founding in 1993, TI has played a lead role in improving the lives of millions around the world by building momentum for the anti-corruption movement.

TI is a global network, including about 100 locally established national chapters and chapters-in-formation. These bodies fight corruption in the national arena in a number of ways and bring together relevant players from government, civil society, business and the media to promote transparency in elections, in public administration, in procurement and in business. TI's global network of chapters and contacts also uses advocacy campaigns to lobby governments to implement anti-corruption reforms.

Politically non-partisan, TI does not undertake investigations of alleged corruption or expose individual cases but, at times, will work in coalition with organisations that do. TI has the skills, tools, experience, expertise and broad participation to fight corruption on the ground as well as through global and regional initiatives. Now in its second decade, TI is maturing, intensifying and diversifying its fight against corruption.

The first international efforts to fight corruption

The first international efforts toward fighting corruption started in December 1975 with a United Nations (UN) General Assembly Resolution condemning corrupt practices by transnational corporations, followed in 1976 with the mention of corruption in the OECD Guidelines for Multinational Enterprises[1] and the International Chamber of Commerce (ICC) Guidelines on Extortion and Bribery. However, it was only after the de-escalation of the East-West conflict (and thus the end of the policy of propping up corrupt regimes) in the mid-1990s, that major states were ready to address seriously the scourge of corruption.

In 1994 the Council of Europe started working on a series of instruments, leading to a 1997 Resolution with "20 Principles for the Fight against Corruption", the formation in 1998 of GRECO (Group of European States against Corruption) with an effective regular review mechanism and the adoption of the Criminal and Civil Law Conventions against Corruption in 1999. The European Union adopted its own first Convention against Corruption involving European Officials in 1997. The Organisation of American States had adopted the Inter-American Convention against Corruption in 1996. All these efforts were crowned by the UN Convention against Corruption in 2005 which significantly broadened the list of practices to be criminalised by the member states and added asset recovery, but which still lacks an effective review and enforcement mechanism (and until now has not even been ratified by several major industrial states such as Germany or Japan).

Work on the corruption topic in the OECD had restarted in 1989, prompted by the United States that felt at a competitive disadvantage in international markets after their Foreign Corrupt Practices Act of 1977 had made the bribery of foreign officials by US companies a criminal offence. In the mid-1990s, the preparatory work at the OECD toward an international agreement took on speed and led in December 1997 to the adoption by the OECD members (and several other non-member states) of the Convention on Combating Bribery of Foreign Public Officials in International Business Transactions, together with the official Commentaries and the Revised Recommendation of the Council dealing with additional important anti-bribery measures such as the abolition of the tax deductibility of bribe payments.

The OECD Convention on bribery

The OECD Convention so far remains the single most effective international instrument in nudging governments toward adopting and implementing more and more effective anti-bribery policies. The effectiveness of the Convention was primarily due to the fact that it was – from the outset – accompanied by a well-designed and, so far unique, detailed peer review system that by now has reached its Phase 3 Reviews (Phases 1 and 2 having concentrated on the quality of the incorporation of the Convention's agreements into the various national laws, and of the initial implementation and enforcement of those obligations respectively).

The OECD has traditionally co-operated with the international business community (represented by the BIAC) and the labour union movement (through the TUAC). TI, the global anti-corruption movement, established contact with the OECD soon after its formation in 1993 and was accepted as more or less a standard observer at all anti-bribery related activities of the OECD, including those concerning the Global Forum and Global Corporate Governance activities. TI contributed regularly through substantive commentaries and recommendations directly to the OECD working groups but also through advocacy work by its National Chapters in the various capitals, urging the governments of the OECD Convention signatory states to adopt a supportive

position toward a comprehensive common anti-bribery effort. Critical in this context was a letter that TI, jointly with the ICC, organised in May 1997 for prominent international industrialists to send to their respective ministers of economy and finance, encouraging them to support the OECD recommendations toward a common anti-bribery agreement. The statement by the industrialists, to the effect that they were ready to join the fight against corruption, made it very difficult for their ministers to maintain their previous position that they "… had to protect their domestic industry against unreasonable demands", and thus helped to obtain a quick consensus (on texts that reflected a strong input from the civil society representatives) and a remarkably fast finalisation of the Convention texts.

TI national chapters as well as other civil society representatives are regularly involved in the OECD Peer Review visits to individual signatory states of the Convention. However, the OECD does not publish overall review reports, only the individual country reports (after they have been discussed with the reviewed country). Therefore, since 2005 TI has published its own annual Progress Report on OECD Convention Enforcement, bringing together the assessment of the enforcement quality by TI associates in the various countries, who draw, *inter alia*, on the OECD peer review reports.

Anti-bribery measures for export credits

In parallel with the development of the Convention, the OECD Working Party on Export Credits and Credit Guarantees (ECG) had, since 1998, investigated how bribery was being addressed under its members' national export credit systems through an ongoing survey of Members' policies and practices to deter bribery in officially supported export credits.

After the OECD Anti-Bribery Convention had come into force in early 1999, TI concluded that the governments' anti-bribery policies now should also be implemented by official export credit agencies (ECAs). TI consequently sought an invitation to the ECG and soon, thereafter, issued a Position Paper on Corruption Fighting by those ECAs represented at the OECD. In November 2000, TI met with the ECG and reminded the members that as public or publicly-supported institutions they were under obligation not to provide export support for corrupt business transactions and thus to introduce measures that would help them identify and eliminate such corrupt business transactions. In particular, TI submitted recommendations on the introduction of a no-bribery declaration by the exporter, the adoption of guidelines and effective sanctions and the public disclosure of all relevant information in cases where payment was claimed under the export credit insurance and full transparency through annual reports. In its oral presentation, TI "… challenge(d) the OECD and its member states to come forward with harmonised strengthening of their ECA rules so that corruption is no longer disregarded, tolerated or even tacitly supported by official export support agencies".

TI's recommendations were, indeed, partially reflected in the ECG's 2000 Action Statement on Bribery and Officially Supported Export Credits. In the following years, TI relentlessly called for stronger and additional measures and thus was pleased to observe the adoption in 2006 of a strengthened Action Statement and its upgrade to a formal OECD Council Recommendation on Bribery by the end of that year.

In 2002, the secretariat for the ECG started to carry out and publish an annual Survey of Measures Taken to Combat Bribery in Officially Supported Export Credits, and the individual ECAs submitted much useful information for this survey. The secretariat called on civil society to comment on those surveys. While welcoming and observing the initiative of the secretariat, TI felt that these surveys did not provide enough detailed, pragmatic information about the actual anti-bribery practices and, therefore, in 2009 carried out its own survey among 14 selected ECAs[2] publishing the results of this work in a report entitled "ECA Anti-Bribery Practices 2010". The work on this report received strong support both from the selected ECAs and from the secretariat. TI's Report found that, in general, good progress had been made in the anti-bribery activities of many ECAs, even though there were significant differences in implementation and approaches among the participating ECAs. While there is still much work to be done, there are now a good number of best practice examples that should be replicated across the world.

The TI Report also identified key areas for improvement, while highlighting good practices that should be replicated by others, these included:

- A more formal, structured approach for advancing anti-bribery commitments, including designating senior management oversight of implementation.
- Training ECA staff on anti-bribery policy and how to implement it.
- Stepped-up outreach to the private sector and practical support for exporter anti-bribery efforts.
- Requiring companies whose exports they support to have internal programmes for preventing bribery.
- Strengthening due diligence review practices.

Proper staff training, meaningful due diligence and effective management controls would help to prevent and detect bribery which, in turn, ensures that both exporting and importing countries get the most value for their money. TI intends to follow up this work with a benchmarking exercise and regular surveys thereafter to measure progress.

Improving the 2006 OECD Recommendation on bribery and export credits

TI still maintains its call for additional changes in the 2006 Council Recommendation on measures to deter bribery in official export credits, such as (1) making ECAs request more information from applicants on a routine basis, including the disclosure of agents' names and commissions paid to them, (2) requiring enhanced due diligence in additional cases, (3) less restrictive use of sanctions, and (4) requiring applicants to introduce codes of conduct and compliance systems. Disclosure of agents' commissions would, in cases of unusually or excessively high levels of commission, trigger enhanced due diligence and thus possibly help spot corrupt business transactions.

In pursuit of its standard coalition-building approach, TI was successful in gaining the confidence of the governments and the ECAs as well as of the OECD secretariats of both the Working Group on Bribery and the ECG, and over the years was thus able to contribute many pragmatic suggestions and recommendations to the effective anti-bribery work of the OECD.

Other non-governmental organisations (NGOs) who occasionally participate in the ECG sessions and consultations have traditionally supported the anti-corruption efforts of TI, while naturally they focus mostly on their own germane issues like environmental and human rights considerations in OECD and ECA activities (*e.g.* export credit support for projects that violate international environmental protection or resettlement rules or allow child labour). The secretariat for the export credit committees, in particular, has broadly reached out to the NGO community over the past years and the NGOs have responded strongly with substantive recommendations on ECAs' policies and business practices. In fact, the NGO representations, both at the national and the international level, led in a number of cases to changes in ECAs' policies and in individual business decisions of ECAs concerning questionable export contracts. TI and the other NGOs bring valuable competence and commitment to the table and enrich the debate; these combined efforts to optimise the fight against corruption, as well as to give full weight to human rights and environmental concerns, deserve general support.

The secretariats of the two OECD working groups deserve the respect of the international community for regularly reaching out to civil society and seeking their comments and input into the process of strengthening the texts as well as the implementation of the internationally adopted rules. The damage caused by corruption is so immense that all interested parties simply have no choice but to co-operate in the effort to fight this major scourge of our time.

Notes

1. The OECD Guidelines for Multinational Enterprises, as recommendations jointly addressed by governments to multinational enterprises, with observance remaining voluntary and not legally enforceable, remain outside the purview of this article, even though they deal with "Combating Bribery" in Chapter VI.
2. The selection of these 14 ECAs was arbitrary in the sense that TI selected ECAs in countries where TI had a national chapter that was active in procurement work and could carry out the inter-action with the respective ECA. Participants in the survey included ECAs in Belgium, Canada, France, Germany, Hungary, Japan, Korea, Norway, Slovenia, Sweden, Switzerland, the United Kingdom and the United States of America

STRENGTH IN CO-OPERATION: THE BERNE UNION AND THE OECD

Kimberly Wiehl

Kimberly Wiehl is the Secretary-General of the International Union of Credit and Investment Insurers (the Berne Union). Founded in 1934, the Berne Union is an international, non profit organisation dedicated to facilitating worldwide cross-border trade and investment by fostering international acceptance of sound principles in export credits and investment insurance, and by providing a forum for professional exchanges among its 49 members.

I am sure that I represent all the export credit insurance community when I say that the work of the OECD has been of vital importance to the development and stability of our industry over the past five decades.

OECD member governments have worked together to create a framework of operation to ensure a level playing field among export credit agencies (ECAs). There have been many important landmark decisions and advances which have benefited the industry on a global scale. As the Secretary-General of the Berne Union for nearly 10 years, it has been a pleasure to work closely with the OECD colleagues among the member countries and in the secretariat.

Close alignment of Berne Union and OECD objectives

While the Berne Union was founded over 25 years before the OECD, since its establishment the OECD has become the governmental platform for national export credit insurers. During this time, the Berne Union has evolved to include member agencies from emerging as well as developed markets and also private export credit and investment insurers.

First and foremost, the Berne Union actively aims to facilitate cross-border trade by supporting international acceptance of sound principles and by providing a forum for professional exchanges among its members. The Berne Union members come together as a group of expert practitioners, in many cases working to assess the practical implications and implementation of decisions taken by the OECD. In a number of ways, this work not only plays a complementary role to that

undertaken by the OECD, but also extends the knowledge of the initiatives taken by the OECD to other agencies and companies beyond the OECD membership.

In recent years, the Berne Union has adopted a series of association principles which have incorporated a number of fundamental themes established by the OECD. The key areas are principles related to environmental practices, ethical business practice and financial responsibility. This is highlighted in the Berne Union Value Statement: "…We are committed to operate in a professional manner that is financially responsible, respectful of the environment and which demonstrates high ethical values – all in the best interest of the long-term success of our industry".

Following the agreement of the Value Statement in 2004, the Berne Union members further elaborated their values in a series of ten Guiding Principles; this was a significant milestone for the Berne Union as private and public entities with different mandates and ownerships agreed to share these principles in the pursuit of the purpose of their organisation. Again, many of the important agreements achieved in the OECD were the inspiration for the following Principles, which were adopted in 2006:

1. We conduct our business in a manner that contributes to the stability and expansion of global trade and investment on a sound basis that is in accordance with applicable laws and relevant international agreements.
2. We carefully review and manage the risks we undertake.
3. We promote export credit and investment insurance terms that reflect sound business practices.
4. We aim to generate adequate revenues to sustain long-term operations reflective of the risks we undertake.
5. We manage claims and recoveries in a professional manner, while at all times recognising the insured's and obligors' rights.
6. We are sensitive about environmental issues and take such issues into account in the conduct of our business.
7. We support international efforts to combat corruption and money laundering.
8. We promote best practices through exchange of information on our activities, policies and procedures, and through the development of relevant agreements and standards, where these are deemed necessary to govern the provision of export credit and investment insurance.

9. We are committed to furthering transparency among members and in the reporting of our overall business activities, reflective of international practices and respectful of the confidentiality of third party information.
10. We encourage co-operation and partnering with commercial, bilateral, multilateral, and other organisations involved in export trade and investment business.

As a final step, in 2008 the Berne Union used the Guiding Principles as the basis for its Operational Guidelines for each of the three business areas, *i.e.* short term (credit tenors of one year or less), medium/long term (credit terms more than one year) and investment insurance (political risk insurance).

Complementing OECD agreements

Under the Operational Guidelines for medium- and long-term business, which is the area most closely aligned with the business of OECD members, there are numerous references to OECD agreements. These areas include repayment terms, premium rates, sector understandings, project finance, environmental impact assessments, bribery, multilateral enterprises, sustainable lending and also untied aid.

The Berne Union has also worked closely with the OECD to promote its outreach initiatives. In fact, a number of existing Berne Union members have become actively engaged by participating in the OECD export credit meetings and various outreach activities as invited observers. As new ECAs have been established in Central and Eastern Europe, the Middle East, Africa and Asia, they have joined the international community as members of the Berne Union Prague Club. Together with Berne Union colleagues, OECD experts have frequently attended the meetings of these newly created ECAs to exchange expertise in order to promote best practice and highest international standards throughout the industry.

Therefore, it is with great pleasure, both personally and on behalf of the Berne Union, to congratulate the OECD, its Chairman, François de Ricolfis, and past and present Heads of the Export Credits Division with whom I have worked, Janet West and Steve Tvardek, and each of the OECD members on this 50th anniversary. Along with all members of the Berne Union, I wish you all the best and hope to benefit from our continued co-operation and professionalism in our roles as key organisations working toward the support and success of our industry's future.

EXPORT CREDIT AGENCIES AT THE OECD: ANY ROLE LEFT?

Wiert Wiertsema

Wiert Wiertsema, co-ordinator of the Capital Flows Programme at Both ENDS, writes on behalf of ECA Watch. Both ENDS is a non-governmental organisation (NGO) in the Netherlands which strives for a more sustainable and fairer world by supporting organisations in developing countries to fight poverty and to work towards sustainable environmental management. ECA Watch is an international network of NGOs that aims for reform of export credit agencies.

The history of export credit agencies (ECAs) goes back to the period between the two World Wars. Governments of major industrialised countries established ECAs at that time to support and encourage exports and outward investment. ECAs were intended to strengthen domestic corporations doing business abroad, thus also contributing to employment generation efforts. Depending on national circumstances, the means by which ECAs operated their export support programmes varied substantially. ECAs were generally expected to provide cover for transactions which private export credit insurance companies would consider too risky or expensive to support. Sometimes governments – especially when facing budget constraints – put their ECAs under pressure to ensure that the costs of their operations and eventual damages would be covered by revenues from the payment of premiums and interest by the companies they served ("break even").

As national agencies, ECAs also contributed to enhanced competition between companies based in different industrialised nations. While the world has faced tremendous changes, the export promotion role of ECAs actually has hardly changed. Since 1963, the OECD Working Party on Export Credits and Credit Guarantees (ECG) seeks to create a level playing field for ECAs and facilitate international co-operation between ECAs. ECA Watch appreciates the opportunity of the 50th anniversary of the OECD to review this role from a civil society perspective.

The original role of export credits in the OECD

The forerunner of the OECD was the Organisation for European Economic Co-operation (OEEC), formed in 1948 to administer American and Canadian aid under the Marshall Plan for the reconstruction of Europe after World War II. The OEEC sought better

co-ordination of the European reconstruction efforts. As new institutions to promote European co-operation gradually evolved in the 1950s, the OEEC was superseded in 1961 by the OECD. Unlike the OEEC, the OECD started with a worldwide scope, aiming to build strong economies in its member countries and to promote free trade and worldwide economic development.

Within the OECD, the ECG was established in 1963. Today, ECG members total 32: all OECD countries except Iceland and Chile. Both senior government officials – often from ministries of finance – as well as senior officials of member countries' ECAs participate in the deliberations of the ECG, which is charged with carrying forward the work of the OECD in the field of export credits. The general objectives of the ECG[1] are noted in its mandate:

- Evaluate export credit policies.
- Determine the problems which arise.
- Resolve or mitigate these problems by multilateral discussion.
- Additional objectives, *inter alia*, concern such as "… working out common guiding principles" and "considering all possibilities of improving co–operation between member countries in this field".

In parallel with the work of the ECG, in the course of the 1970s, some major OECD governments providing export credit support expressed the desire to develop a "Gentlemen's agreement" to bring more order to official export financing. The specific focus of this agreement was to harmonise interest rate subsidies. In 1976, the G7 Summit at Rambouillet provided the backdrop for a "Consensus" on official export credits among a limited number of OECD countries. Two years later, in April 1978, the Arrangement on Guidelines for Officially Supported Export Credits was established at the OECD in Paris with 20 participating countries. Quite remarkably, the Arrangement was formed outside the then established framework of the GATT, the predecessor of the WTO. Today, 30 of the 34 OECD member countries are involved in the Arrangement (Iceland, Israel, Mexico and Chile are not), plus Brazil which is a Participant to the 2007 and 2011 Sector Understandings for Civil Aircraft. The Participants to the Arrangement negotiate and implement rules in support of their national policy objectives related to officially supported export credits.

Even today, the status of the Arrangement remains that of a Gentlemen's agreement, which qualifies as "soft law" without any legally binding character.[2] Nevertheless, it quite correctly has been described by the current US Secretary to the Treasury, Timothy Geithner, as an instrument that evolved from a simple creditors' cartel to a powerful force for improved international and domestic economic policies worldwide.[3] ECA Watch would contest that its force resulted in

policy improvements, but the power of the Participants to the Arrangement is clearly reflected in the privileged position it obtained in the WTO Agreement on Subsidies and Countervailing Measures (ASCM),[4] which is meant to discipline and regulate government subsidies for private sector undertakings. Annex I of the ASCM provides an Illustrative List of Prohibited Subsidies; however, in article (k) of that Annex all official export credits that comply with the provisions of the Arrangement are declared not to be considered prohibited subsidies. In practice, this implies a "safe harbour" for Arrangement-compliant transactions. The member states of the WTO actually empowered the Participants to the Arrangement to determine the difference between permissible export credit support and prohibited subsidies.

Systematic shortcomings

The privileged, well protected and fairly exclusive group of Participants to the Arrangement surely reflects the membership base of the OECD. A full review of the global impacts of the dominant role of the OECD in guiding the policies of ECAs is beyond the scope of this article. Given the primary purpose of ECAs, to support domestic industries in doing business abroad, one may assume that the economies of the OECD member countries benefited well. Some may interject that non-OECD member countries also benefited from the cheaper access to credit provided through ECAs. However, it is only in recent years that ECAs have paid attention to the social and environmental implications of the transactions they support[5]. Social, environmental and human rights safeguards are essential if properly designed and implemented, especially since ECAs have no development mandate whatsoever.

From a civil society perspective, ECAs are far too often responsible for supporting credits for transactions in developing countries that are unaligned to local development strategies, detrimental to sustainable development objectives and mainly beneficial to local and foreign elites. However, it is helpful at the level of individual ECA-supported transactions that the ECG concluded an agreement on a set of environmental review measures which was adopted by the OECD Council as a Recommendation on Common Approaches on the Environment and Officially Supported Export Credits in 2003 (later revised in 2007). Similarly, the 2005 (revised in 2009) Sector Understanding on Export Credits for Renewable Energies and Water Projects agreed by the Participants to the Arrangement to provide special financial terms for enhanced energy efficiency and low carbon projects has been welcomed by ECA Watch[6]. But, concerns about the impacts of ECA-supported transactions on climate change have not yet been translated into improved policies. A very substantial part of ECAs' portfolios is supporting fossil fuel-related activities, while the number of transactions supporting green technologies is far behind. Also, no policies are yet in place to ensure the transposition by ECAs of international legal obligations on themes such as respect for human rights. Overall, the ECG is struggling with the implementation of sustainability issues. Moreover, the focus of such measures at the transaction level fails to address more systemic shortcomings of current ECA policy making at the OECD.

Export credit support for unproductive transactions often results in defaults on the loans supported/provided by ECAs, thus contributing to debt problems in many developing countries.[7] Export credit debt counts for a substantial part of the problematic debts of non-industrialised countries; in case any such country fails to repay its debts, it is forced to negotiate the cancellation or rescheduling of the debt at the Paris Club, where all creditors – including the ECAs – are represented. Eventual cancellation of such debts may be reported as Official Development Assistance (ODA) under rules set by the Development Assistance Committee, another OECD body. Since such ODA expenses cannot be spent for more productive purposes, ECA Watch concludes that, ultimately, developing countries are forced to pay the costs of the failure of ECA policies through the very design of these policies. As a partial recognition of this problem, in 2008 the ECG adopted a Statement of Principles on Sustainable Lending; these principles lean heavily on the Debt Sustainability Framework as developed by the IMF and the World Bank. Neither developing countries, nor civil society have had any substantial say in the formulation and implementation of these Principles.

Another related systemic shortcoming of ECA policy making at the OECD concerns the "safe harbour" for the Arrangement in the context of the WTO ASCM. While it is stated that the Arrangement focuses on harmonising interest rate subsidies,[8] ECAs claim not to provide such subsidies but rather to comply with the requirement in the Arrangement to cover long-term operating costs and losses with the revenues from interest and premium payments.[9] The ECG has not developed mechanisms to allow for an independent verification of this break-even claim; the most likely reason for the failure to do so is that all ECAs which participate in the Arrangement and/or are represented in the ECG remain mutual competitors. And as competitors, ECAs tend to disclose as little operational-related information as possible. If, nevertheless, the ECAs' break-even claims were true, their revenues of interest payments and premiums would account for writing-off their losses. Thus, the political rationale would be removed for the general *praxis* of ECAs to report cancellations of export credit debt as ODA.

A third systemic shortcoming of the ECG and the Participants to the Arrangement is their failure to develop inclusive policies that allow for the growing role of ECAs and governments of non-OECD countries. Over the last decade, the role and global significance of emerging market economies –countries such as Brazil, China, India and South Africa – have grown dramatically. Many of these countries have established their own ECAs to promote their domestic companies doing business abroad. Although the OECD, the ECG and the Participants reportedly undertook strenuous efforts to enhance outreach to these countries and their ECAs, the results of such efforts remain very disappointing. As in all such *rapprochement* efforts, movement is required on both sides. And as in other international trade negotiations, the stakes are very much connected to the increasing competition between established and emerging economies.

Future role for export credits in the OECD

It appears that the ECG is under quite some pressure from OECD-based corporations – among others represented by the BIAC – to lower social and environmental standards in response to the competition of companies receiving official export credit support from non-OECD ECAs. Also, the American United Steel Workers Union (USW) recently filed a petition under Section 301 of US trade laws arguing that China engages in illegal practices that stimulate and protect its domestic producers of green technology, ranging from wind and solar energy products to advanced batteries and energy-efficient vehicles. In this petition, the USW argues that Chinese export credit support for green technologies violates WTO rules on prohibited subsidies.[10]

The ECG and its members, thus, have to deal with increasing pressure to stand by their original mission to support domestic corporations doing business abroad. In sticking to this role it is likely to have little influence on the policies of ECAs of quickly-growing economies outside its direct sphere of influence. This dilemma illustrates very well that the OECD is facing the real possibility of becoming an increasingly less relevant international body for effectively working out common guiding international principles and bringing order to international export financing. To avoid such demise, the OECD has no choice but to insist that the business sector within the OECD faces up to challenges from abroad, not by restarting export subsidy wars, but by raising its own competitive edge. As an acknowledgement of the importance of sound export credit policies for fruitful international economic co-operation, the OECD has to embark on a greater openness and transparency, to allow for a meaningful dialogue with non-OECD ECAs.

To make sure that the progress made so far in limiting the social, environmental and human rights impacts of ECA-supported transactions is not lost in a new "*race to the bottom*", the OECD should also insist that civil society and the recipient host countries of ECA-supported transactions are able to participate fully in a meaningful negotiation process on a truly global regulatory regime for officially supported export credits.

In the end, the OECD should stress to the ECG that its mission cannot just be focused on a rather protectionist drive to strengthen the economies of its members. In order to avoid losing its leading position, the ECG has to face up to the other part of the OECD mission, to advance effectively worldwide economically sustainable development. To be able to do so, the ECG and its members will have to commit to a much more open and reciprocal dialogue with civil society than it so far has been prepared to do. The 50th anniversary of the OECD would be an excellent occasion for the ECG to make a fresh beginning. Continuing business as usual does not appear an attractive option.

Notes

1. See: *www.oecd.org/document/24/0,3343,en_2649_34169_1844760_1_1_1_1,000.html*.
2. 30 years of innovation, by Janet West, in *The Export Credits Arrangement 1978–2008*, OECD: *www.oecd.org/dataoecd/17/24/40594872.pdf*.
3. *The Export Credit Arrangement 1978/1998: Achievements and Challenges*, OECD: *www.oecd.org/document/1/0,3343,en_2649_34171_1888873_1_1_1_1,00.html*.
4. See: *www.wto.org/english/docs_e/legal_e/24-scm_03_e.htm#annI*.
5. The first Common Approaches on Environment and Officially Supported Export Credits were adopted in 2001: *www.oecd.org/dataoecd/2/32/2726700.pdf*.
6. ECA Watch however remains critical of the fact that this Sector Understanding applies to disputed technologies such as high dams. ECA Watch has also opposed enhanced financing terms for nuclear power, as well as for other technologies that the network considers to be false solutions to climate change based on environmental, social, technological and financial reasons.
7. A notorious example has been the Bataan nuclear power plant in the Philippines that was completed but never fuelled. The total costs of this project rose to more than USD 2 billion, and part of the project was financed by a loan of the US Ex-Im Bank. Despite the fact that this power plant never became operational, the Government of the Philippines was forced to pay back the full loan.
   Also see: www.eca-watch.org/problems/asia_pacific/philippines/index.html#Bataan.
8. 30 years of innovation, by Janet West in *The Export Credits Arrangement 1978–2008*, OECD: *www.oecd.org/dataoecd/17/24/40594872.pdf*.
9. Article 23 of the Arrangement [28 January 2010, TAD/PG(2010)2] reads: "The Participants shall charge premium, in addition to interest charges, to cover the risk of non-repayment of export credits. The premium rates charged by the Participants shall be risk based, shall converge and shall not be inadequate to cover long-term operating costs and losses."
10. United Steelworkers' Section 301 Petition Demonstrates China's Green Technology Practices Violate WTO Rules: *assets.usw.org/releases/misc/section-301.pdf*.

Part IV

THE GLOBAL FINANCIAL CRISIS

1. *Statements on export credits and the financial crisis*

2. *Credit where credit is due: Averting a global meltdown*

3. *The OECD export credit regime: A bright past, what of the future?*

STATEMENTS ON EXPORT CREDITS AND THE FINANCIAL CRISIS

Statement: Export credits and the financial crisis[1]

OECD, Paris, 24 November 2008

OECD Members of the Working Party on Export Credits and Credit Guarantees,[2] the Participants to the Arrangement on Officially Supported Export Credits,[3] Non-Member Economies[4] and the WTO Secretariat met to discuss the impact of the global financial crisis on official export credits. Governments confirmed their strong commitment to continue to be reliable partners to exporters and financing banks; a global problem requires a coordinated global solution.

Official export credit support and finance play an enhanced key role in counterbalancing instability in periods of economic uncertainty and risk averse behaviours of economic players, by helping to fill the gap where market capacities are temporarily limited.

In the light of these considerations, these OECD member and non-member governments are determined to maintain their export credit support and ensure that sufficient capacity is available with the aim of supporting international trade flows, in line with sound underwriting principles, within the limits of their respective international obligations.

This action will, inter alia, contribute to the fulfilment of one of the undertakings identified in point 7 of the declaration by leaders of the G20 countries, expressed at the summit on financial markets and the world economy, held in Washington on 15 November, *i.e.* "help emerging and developing economies gain access to finance in current difficult financial conditions, including through liquidity facilities and programme support".

During previous financial crises, governments developed experience of expedient and co-ordinated use of their schemes for officially supported export credits and are utilising this experience to limit the impact of the present crisis on the financing of trade transactions in the world. Members and non-member economies are closely monitoring developments, exchanging information and taking appropriate measures as deemed necessary and in accordance with their respective international obligations.

Statement: The global financial crisis and export credits[5]

OECD, Paris, 22 April 2009

OECD members that provide official export credits, Brazil, the People's Republic of China, Estonia, Indonesia, Israel, Romania, Singapore, Slovenia, together with the European Commission, IMF, World Bank, IFC, MIGA, WTO (hereafter referred to as "governments and participating institutions") and the International Union of Credit and Investment Insurers met in the OECD to discuss developments in export and trade finance for short term transactions and for capital goods and projects, in the context of the global financial and economic crisis and the outcomes of the G-20 London Summit held on 2 April 2009.

These governments and participating institutions:

- Welcome the commitment identified in points 5 and 22 of the G20 Communiqué "to ensure availability of at least USD 250 billion over the next two years to support trade finance through export credit and investment agencies and through the Multilateral Development Banks". This pledge reinforces the November 2008 OECD Statement on export credits and the financial crisis in which governments, the European Community and the WTO confirmed their strong commitment to continue to be reliable partners to exporters and financing banks and pledged to maintain their export credit support and ensure that sufficient capacity is available with the aim of supporting international trade flows.

- Agree that a recovery of world trade flows is a vital component in the broader recovery of the international economy and achieving sustainable growth. Recent declines in trade volumes are attributable to recessionary forces and frozen financial markets resulting in the declining availability and high price of trade finance in private markets both for short term transactions and for capital goods, services and infrastructure projects which, typically, are the subject of official export credits. These developments, in turn, could further reduce trade flows and export financing, especially for emerging markets and developing countries.

- Recognise that the measures they have already taken, together with the pledge of the G20 governments, should ensure the increased availability of both short-term and medium- and long-term export credits, especially to emerging markets and developing countries, in supporting the investments necessary for moves towards sustainable economic recovery. Additional measures could include co-operation among ECAs and MDBs, such as strengthening re-insurance schemes.

- Agree that any measures be in place until market conditions recover and should be consistent with their respective international obligations and in line with sound underwriting principles.

These governments and participating institutions recognise the need for a coordinated approach to implementation and, to this end, agree to meet regularly in the OECD to exchange information on the measures taken by these governments and participating institutions, in support of the G20 trade finance initiative, and to ensure the continuation of medium- and long-term export financing.

These governments and participating institutions invite other major providers of official export credits to join this Statement.

Notes

1. TAD/PG(2008)28/FINAL and TAD/ECG(2008)22/FINAL.
2. Australia, Austria, Belgium, Canada, Czech Republic, Denmark, Finland, France, Germany, Greece, Hungary, Ireland, Italy, Japan, Korea, Luxembourg, Mexico, Netherlands, New Zealand, Norway, Poland, Portugal, Slovak Republic, Spain, Sweden, Switzerland, Turkey, United Kingdom and United States.
3. Australia, Canada, European Community, Japan, Korea, New Zealand, Norway, Switzerland and United States.
4. Brazil, Estonia, India, Israel, Romania, the Russian Federation and Slovenia.
5. TAD/PG(2009)14/REV and TAD/ECG(2009)3/REV.

CREDIT WHERE CREDIT IS DUE: AVERTING A GLOBAL MELTDOWN

John Ahearn

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As the economies of the world begin to normalise and the idea of "business as usual" starts to feel comfortable again, it is appropriate to reflect upon key actions that helped facilitate the recovery. The recent economic crisis created a unique set of problems that required a series of bold and innovative solutions. These solutions were supported in large part by organisations such as the OECD, working in conjunction with bilateral and multilateral agencies and export credit agencies (ECAs). These official agencies have become increasingly vital in supporting global trade during the crisis and into this transitional period.

As the recovery continues, threats to its continued health are on the horizon. Two threats in particular merit careful consideration: a troubling resurgence of protectionism and the prospect of new regulations that could stifle trade. A look back at how we navigated the recent financial crisis offers important lessons on how to avoid the pitfalls that caused the economic troubles in the first place – and could still spell trouble for the recovery.

The roots of recession

It seems a lifetime ago that liquidity was easy to come by, but in fact it was only three years ago. Constraints in liquidity coupled with the sub-prime fallout caused a domino effect, directly impacting commercial bank credit and credit availability.

The liquidity freeze frightened many investors and institutions because without liquidity they were unable to sell assets quickly and at a reasonable margin. Without the option to sell an asset, short-term financing became more risky and even lending to firms with good credit ratings slowed to a trickle. With such non-discriminatory views, many financial institutions were unwilling to take on

additional credit risk by lending cash. Firms were unable to borrow *via* their traditional avenues and projects stalled as credit tightened. There were no wheels in motion, no one was able to continue operations as usual and funds stopped circulating between banks, companies and individuals.

Eventually, the liquidity crisis snowballed to the point where credit availability dried up as well. Bad securitisations, in which overvalued loans were pooled together and sold to investors, ran rampant in the market. Many of these securitisations were made up of sub-prime mortgages. The commercial paper issued to fund these pools of assets quickly lost its draw. Asset backed commercial paper (ABCP) is a prime example of a market that was downsized due to the restrictions in liquidity and credit availability. Historically, ABCP was issued by commercial banks and sold as a short-term asset; however, with securitisations facing extreme stress, investor demand for these and other loans fell considerably. As a result, the issue of commercial paper and other securitised assets has decreased. The new market conditions, marked by a more conservative investor profile, lower liquidity, increased market volatility and increased pricing for credit, are not conducive to growing the asset-backed securitisation markets.

Consider the bursting of the US housing bubble, which peaked sometime during 2005 to 2006. An increase in loan incentives, such as artificially low teaser rates, adjustable rate mortgages and sub-prime loans, along with the long-term rise in housing prices, had encouraged borrowers to assume unaffordable mortgages in the belief they would be able to refinance quickly at more favourable terms. However, once interest rates began to rise and housing prices started to drop moderately in 2006 to 2007 in many parts of the United States, refinancing became more difficult. Defaults and foreclosure activity increased dramatically as easy initial terms expired.

This combination of factors caused the financial system to become increasingly fragile. Some regulated banks had assumed significant debt burdens while providing easy credit, and did not have a financial cushion sufficient to absorb large loan defaults or losses of mortgage-backed securities. These losses constrained the ability of financial institutions to lend, slowing economic activity. Almost immediately, supporters of free trade and those who advocated protectionism began to battle over the scope and degree of new international trade regulation.

The role of official agencies

The OECD works with many other organisations, including official agencies, to stifle the spread of protectionism and facilitate a return to open markets and international trade finance. As noted earlier, because of the crisis, many companies were unable to obtain credit and financing through their traditional channels; someone was going to have to take the place of banks in issuing financing. Official agencies, including ECAs, development financial institutions and multilateral finance institutions have become increasingly involved in trade and development

projects. During the crisis, these organisations played a crucial role in supplying credit, liquidity and support to a variety of industries.

Consider the role of official agencies in supporting the aircraft sector during the crisis. With traditional commercial lenders unwilling to fund carrier purchases of aircraft, the Export-Import Bank of the United States (US Ex-Im Bank) and comparable ECAs in other countries proved vital to international transactions. The US Ex-Im Bank, for example, boosted its guarantees for US-manufactured commercial aircraft to an historic high of USD 8.6 billion. The US Ex-Im Bank's programme has grown to support financing of foreign purchases of US-manufactured commercial and general aviation aircraft under its direct loan, guarantee and insurance programmes. The OECD has an ongoing intellectual and policy interest in these transactions: it is responsible for governing the terms and conditions of the US Ex-Im Bank's (and other ECAs') financing support for the aircraft sector.

Along with my colleagues at Citi Bank, I have had a close-up view of the role of public-private partnerships in keeping trade flowing. As recently as mid-2010, Citi Bank acted as a structuring agent for support of a US Ex-Im Bank bond for USD 126 million. The deal was formulated to sustain a build by Boeing for Dubai Aerospace Industries. Citi Bank was also involved in a similar bond deal for the Brazilian carrier GOL and acted as book runner for the aircraft finance deal. COFACE, ECGD and Euler Hermes, the ECAs of France, the United Kingdom and Germany respectively, all provided similar support for their sovereign aircraft industries.

Beyond the aircraft business, the US Ex-Im Bank has also taken steps to support 21st century industries such as renewable energy: among the recent initiatives supported by the Bank are India's Sasan Power Plant, a hydro-electric dam in Turkey and a wind farm in Honduras. The US Ex-Im Bank has deemed its environmental exports programme "… one of three special initiatives – along with medical equipments and transportations security exports – for which we provide enhanced volumes of financing for US exports beyond what is offered through our regular financing". Other official agencies have launched similar programmes across vital industries; there are examples from almost every corner of the world.

Citi Bank has worked closely with the US Ex-Im Bank and other multilateral institutions to pump liquidity back into the global markets; we recently engaged with the Bank to introduce a series of short-term financing approaches for exporters, the most innovative of which is the "Put Option". The Put Option allows assets to be viewed more favourably by potential investors because the US Ex-Im Bank is able to waive liquidity premiums for that asset category. The outcome of the Put Option is a reduced cost of funding for the US Ex-Im Bank funded financing; the competitive cost structure is significantly lower than that of an equally rated European ECA financing.

In June of 2009, Citi Bank and the World Bank Group's International Finance Corporation (IFC) entered into a Memorandum of Understanding to work on the development of a USD 1.25 billion funding facility. The facility is intended to simulate global trade in emerging markets over the next three years. This agreement between Citi Bank and IFC marks one of the industry's highlights, as it falls under the umbrella of the latter's Global Trade Liquidity Program (GTLP). The GTLP is one of the key initiatives led by the World Bank Group to bring together governments, international development agencies and private sector banks to stimulate trade finance in emerging markets. Citi Bank has been using this facility to address the needs of importers and exporters worldwide by originating transactions from emerging market banks therefore enabling these banks to extend financing locally.

The Asian Development Bank has also been a key contributor to jump-starting global trade through its Trade Finance Programme (TFP), which provides guarantees and loans to partner banks. As an example, TFP provided a 100% guarantee covering payment risk on an Azerbaijani bank in support of a transaction involving a USD 600 000 purchase of capital equipment used for drying fruits and vegetables where the exporter and confirming bank were in Germany. TFP provided a USD 6 million Revolving Credit Facility to a bank based in Colombo, Sri Lanka; from this facility, the partner bank provided pre-export finance worth USD 250 000 to an apparel manufacturer based in the town of Mawathagama and the funds were used as working capital to finance the export of finished garments to Europe, India and the Russian Federation. TFP also provided 25% risk protection for an USD 8 million trade loan provided by an American bank to a Vietnamese bank; this trade loan supported the export/import of technical designs and infrastructure equipment from Sweden for the installation of 3G cellular networks in southern Viet Nam.

The IFC has committed up to USD 35 million in equity to support an investment in the development of West African business. The IFC African, Latin American and Caribbean Fund (ALAC Fund) has committed to fund the modernisation and expansion of a German cement company across multiple African countries. The IFC is dedicated to creating opportunities which help cultivate economic growth in developing nations; the ALAC Fund is just one of many being proposed in the African continent.

In the third quarter of 2010, Citi Bank, in partnership with the IFC and the African Development Bank (AfDB), signed an agreement to provide USD 300 million in trade financing to support African exporters and importers. The assets have been allocated to support further the growth in the continent's economy and address the shortage of trade financing available to exporters and importers operating in Africa. Designed as a short-term revolver, the asset could potentially have an impact of over USD 1.5 billion in trade financing direct to African companies.

The AfDB also established a multiphase USD 1 billion Trade Finance Initiative (TFI) in response to the economic crisis and the resulting shortage of trade finance. In the first phase of the TFI, the AfDB launched a new trade finance line of credit that allowed African commercial banks and Development Finance Institutions to use AfDB resources to support trade finance operations. The Bank also launched a "multi-purpose" line of credit that enables the borrower to use the proceeds for trade finance as well as long-term project and corporate finance operations; this is an excellent example of a rapid response to a fast-moving crisis, precisely the sort of initiative encouraged by the OECD.

In the United States, Citi Bank has worked to champion domestic policies. As part of President Obama's National Export Initiative, which has proposed to double export volume from the United States within five years, Citi Bank united with the US Ex-Im Bank once again to approve the first transaction under the Bank's Supply-Chain Finance Guarantee Programme. This transaction will provide a 90% guarantee to support up to USD 100 million in liquidity from Citi Bank to small and medium-size suppliers of the company Case New Holland America. Initiatives such as this are small but important steps towards injecting liquidity back into the US market. The Supply-Chain Finance Guarantee Programme is another example of an innovative programme that is designed not only to introduce liquidity into the markets but also to assist in strengthening the supply chains of locally based companies, in turn contributing to the maintenance and creation of jobs.

In fact, all these examples underscore the interconnectedness of today's economy and the power of official agencies to keep trade moving even in the face of a severe global economic slowdown; they also demonstrate the successful use of official ECAs to activate global trade. While each official agency is primarily interested in supporting companies and industries in its own country, the collective outcome of their efforts is more trade, not less. They enable capital, labour and goods and services to move more freely across borders. The actions of these organisations, and the global co-ordination and support of the OECD, certainly helped prevent a serious economic crisis from devolving into a disaster.

The lure of protectionism

During any crisis, there is an understandable instinct to circle the wagons to protect one's own interests. During times of economic turmoil, there is a similar tendency toward protectionism –discouraging imports and protecting domestic markets through tariffs on imports, restrictive quotas and other government regulations. The recession officially ended in the United States in June 2009, after 18 long months, but the instinct to "circle the wagons" has not abated. If this trend continues, increased protectionism will throw the proverbial wrench in the works, stalling or reversing the recovery. Protectionism, by restricting trade trough tariffs and quotas, drives up costs and, as a consequence, the price of goods. Economies of scale and competitive bargaining are lost.

Additional evidence that protectionism is far from dead comes from the Doha Development Agenda, the current trade-negotiation round of the WTO, which began in November 2001 with the objective of lowering trade barriers. Since 2008, talks have stalled over a divide on such issues as agriculture, industrial tariffs and non-tariff barriers, services and trade remedies.

The continued threat of protectionism is ironic, in a way, because the recent crisis has if anything strengthened the case for open trade. With consumer demand still weak and corporate investment tepid at best, it is imperative to rejuvenate the global markets by spurring demand and investment.

The OECD: Vigilant monitors of protectionism

Fortunately, the OECD has been a relentless watchdog on the protectionism front. Throughout the crisis and even now, as the recovery limps along, the OECD has implored the leaders of the G20 countries to resist moving their economies toward protectionism. Sensible but not overly restrictive government regulations will be more important than ever on the road to worldwide economic stabilisation.

The OECD has worked closely with other organisations, such as the WTO and the United Nations, in pursuit of open economies and in support of global trade. The concern is that protectionism will result in closed markets and decreased foreign investment, which will negatively impact individual income.

With support and co-operation of like-minded individuals and organisations, the OECD has worked to illuminate the benefits of trade liberalisation. The OECD has strongly recommended "… an immediate roll-back of the most trade distorting measures" – in other words, restrictions on free trade.

Vigilance must continue

As the economy continues to recover, global trade will play an important role in sustaining growth. One key determinant of the future strength of trade will be the outcome of Basel III, the update to the Basel Accords – recommendations on banking laws and regulations issued by the Basel Committee on Banking Supervision. Basel I (1988) and II (2004) have had a profound impact on international banking and, hence, on global trade. Basel III, now under consideration, promises to have an equally significant impact on trade.

As proposed, Basel III will result in profound changes in the global banking business. Perhaps most importantly, it will require banks to hold significantly higher levels of capital, with the

goal of constraining excessive risk-taking and strengthening banks' abilities to absorb losses. In addition to the amount of capital required, Basel III will specify the quality of the capital held.

Because the cost of capital has increased in recent years, it will be quite expensive for banks to raise the additional capital proposed by Basel III, should it be adopted. This may result in banks reducing the array of products they offer, including trade-related products. What's more, Basel III, in combination with Basel II, would require that banks put more capital against less credit-worthy loans than against triple-A rated loans. The result may require banks to allocate capital to top-tier corporate customers and, therefore, be less inclined to lend to small and medium-size enterprises – the very businesses that are expected to lead the global economy in job growth.

Finally, Basel III is likely to put pressure on banks to raise their pricing structures – estimates have ranged from a 37% increase to a 200% increase. The question for regulators is a critical one: do you really want to put this price burden on global trade, the engine of recovery, when the global economy remains fragile?

Through creative active engagement on a global scale, the OECD, working with its official agency partners, helped to avert an economic catastrophe. Leveraging the power of export credits and its peerless stature and influence among leading trading partners throughout the world, the OECD helped to keep trade flowing while pushing to resist the inevitable lure of protectionism during troubled economic times. But economic growth is still tepid at best and the need for robust international trade as crucial as ever.

Thankfully, the OECD remains vigilant in monitoring protectionist policies around the globe while co-ordinating a vast array of sovereign and international organisations to support free and open trade, including official agencies. With the adoption of Basel III on the horizon, it is vital that all interested parties, including the OECD, financial institution and official agencies, understand the ramifications of proposed new rules.

THE OECD EXPORT CREDIT REGIME: A BRIGHT PAST, WHAT OF THE FUTURE?

Denis Stas de Richelle

Denis Stas de Richelle is Global Head of Export Finance at Société Générale, France. Société Générale is one of the oldest banks in France; it was founded by a group of industrialists and financiers in 1864 to support the development of French commerce and industry. Société Genérale has a substantial global presence across 85 countries, in domestic and international retail banking, specialised financing services and corporate and investment banking.

The financial and economic crisis that the world has been experiencing in the wake of the sub-prime fallout – described as the most severe economic turmoil since World War II – has put the advantages of officially-backed export credits in the spotlight. When the interbank market froze after the Lehman collapse in September 2008, when the syndicated loan market vanished and underwriting disappeared, when capital markets plummeted and, finally, when the liquidity crunch got under way, export credit agencies (ECAs) stepped in. Their cover programmes and – for some of them – their direct funding or interest rate subsidy mechanisms helped sustain the global economy by enabling big long-term financing solutions.

OECD members' export credit agencies helped ease the impacts of the global crisis

The demand for OECD ECAs' risk-enhancing products has significantly increased. Furthermore most – if not all – OECD ECAs have introduced measures to improve access to liquidity and ease the stress in international trade finance markets. Such measures took on various forms: the increase of country ceilings, assistance for short tenor deals, working capital programmes to support the current liquidity needs of clients – an innovative approach, take-out options and refinancing schemes to fight against a possible liquidity squeeze. We feel that the measures taken by the ECAs and their guardian authorities were an appropriate and well calibrated response to the financial turmoil.

During this period of uncertainty, some projects were postponed and others cancelled. But there was also the stimulus measures worth USD 250 billion (agreed at the London Summit 2009 by G20 countries) that promoted global trade and investment, bringing supports for infrastructure and industrial projects among others.

Over the last two years, ECAs have been increasingly active in all industry sectors, such as oil and gas, power, transportation, telecommunications and satellites, as well as in all regions of the world – not only in emerging countries – which was a rather new outcome. Indeed, ECA-backed loans were much more frequently implemented in developed countries than in the past, specifically by automobile manufacturers, steel producers and telecommunications operators. The aircraft and shipping industries – both heavily impacted by the crisis – also took advantage of these financing tools.

As for project finance, Société Générale's strategy has been to propose systematically ECA-backed loans to its clients for their debt strategies. Not only tied financing tools (available in direct connection with the export of capital goods and services) but also untied loans, generally granted as a counterpart of a strategic interest for the lending country (secure access to natural resources, promote industrial diversification and/or address environmental issues). As a matter of fact, all recently closed "jumbo" deals have presented such a combination and benefited from official state support at levels never seen before: Papua New Guinea LNG with USD 3 billion and USD 900 million US Export-Import Bank and SACE (Italy) tickets respectively, the Nordstream pipe-line with a USD 2.2 billion Euler-Hermes (Germany) commitment, the Jubail refinery with a USD 2.2 billion covered by six ECAs and Iridium with USD 1.8 billion COFACE (France) support. Not surprisingly, business volumes reached record levels in 2009 with USD 50.6 billion. And this year should be more or less on the same trend.

Outlook for global recovery

Export finance is a counter-cyclical business. It is a means of financing that is well adapted during times of financial crisis. Thanks to the risk mitigation provided by ECA cover, it is a low-risk financing tool that does not use large amounts of capital, in contrast with other long-term lending solutions. Consequently, export finance experts have been in the spotlight working with all the global market players. We offer our clients reliable long-term financing in times when people need to have concrete solutions during a volatile evolution of economic cycles.

Given this context, one wonders about the outlook for the world economy in times to come. It is difficult to predict the outcome but we can already make a few observations. The global recovery continues. Economic activity in emerging markets has quickly resumed and is the driving force of international trade. Another major player is the United States, whose domestic demand is mainly supported by stimulus measures. The Eurozone is emerging from the recession more

slowly, as several countries are confronted with a large debt burden and unemployment. Overall, the global recovery remains muted, fragile and, not least of all, uneven. Headwinds and concerns (imbalances, waves of budget austerity measures currently washing over Europe, monetary policies …) are still here. Unfortunately, we cannot yet say that we are out of the woods. Under these circumstances, Société Générale believes that export finance has a crucial role to play since ECAs provide vital international trade financing. The need for ECAs' backing is regarded as particularly important for very large projects in order to add liquidity at attractive pricing and to support new technologies and strategic sectors – such as nuclear power plants, solar and wind projects and telecommunications networks.

Beyond the immediate economic environment – likely to be volatile and uncertain – as a consequence of the deep turmoil we have gone through, we strongly believe that our clients should keep in mind that they have, at their disposal, several long-term funding solutions for going forward, export finance being one of them.

Concerns for the level playing field: Basel II, large emerging economies

However, export finance banks need to call for vigilance and a level playing field in two important areas. The first is related to the Basel Committee's proposals to strengthen the resilience of the banking sector, pursuant to the G20 recommendations (and better known as Basel III). New requirements could be damaging for the financing of international trade (notably the leverage, liquidity coverage and net stable funding ratios), either by limiting the banks' capacity to provide long-term export finance solutions and/or by pushing pricing upwards. In all cases, these measures would be detrimental to the global economy if not properly considered. This is a subject that is being closely followed by all financial institutions.

The second key issue is related to the current revision of the OECD Recommendation on Common Approaches on Environment and Officially Supported Export Credits, implemented in 2003, later revised and strengthened in 2007. While we fully support measures to improve the environment and combat climate change, it is our belief that a balance between promoting exports and sustainable economic behaviour must be maintained. There is a general fear that the OECD process might go "too quickly and too far." The Equator Principles[1] can be applied in the context of project finance or limited-recourse projects – where the sponsors can have control over the whole value chain (already introduced at Société Générale) – but these prove to be a serious hindrance in most financing linked to the export of capital goods. Subsequently, these Equator Principles rules would widen the gap between OECD ECAs and non-OECD ECAs. For this reason, we believe there is a need to ensure a level playing field and to keep in mind that OECD exporters increasingly face competition from large exporting economies such as China and Brazil who are not OECD members and, therefore, not bound by the OECD Arrangement on Officially Supported Export Credits. As said by OECD Deputy Secretary-General Richard Boucher in January 2010,

"… If we are going to be the world's premier economic management organisation, we've got to have that relationship with the countries that now constitute a significant portion of the world's GDP" and "… big economies outside the OECD – with China, India, Brazil, Indonesia and Russia … complain sometimes 'why should we be expected to meet standards we didn't have a hand in making?' It's in our interest to have them in standard setting."

In December of 2010, the OECD was 50 years old; this is the age of maturity. We are pleased to wish this important Organisation a very Happy Birthday. We hope that this institution and the participants to the OECD export credit regime will continue to dedicate their energy and ideas to financing support of capital goods exports.

Note

1. The Equator Principles are a voluntary set of standards for determining, assessing and managing social and environmental risk in project financing. Project financing is a method of funding in which the lender looks primarily to the revenues generated by a single project both as the source of repayment and as security for the exposure.

Part V

GREENER EXPORT CREDITS

1. *A cleaner future?*

2. *Development of export credit rules in new areas*

3. *The greening of export credits*

4. *Implementing environmental common approaches*

5. *The US perspective on export credits going green*

A CLEANER FUTURE?

Julian Paisey

Julian Paisey is a Senior Policy Analyst in the OECD Export Credits Division who has had prime responsibility for issues relating to the greening of export credits since 2005.

Since the mid-1990s, the OECD Working Party on Export Credits and Credit Guarantees (ECG) has been broadening its approach to export credits issues. Prior to this date, ECG members were chiefly concerned with exchanging information, including on their export credit systems' related financial results, and surveys and analyses of *ex post* transaction data. However, members have increasingly considered some good governance issues that have arisen around the provision of officially supported export credits.

A good governance framework

The first good governance issue to be addressed by the ECG was the potential environment impact of projects for which export credit support is provided; the second such issue was to ensure that these projects do not involve bribery or corruption. Lastly, members considered provisions to ensure that the support they provide is in line with the sustainable lending principles for Heavily Indebted Poor Countries (HIPCs), developed by the International Monetary Fund (IMF) and the World Bank (WB).

Progress in considering these good governance issue has followed a common pattern. In line with the mandate of the ECG to hold regular confrontations on the export credit policies pursued by the Governments of OECD member countries, members initiated information sharing on their policies, practices and experiences, as a result of which the ECG further followed its mandate by working out common guiding principles in the form of two OECD legal instruments, *i.e.* Recommendations, concerning environment review policies and anti-bribery measures, as well as a Statement of Principles about support for HIPCs. Taken together, these three agreements provide an overall good governance framework for the provision of officially supported export credits.

The impetus to develop this framework came from a variety of sources. Governments recognised that their official export credits programmes needed to operate in a manner consistent with wider government policies. Additionally, non-governmental organisations (NGOs) were extremely vocal in calling for official export credit agencies (ECAs) not to support projects that harm the environment or adversely affect local communities (for many years, the annual OECD consultations between ECG members and Civil Society Organisations were dominated by NGOs, such as ECA Watch, providing examples of what they perceived to be environmentally-harmful projects supported by ECAs). The result of all these pressures was an ECG Statement of Intent in 1998 and an Agreement on Environmental Information Exchange for Larger Projects in 1999. At that point, OECD Ministers at their annual Council Meeting (MCM) in May 1999 provided additional impetus by mandating the ECG to strengthen common approaches on the environment and export credits.

Similarly, for the anti-bribery rules, in the mid-1990s, OECD governments were negotiating rules to combat corruption - resulting in the 1997 OECD Convention on Combating Bribery of Foreign Public Officials in International Business Transactions. At the same time, NGOs, in particular Transparency International, were advocating that the ECG adopt anti-bribery measures for export credits. The result was an ECG Action Plan and a Statement of Intent in 2000 and subsequently, in 2006, an OECD Recommendation.

The same method of approach can also be seen with regard to sustainable lending: pressure came from both governments and NGOs concerned about ECA debt to developing countries and the ability of such public borrowers to generate sufficient revenues to service their debt. The first step was agreement to a Statement of Principles in 2001 that urged caution in providing official export credits to the HIPCs and discouraged ECAs from providing official export credits for unproductive expenditures. Based on experience with implementing this Statement, and in cooperation with the IMF and the WB, ECG members agreed the Principles and Guidelines to Promote Sustainable Lending to Low-Income Countries at the end of 2008 to ensure that the provision of official export credits to public or publicly-guaranteed buyers in IDA-Only countries should reflect sustainable lending practices.

Having described the events leading to the framework for good governance issues insofar as export credits is concerned, my focus below is on the environment issue – about which others have also written from their perspectives – which has, and continues to, subsume most of my professional energy!

Environment: Statement of Intent to OECD Recommendation

Following the impetus provided by the 1999 MCM, the ECG started negotiations for a set of rules, “common approaches”, on the environment and export credits. In this context, the first

agreement, a set of common approaches, was concluded in 2001; however, this was implemented on a unilateral and voluntary basis as not all members could agree its terms. In 2003, members re-negotiated the 2001 common approaches and these were unanimously adopted by the OECD Council in the form of a Recommendation. Since then, the 2003 Recommendation has been updated: in 2005, some minor technical amendments were made as a result of experience in implementing the common approaches and, in 2007, a more comprehensive review took place resulting in, for example, stronger transparency provisions and a wider use of international standards as a benchmark. The terms of the 2007 Recommendation call for a review of its terms in the light of experience in its implementation and this review is currently under way with the expectation of a new and expanded Recommendation in 2011.

Looking at the development of environmental measures adopted by the OECD export credit community since their first considerations in the mid-1990s, one of the main changes that stand out is the scope of the issues that have been addressed. The 2003 Recommendation focussed very much on reviewing the potential environmental impacts of the projects for which export credit support was provided: the word "social" appeared nowhere in the text. The only implicit reference to social impacts was in the recognition that OECD members should benchmark projects against the WB Safeguard Policies relating to involuntary resettlement, indigenous peoples and cultural property.

In the 2007 Recommendation there is an explicit reference to the potential impacts of a project encompassing all relevant environmental and social impacts addressed by the international standards applied to projects; and there is an expanded list of international standards to be used for benchmarking projects, encompassing either all ten WB Safeguard Policies or, where appropriate, all eight International Finance Corporation (IFC) Performance Standards. Although the word "social" is still not given the same prominence as the word "environmental", it is clear that members accepted that social risks could not be ignored when reviewing projects where social impacts might be expected.

Current review of the environmental common approaches

Social impacts: With regard to the review of the common approaches that is now underway, there has been general agreement in the ECG that references to environmental impacts and risks should be expanded to include explicit references to social impacts and risks. At the same time, there is a growing consensus that the WB Safeguard Policies should be replaced by the new 2011 IFC Performance Standards as the main international standards for benchmarking projects. If these changes were to be agreed, the result would be a considerable increase in the scope of issues that should be addressed by ECAs when reviewing projects for their potential impacts. As an example, IFC Performance Standard No. 2 includes provisions on working conditions and

terms of employment, on non-discrimination and equal opportunity, on child and forced labour and on occupational health and safety.

The 2011 IFC Performance Standards also give more prominence to human rights and climate change, two issues that are also increasingly being discussed in the context of export credits.

Human rights: The move to consider in more detail the issue of human rights is, in some respects, a natural extension to addressing social issues such as living and working conditions or the potential impacts of projects on affected communities. It also comes at a time of increasing international prominence for this issue. Professor John Ruggie, the Special Representative on business and human rights, appointed by the United Nations Secretary-General, has recently published his March 2011 report "*Guiding Principles on business and Human Rights: Implementing the United Nations 'Protect, Respect and Remedy' Framework*" which were endorsed by the UN Human Rights Council in mid-June 2011. This Framework sets out the State's duty to protect against human rights abuses by third parties (including business), the corporate responsibility to respect human rights and the need for greater access by victims to effective remedy – both judicial and non-judicial. This Framework has added impetus to the ECG discussions on human rights and the actions that businesses, including those supported by ECAs, should take to avoid infringing human rights. As a result, NGOs, notably Amnesty International, have been quick to call on ECAs to incorporate human rights issues in any revised OECD Recommendation.

Professor Ruggie's Framework is also the basis for both the human rights elements of the 2011 IFC Performance Standards and the new human rights chapter in the 2011 OECD Guidelines for Multinational Enterprises (MNE Guidelines) – the latter has 42 participating countries and contains recommendations by governments covering all major areas of business ethics. These two reference points are supplemented by the Equator Principles – which are based on the IFC Performance Standards – and to which 72 financial institutions globally have signed up. As a result, banks and businesses worldwide are expected to take into account human rights in their commercial operations. Given these converging global views about the importance of respecting human rights and the fact that the ECG is made up of the same governments that are present at the UN, the IFC and the OECD Investment Committee (which negotiated the MNE Guidelines), from a policy coherence point of view, it is only natural that ECG members should consider how to encompass human rights in the OECD Recommendation on common approaches.

Climate change: There are also converging views when it comes to climate change; but for the OECD export credits committees this is not a new issue. In 2005, the Participants to the Arrangement on Officially Supported Export Credits agreed a Sector Understanding on Renewable Energies and Water Projects, with the express intention of encouraging a move to renewable technologies and away from the more traditional, carbon-intensive means of energy

production. This was to be achieved by special financial terms and conditions which provided, *inter alia*, maximum repayment terms of 15 years – to match those available for nuclear power plants. This Understanding was updated in 2009 (the maximum tenor was extended to 18 years to reflect the extension of such tenor for nuclear power plant) and, since then, the Participants have been discussing how to expand further the scope of the renewable energies and water agreement to include climate change mitigation sectors and technologies. In parallel, the ECG, in its current review of the 2007 Recommendation on environmental common approaches, has been considering various proposals relating to climate change. Whereas the Participants used the vehicle of a sector understanding to incentivise the use of greener energy, ECG members are considering measures to disincentivise greenhouse gas emissions, *via* additional provisions relating to accounting and reporting of such emissions.

Additional impetus for the climate change discussions has come from both OECD governments and NGOs. OECD Governments have negotiated various multilateral agreements with a view to combating climate change; such measures include providing green funds for supporting climate change mitigation and adaptation initiatives, setting targets for reducing harmful emissions and a G20 mandate to phase out fossil fuel subsidies. And the OECD is at the heart of these measures, providing statistics, policy advice and a forum for promoting green growth for both OECD and non-OECD countries alike. The OECD Green Growth Strategy was launched at the May 2011 MCM to provide a practical framework for governments to boost economic growth and protect the environment. It is, therefore, only logical that the OECD export credits committees are considering what measures to take to support these initiatives. Additionally, NGOs have called for ECAs to respond to the global climate change crisis by phasing out official support for fossil fuel projects.

What next?

Of course, at the moment, it is still not clear to what extent ECG members will adapt the prevailing common approaches in the 2007 OECD Recommendation to address the newer issues of human rights and climate change. For some, any additional good governance measures will be seen as further constraints on their ECA-supported business, particularly given the emergence of competition from exporters in non-OECD countries whose ECAs are not obliged to apply the same disciplines. In addition, while arguments about policy coherence are valid, ECAs are not development agencies but trade-related institutions that exist to support exports and domestic employment. There are also questions about the extent to which the policies adopted by developed countries should be imposed on developing countries.

Whatever the result of the current negotiations for export credit environmental guidelines, it is clear that the scope of issues that members are considering has grown over the years and that these latest issues will not go away. Going forward, members may face pressure to consider

other similar issues, such as gender equality in their export credit agreements; these pressures may also provide impetus to re-visit the ECG's anti-bribery provisions and sustainable lending principles. Either way, the days when export credits discussions at the OECD focussed only on financial terms and conditions are long gone – we need to continue to ensure that the export credits rules at the OECD encourage clean, smart and responsible trade!

DEVELOPMENT OF EXPORT CREDIT RULES IN NEW AREAS

Birgitta Nygren

Birgitta Nygren is Ambassador in the Ministry of Foreign Affairs, Sweden and a delegate to the OECD's Working Group on Bribery. The author was the Chairwoman of the OECD export credit committees from 1999 to 2004, Vice-Chairwoman from 1992 to 1995 and Deputy Head of the Permanent Delegation of Sweden to the OECD from 1991 to 1995.

When I unexpectedly had the honour to chair the OECD export credit committees of the Participants to the Arrangement on Officially Supported Export Credits (the Participants) and the Working Party on Export Credits and Credit Guarantees (ECG) in 1999 (through to 2004), there had already been some discussion on finding ways and means to deal with the new issues of environment, bribery and the debt burden of the Heavily Indebted Poor Countries (HIPCs).

Some OECD members were very enthusiastic about trying to find ways to ensure that export credit agencies (ECAs) would not support projects that could adversely affect the environment. Others were maybe not less interested but saw difficulties in engaging in a topic where ECAs had no competence. However, civil society organisations pushed strongly for action to be taken by the ECG – as other international organisations, such as the International Finance Corporation (IFC), had taken the lead. So the ECG had to follow.

Bribery was a little different. The OECD Convention on Combating Bribery of Public Officials in International Business Transactions had just entered into force. There was an expectation from some members, and certainly from the OECD Working Group on Bribery (WGB), that ECAs should do their part in order to assist all OECD members' implementation of the Convention in an effective manner. I don't think I detected much enthusiasm in the ECG for the subject at the time; this still puzzles me! How could ECAs, which are professional when it comes to analysis of risks in the transactions they finance/guarantee, fail to see that financing/guaranteeing transactions tainted by corruption could severely damage their reputation and cause considerable losses? My predecessor as Chairman, Kurt Schaerer (Switzerland), had introduced the issue of anti-bribery to the ECG although discussions had been perfunctory. But, later I was pleased, also in my role as delegate

to the WGB, that in 2000 the ECG agreed an Action Statement on a set of measures to deter bribery in export credits and that this was adopted in 2006 by the OECD Council as an OECD Recommendation.

As to the debt burden of the HIPCs, I was also pleased that the ECG agreed a Statement of Principles in 1999, revised in 2001 and updated in 2007. This noted that as official export credits contribute to a country's overall debt burden, such credits should not be provided for unproductive expenditure (*i.e.* transactions that are not consistent with the these countries poverty reduction and debt sustainability strategies, and do not contribute to their social and/or economic development).

Environment: An inclusive process

When I took over as Chair, the ECG had already initiated a process to address the environmental issue: a Statement of Intent had been concluded in 1998 and an agreement to exchange views on large projects had also been reached. Furthermore, individual Members of the ECG had been encouraged to present their policies and/or measures for taking into account environmental impacts as part of the decision-making process for official export credit support. At the time these discussions started in 1996, only the United States and Canada had policies in place.

A few events came to influence the course of the ECG's action in developing environmental rules. The ECG had for a long time discussed identifying components/aspects which should be taken into account when developing a new instrument for export credits and the environment. In the margins of a conference on export credits and environment in Tokyo in April 2000, I, together with Bob Crick, a member of the export credit Bureau, and Janet West, then head of the OECD export credit secretariat, brought together a group of interested people to discuss how to move the issue forward. It was tentatively agreed that the components/aspects of the environment/export credit issue would be assigned to volunteers to develop these further; in this way, many of the most influential ECG members undertook to contribute in a way in which I had not experienced before in export credit negotiations. This approach helped to create ownership in the process, to secure contributions from those who had more specialised knowledge than others and to stimulate creative thinking.

It was also important to engage others with specialised knowledge in the area of environmental review. Valuable contributions were received from the World Bank and the IFC and from other stakeholders with whom the ECG had regular consultations. However, such consultations were not without problems; some non-governmental organisations (NGOs) were rather militant. I thought I had made best efforts to invite dialogue and, indeed, Janet West and I went to Washington to visit some of them in order to try to convey the message that the ECG was interested in their views and would endeavour to take them on board. But, in spite of these

efforts, the NGOs found it necessary to demonstrate outside the OECD and to throw stones at the building! And when the demonstration was over, we continued the dialogue with the NGOs inside the building as if nothing had happened. I suppose the demonstration was not aimed at the ECG but was for the benefit of NGO supporters.

So what about the OECD's Environment Policy Committee (EPOC) and Environment Directorate? It seemed that the work of the ECG on the environment, at least initially, was seen by the EPOC more as a threat than something that could help spread the message about the importance of paying attention to the environment. In spite of meetings with EPOC's Bureau, that Committee endeavoured to arrange a meeting devoted to export credits and the environment without informing the ECG or its secretariat.

I also recall the June 2000 Round Table on Sustainable Development, chaired by Simon Upton, which apparently considered that the issue of export credits and the environment was too important for the ECG to take forward. I insisted on attending the Round Table and presented the significant progress made in the ECG. I noted that, against the background of OECD and G8 Ministerial mandates which urged common approaches with respect to the environment and export credits, the ECG had concluded a number of agreements, including the April 1998 Statement of Intent (which consisted of six broad statements of practices and principles and a commitment to share information on their application in national export credit systems), the April 1999 Agreement on Environmental Information Exchange for Larger Projects (under which members agreed to share information on the environmental aspects of projects) and the February 2000 Action Statement to facilitate the fulfilment of the mandates and which included a commitment for completion of these by the end of 2001. After that, I think we were left to carry out our work without interference from other interested parties in the house, but we made efforts to inform others about progress and listen to their views.

Much discussed issues

What were the issues that members were concerned about in seeking to fulfil their Ministerial mandates to establish common approaches towards export credits and the environment? There were many issues, the priorities of which were:

- Whether to screen all projects or only projects above a certain value-threshold: BIAC argued for using the same threshold as that employed by the Equator Principles of USD 50 million, whereas many argued for a much lower threshold.

- Classification of projects into three categories, those with (1) low environmental impacts, (2) medium or large impacts and (3) all others; this approach was not controversial.

- Review of projects, including scrutiny of Environmental Impact Assessment (EIA) reports in sensitive sectors and locations: this was a much more controversial issue. According to which standard should the review take place: the highest international standards or other standards, *e.g.* host-country.

- Disclosure was another thorny issue: representatives of NGOs required that EIA reports be made public prior to any decision by an ECA on a guarantee/credit application, whereas most members felt that such studies had to remain confidential as long as their customers required this.

Start of negotiations

In July 2000, the Participants to the Arrangement were to come together in order to try to advance the negotiations on a sector understanding on agriculture. As is well known (and reported on by Mike Roberts in this publication), our serious attempt at establishing rules for agricultural commodities failed. However, at that point in time we were still hoping to reach an agreement in spite of the difficulty in finding common ground on some of the issues involved. Shortly before the July 2000 agriculture meeting was to take place, the United States requested a short postponement. Some Bureau members, including myself, had travelled to Paris before receiving the US' request, so we met as scheduled and took the opportunity to review all the issues on the agendas of both the Participants and the ECG.

In the context of the ECG work, and talking about what to do next with the environment issue, I remember Bob Crick saying that we more or less knew what should be included in an agreement so why not start developing a first draft, rather than awaiting a new discussion on the elements in the following September, which was what the ECG had earlier agreed to do. And so the Bureau and the secretariat (Janet West with input from Christine Tebar Less of the Environment Directorate) did just that!

If I recall correctly, the first draft of an export credit environment agreement was well received, even if some felt that things had moved rather fast. The perception of the Bureau and the secretariat, but primarily Bob, that the time was ripe to move from preliminary discussions to negotiations on a first draft was a good call.

An unexpected outcome

After long negotiations, where we more or less seemed to have everybody on board, it turned out that the United States, which from the beginning had been in the forefront of advocating stringent rules, could not accept a compromise which all other ECG members could. The United States considered that the proposed environmental standards, against which projects would

be reviewed in order to benefit from official export credit support, were too low. That was in November 2001. There were strong voices in the ECG advocating acceptance of the agreement on the basis that this would be valid for all members except the United States.

The meeting was adjourned for consultations. I and the secretariat reported what had happened to the Director of the Trade Directorate, at that time Jean-Marie Metzger, who was of course happy to hear about the progress, but at the same time deeply concerned. It turned out that the Secretary-General of the OECD, Donald Johnston, was in Washington with the main purpose of securing increased budgetary support for the OECD from the United States. Jean-Marie's concern was that an agreement on export credit and the environment, which did not include the United States, could risk negatively affecting the talks in Washington. So the Secretary-General was informed of the situation. When we resumed the meeting, all ECG Members, except the United States, were agreeable to implementing voluntarily and unilaterally the agreement which as of then was called the Common Approaches on Export Credits and the Environment (REV. 6 – as the final text was the sixth draft). As far as I know, the implementation of an agreement in the OECD on a consensus minus one basis is unique. However, it has to be recognised that this would not have been possible unless the United States had tacitly agreed.

It subsequently appeared that some Members did not fully understand what had happened, some even required that the United States should be excluded from further participation in the discussions on environment, whereas by allowing all others to implement unilaterally the Common Approaches, the United States had in fact helped move the agenda forward. Finally, the OECD welcomed the agreement and on 4 December 2001, OECD Secretary-General Johnston said in a press release "... The implementation of this proposal by most members from January 2002 will mean that all major exporting countries of the OECD will now be applying environmental review mechanisms. This results in the first common "greening" of export credits and should be seen as a major accomplishment".

Towards a full agreement

It took the United States quite a lot of time to come back into the game and support the common approaches so that the agreement could be sent to the OECD Council for adoption as an OECD Recommendation. In fact, it was not until April 2003 that the Council adopted the Recommendation on Common Approaches for the Environment and Officially Supported Export Credits.

The 2003 Recommendation required Members to screen all transactions with a repayment period over two years; the projects had to be classified into three categories and international standards were the benchmarking norm. Information about Category A projects, those with significant adverse environmental impacts, had, at some stage, to be disclosed and Members

were required to report on Category A and Category B projects on a yearly basis and aggregated information had to be publicly available.

I am happy to note that following my departure from the Chair in 2004, work on the environment and export credits developed further and a revised and more robust Recommendation was adopted by the OECD Council in 2007. I am greatly impressed with this feature of the export credit community; it always regards progress only as a stepping stone to further achievements.

THE GREENING OF EXPORT CREDITS

Patrick Crawford

Patrick Crawford is Chief Executive of the Export Credits Guarantee Department (ECGD), the United Kingdom's official export credit agency. ECGD complements the private market by providing assistance to exporters and investors, principally in the form of insurance and guarantees to banks.

For most of the period of their existence, export credit agencies (ECAs) focused on the repayment risks of projects they supported and did not pay regard to related environmental and social impacts; this all began to change in the 1990s. The main influence for change for ECGD was the new UK government that came into power in 1997, at a time of mounting pressure from certain non-governmental organisations (NGOs). Further impetus was provided by the leadership demonstrated by the Export-Import Bank of the United States (US Ex-Im Bank) which had unilaterally started to take account of environmental issues in its decision-making. Specific projects contributed to this growing need for a multilateral approach; these included the Ilisu dam project in Turkey, under consideration by several ECAs, which involved the resettlement of a large number of people and submersion of the cultural heritage at the ancient town of Hasenkeyf.

Discussions on whether, and how, to take account of environmental issues when providing official export credit support started at the OECD in the mid-1990s, leading to the 1998 Statement of Intent from the OECD Working Party on Export Credits and Credit Guarantees (ECG). Initially, these discussions consisted of exchanges among political negotiators. Subsequently, a few ECAs recruited specialist environmental advisers: the US Ex-Im Bank, EDC (Canada) and COFACE (France) were first to do so; ECGD recruited its specialist in late-2000 and several other ECAs followed shortly afterwards. Under the influence of this growing number of specialists, discussions in the ECG soon focused on presentations of how, in practice, individual ECAs had started to address environmental issues. In 2000, the ECG issued an Action Statement and, subsequently, a Work Plan that set out the steps that it hoped would lead to a multilateral agreement among ECAs on common approaches to environmental issues.

Establishing common approaches

In 2001, under the leadership of Birgitta Nygren of Sweden (then the Chair of the ECG), discussion began on the text for common approaches to export credits and the environment and by December 2001, this text was sufficiently advanced for almost all members of the ECG to accept it. As a consequence, the terms of these common approaches were implemented on a voluntary basis. However, following further negotiations in the ECG, consensus was achieved by the end of 2003 and a set of common approaches were formally adopted by the OECD Council as the Recommendation on Common Approaches on the Environment and Officially Supported Export Credits.

The value of having a multilaterally agreed approach was already being demonstrated by projects involving several ECAs; for ECGD, this was most evident in the Nigeria LNG and the BTC Pipeline projects, both of which involved several ECAs and International Financial Institutions (IFIs). All parties, not least the project sponsors, benefitted from there being a common understanding of the information that all the financial parties needed and the benchmarks that would be used to determine a project's environmental impact and its acceptability for export credit support.

During 2004 some of the shortcomings of the 2003 Recommendation became evident; these included a lack of clarity regarding the term "benchmarking" in the context of environmental and social standards. Benchmarking for some meant the setting of a minimum standard that must be met or exceeded for a project to be acceptable; for others, however, the term meant the identification of the project's performance compared to such benchmark standards, but projects could still be given support even if the project's performance was below the benchmark standard. So, in 2005 a revision of the OECD Recommendation on Common Approaches was agreed and this clarified some areas where implementation by ECAs had been inconsistent.

In parallel with the work by ECAs in the OECD, the commercial banks were also considering how they should address environmental issues. In 2003, the Equator Principles were established; these represented a significant industry-wide initiative and were drafted by the banks in consultation with the International Finance Corporation (IFC), project sponsors, project engineers and NGOs. The Equator Principles used the then IFC Safeguard Policies as benchmarks and minimum standards for acceptability for financing a project. However, the Equator Principles only applied to projects that were being funded on a project finance basis and with a value of at least USD 50 million, whereas the OECD Common Approaches applied to all medium- and long-term business supported by ECAs.

So for a short time, virtually all financial parties – such as the IFC, Asian Development Bank and African Development Bank, bilateral development finance institutions, commercial banks

that had adopted the Equator Principles and government ECAs that had implemented the OECD Recommendation on Common Approaches – were benchmarking against the same international standards for the evaluation of projects. This must have been something of a golden era for project developers as they knew the standards their projects needed to meet, whichever source or sources of funding they would eventually choose. This all changed in 2006 when the IFC published its Performance Standards and the Equator Principles were revised shortly afterwards to make reference to the IFC Performance Standards.

However, when the OECD Common Approaches were adjusted in 2007 and, in consequence, a revised Recommendation was adopted by the OECD Council, ECG members decided to retain the Safeguard Policies of the World Bank (WB) as the default benchmark standards and made reference to the IFC Performance Standards only for private sector limited- or non-recourse project finance cases. So, project sponsors now need to consider the finance structure and source of funding when they decide which standards their projects should be designed to meet.

What's next?

The benchmarking issue is again in the air at the start of this new decade: the ECG is reviewing, for the third time, the OECD Common Approaches; key considerations include whether or not to adopt the IFC Performance Standards as the default standards for all transactions and to address human rights issues. In parallel, the IFC is reviewing its Performance Standards and, recently, the WB announced that it will update its Safeguard Policies over the course of the next two years.

ECAs have come a long way since the mid-1990s, but we are only part way along our journey. As well as working with our OECD colleagues to refine the 2007 OECD Recommendation, we need to work with the IFC and the WB to ensure that the standards which they set are appropriate for ECAs. And we need to engage with non-OECD countries to encourage them to adopt policies that respect the global environment in all its facets. There is a good deal of work still to do, but we should all acknowledge the material progress that has been achieved to date within and outside the OECD towards better standards for export credits.

IMPLEMENTING ENVIRONMENTAL COMMON APPROACHES

Pekka Karkovirta

Pekka Karkovirta was Vice-Chairman of the OECD export credit committees from 2001 to 2010 and chaired the export credit working group of Environmental Practitioners The author is also a Vice-President of Finnvera, the official Finnish export credit agency, and is currently seconded to the European Commission in Brussels.

Environment became a live issue in the OECD's Working Party on Export Credits and Credit Guarantees (ECG) in the mid-1990s, resulting in a unilateral declaration in 2001 by most members to implement common measures to protect the environment when providing official support. In 2003, further negotiations on environmental measures for export credits led to consensus and adoption, by the OECD Council, of the Recommendation on Common Approaches on Environment and Officially Supported Export Credits (hereinafter "Common Approaches"). The 2003 set of measures was superseded in 2007, after intensive review, by a more robust OECD Recommendation on Common Approaches.

In summary, the Common Approaches seek to ensure that all officially supported export credit transactions with a repayment term of two years or more are reviewed for their potential environmental impacts, and any negative impacts are mitigated or eliminated in order to achieve a high level of environmental protection.

Implementation of the Common Approaches

In consequence of the adoption of the Common Approaches, an important task lay ahead for the ECG: how to put these into practice. After all, a political agreement would only be successful through its practical implementation; in this instance, the challenge was to combine environmental sustainability with a level playing field, the latter being a central principle in all OECD export credit rules. To address these implementation issues, the ECG looked to

its environmental working group, known as the Environmental Practitioners, which had been brought together in 2003 and of which I was the Chairman. The work of the Practitioners informed and significantly contributed to the 2003 Common Approaches, as well as the more robust set of measures in the 2007 Recommendation; their work is ongoing with the 2011 revision of the Recommendation in their sights!

Many export credit agencies (ECAs) opted for establishing in-house environmental expertise by hiring specialists and, in consequence, it was quickly realised by the Practitioners that a mutual understanding of every component of the Common Approaches was essential for successful implementation. In this process, the OECD secretariat provided invaluable support, not only with organisational matters and documenting results of meetings but also by compiling and analysing data.

The Common Approaches did not set down new environmental and social standards for export credit transactions but rather referred to existing benchmarks within the financial sector, *i.e.* the standards developed by international financial institutions (IFIs), mainly the World Bank (WB) and the International Finance Corporation (IFC). However, the mandate and activities of these institutions are not the same as those of ECAs, whose main priority is to support national exports. Consequently, there were considerable discussions about the IFIs' implementation of their own standards and procedures as well as comparison of these with ECAs' emerging approaches. Moreover, many ECAs act as guarantors or insurers with no direct contact with the buyers/project sponsors and so their leverage for influencing behaviour is obviously limited.

The basic question for ECAs was the definition of what they should review in the context of environmental impacts. The answer was not so simple, bearing in mind the very different transactions for which ECAs provide export credit support: ranging from supplies in small volumes to large scale new investments, from spare part sales to green field turnkey projects, from supplies to existing industrial plants to exports for environmentally sensitive areas. There was also the difference in facilities offered by ECAs, ranging from cover for letters of credits to support for highly sophisticated financially engineered project finance transactions. Initially, the Practitioners' discussions focused on exported goods and their possible environmental implications. However, it soon became obvious that potential environmental impacts are usually more evident with regard to an overall project – including planned and existing or associated facilities – than to brand new, perhaps state of the art, technology or exported capital goods destined to be an integral part of a project.

It also became clear to the Practitioners that more sophisticated environmental and social policies and practices were needed to implement the Common Approaches if the level playing field was to be achieved, not only in interpretation but in practical terms. Therefore,

discussions also focused on how to screen export credit applications in order to identify those transactions subject to the Recommendation and, thereafter, how to classify them according to the significance of their potential environmental impacts. These deliberations resulted in agreement that transactions should be classified into three categories: "A" – potential to have significant adverse environmental impacts, "B" – environmental impacts less adverse than category A and "C" – likely to have minimal or no adverse environmental impacts. In effect, the categorisation defined the environmental information, as well as the depth of the environmental review, required under the Common Approaches. And to ensure consistency of treatment, not only from the exporters' but also from the financiers' point of view, a similar interpretation of the Common Approaches was an absolute necessity in order to avoid, in a competitive situation, the same project being categorised differently, thereby un-levelling the playing field.

The scope of environmental review was discussed at length. These discussions encompassed whether the replacement of existing machinery merited the same in-depth environmental review as a turnkey plant; whether associated facilities (such as a power plant adjacent to an existing plant) should be extensively reviewed; how could an ECA influence the environmental plan of a project if the design or construction of the plant had already started and the ECA's involvement had been sought only at the later stages of the project. Another topic of discussion was project monitoring for the duration of the export credit and what could be done in an environmental non-compliance situation, *e.g.* to withdraw the export credit support, which would *de facto* result in indemnification of a claim by the ECA. In the end, all these major issues were resolved as can be seen from the provisions of the prevailing Common Approaches which were adopted by the OECD Council in 2007.

Once the larger issues had been dealt with, there were always smaller devils in the detail, such as how to define "green field" or "brown field"; what is a major or large scale extension; what is the equivalent of heat output in terms of electric output for thermal power stations; why is 200 air dried metric tonnes *per* day the threshold for production of pulp. These too were resolved in a pragmatic and practical way.

Reputational risk and other concerns

It has always been the case that most ECAs' environmental experts are required to be strong advocates of their mission, not only in the context of environmental issues in export industries but also with regard to the importance of environmental assessment; their audiences vary from clients, such as export companies and financiers, to other stakeholders (including industry associations and NGOs). Sometimes, the toughest or most stubborn audience, however, could be within their own organisation! The new element of environmental assessment has had to be incorporated in ECAs' underwriting processes, *i.e.* when making decisions on whether to provide official export credit support. So, reputational risk has emerged as an important element of

ECAs' business and, therefore, top management has had to take a stand on committing their ECAs to sustainable development and, where appropriate, declining support on environmental impact grounds – the Three Gorges Dam project in China is an example.

Multilateral development banks have entire departments for assessing environmental and social issues in relation to the transactions they intend to support; this, of course, could not be the case for ECAs as their size and resources are not comparable. It was only natural, therefore, that the Practitioners should develop a network where collegial support and exchange of information and views could take place. This was all the more important as different ECAs might often participate in the same transactions, either in a co-financing or in a competitive situation. In either case, a common line on environmental requirements between ECAs is much more effective than each having their own, possibly different, views; and importantly, buyers or project sponsors would not be able play the ECAs against each other when it comes to environmental matters.

The Practitioners also closely followed developments in international environmental standards, including the review of the IFC standards. To this end, IFC representatives were invited to the meetings of the Practitioners and contact was maintained with the Equator Principles Financial Institutions who had established guidelines for environmental review of project finance transactions with a value of at least USD 50 million.

Many ECAs were confronted with redefining their disclosure policies because one of the requirements of the OECD 2003 Common Approaches was to endeavour to disclosure EIA reports 30 days before commitment of export credit support for a category "A" transaction. However, such disclosure was not compulsory and, in the face of mounting concern from within and outside the export credit community, in the 2007 Common Approaches the disclosure provision on EIA reports was strengthened from "best endeavours" to a "commitment".

Ex ante guidance

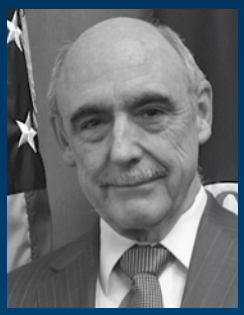
The ECG experienced a very steep learning curve on environmental matters, including through case studies and reports of categories A and B projects underwritten by ECAs. The OECD export credit secretariat collated and analysed the reported data as a result of which peer pressure could be exercised if "oddities" were revealed in any specific projects, insofar as the environmental review process was concerned. After some time, it was only logical to take stock of best practice and build a body of experience for future guidance and this was completed in 2010 in respect of different environmentally sensitive industrial sectors, *e.g.* iron and steel, pulp and paper, mining, refineries and petrochemicals. This body of experience will provide a useful reference for the 2nd generation of Practitioners and will help inform, from a technical perspective, the review of the 2007 Common Approaches.

Future issues

The issue of environmental assessment for official export credits paved the way for wider discussions on corporate social responsibility, which led to intense developments in ECAs' public relations and disclosure policies, and shifted their activities towards more coherent sustainability policies. These discussions continue among the Practitioners, including on the issues of human rights and greenhouse gas emissions. And one should not underestimate the educative role that ECAs have towards their clients as well as the dialogue with civil society organisations on these increasingly important issues within the sustainable development agenda.

The introduction of the Common Approaches and their implementation has led to a new and inseparable element in official export credits – the protection of the environment. The environment experts in ECAs take up the daily challenge of ensuring environmental and social sustainability in export credit transactions; they are often in the frontline negotiating with clients, contributing to the environmental policy of their own organisation and taking part in the OECD negotiations for further revision of the Common Approaches – they are multitalented and very passionate people!

THE US PERSPECTIVE ON EXPORT CREDITS GOING GREEN



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Global attention to problems of environmental protection and socio-economic development had been heightened following the first international Earth Summit in Rio de Janeiro in June 1992. The Rio Summit was an extraordinary event attended by 108 Heads of State that drew attention to issues ranging from biodiversity and climate change to the state of the world's resources of water and forests. OECD governments, as providers of export credits, meanwhile had been taking steps to address domestic environmental issues through regulations aimed at pollution control and policies directed at adverse environmental impact mitigation of domestic industrial activities. Awareness now was turning to the environmental conditions in non-OECD countries and the role being played by international financial institutions in these developing nations that were recipients of export credits. Pressure from public stakeholders and non-governmental organisations (NGOs) was mounting on international financial institutions to adopt measures to address the environmental and social impacts of the projects they finance.

The World Bank (WB) took an early lead in establishing environmental and social policies for projects it financed; by the late 1980s it had established a set of operational procedures that eventually became its Environmental Safeguard Policies and subsequently developed environmental performance standards for projects in various sectors that would later be formalised in its Pollution Prevention and Abatement Handbook. In 1992, US Ex-Im Bank was mandated by Congress to establish environmental review procedures and US Ex-Im Bank's Board of Directors was authorised to grant or withhold financing after taking into account the beneficial and adverse environmental effects of proposed transactions. This approach led US Ex-Im Bank to issue interim environmental procedures based on those adopted by the World

Bank Group and to begin reviewing the environmental effects of projects that were the subject of applications for export financing. By early 1995, US Ex-Im Bank became the first export credit agency (ECA) to adopt a formal set of environmental procedures and guidelines applicable to projects it financed. At that time, US Ex-Im Bank pledged that in order to avoid competitive disadvantages to its exporters, it would explicitly seek the adoption of common environmental guidelines by all members of the OECD's export credit community.

The ECG awakens to environmental concerns

Until 1995, environmental discussions in the OECD on specific projects were primarily the purview of the Development Assistance Committee where members focused on examining the environmental impacts of projects that were supported with development aid. The United States made every effort to place environmental topics on the radar of the Trade Directorate, responsible for export credits issues, which to that point, had been limited to economic and financial trade issues. But now, the United States had announced its intent to advocate for common environmental procedures in order to maintain a level playing field. In July 1994, the US Ex-Im Bank proposed an initiative to develop common environmental procedures for export credits as well as guidelines to minimise prospects for environmentally damaging trade distortions caused by potential differences in the handling of environmental concerns by official ECAs. What followed was a decade of realisation by the OECD export credit community that becoming green would not be easy, although staying brown and taking the path of least resistance would become equally difficult and, ultimately, unsustainable.

Initial discussions meet ECG reluctance to environment reviews

In the mid-1990s, US efforts to put forward an environmental initiative were met by strong resistance from many members of the OECD Working Party on Export Credits and Credit Guarantees (ECG) who argued that the topic was beyond the scope of export credits and members were not competent to address it. The issue of environment was viewed as broad and political, one substantially different from trade and financial matters that OECD members had previously negotiated. Although transparency and predictability regarding the financing terms and conditions offered by ECAs and governed by the OECD Arrangement on Officially Supported Export Credits were accepted principles, treatment of the environment was viewed as unrelated to export credit considerations. However, as the environment was considered a good governance issue, the venue that ultimately became host to the environmental negotiations was the ECG and not the forum of the Participants to the Arrangement.

As a way to begin understanding the extent of ECAs' practices and policies on the environment, the OECD export credit secretariat prepared an environmental questionnaire that members were requested to complete for discussion at the April 1995 ECG meeting. The secretariat's

report on the survey results showed that several ECAs, in fact, had adopted policies that took environmental considerations into their decision-making processes. However, the responses also reflected the degree of differences on how members viewed the environment and few were willing to consider the environmental assessments of transactions as a policy matter that they should adopt. Members considered that export credits were not an appropriate tool to introduce environmental impact assessments of a project in the country to which the project was destined. In effect, most members considered that the environment was outside the scope of ECAs' export promotion mandates and any requirements on environmental matters placed on the overseas buyer or exporter were viewed as unsavoury.

During 1996, those ECG members with policies that addressed the environment began to exchange information, case-by-case, on the environmental aspects of projects they officially supported. However, participation by members in the information exchange remained weak as most continued to resist adamantly any actions on this topic.

During 1997, a steady drumbeat of questions regarding the environmental impact of projects began appearing in the press and greater political-level attention was being directed to environmental issues. The United States had declined a request to provide financing for a highly visible project in Asia due to what it reported as a lack of sufficient environmental information, notwithstanding offers of support for the same project from other ECAs. This action by the United States drew further attention to the differences among members on this rapidly emerging OECD issue.

An important influence on the discussions being held in the ECG were the actions taken by the G7 Heads of State, the Ministers of the OECD and the Heads of the G7 ECAs. The G7 Communiqué issued from the Summit at Halifax in 1995 noted the importance of safeguarding the environment and the Communiqué of the subsequent Lyon Summit in 1996 urged integration of environmental protection into multilateral trade. However, it was the Communiqué of the 1997 Denver Summit of Eight that unequivocally addressed the issue of export credits and the environment. The Denver Communiqué stated, "… Governments should help promote sustainable practices by taking environmental factors into account when providing financing support for investment in infrastructure and equipment. We attach importance to the work on this in the OECD, and will review progress at our meeting next year." Thus, the Denver Summit provided new impetus to the work on environment in the ECG and the G7 ECAs would now be held accountable for advancing environmental negotiations by their respective governments.

Formal negotiations commence in the ECG on the environment

At the November 1997 ECG meeting, Chairman Kurt Schaerer (Switzerland) issued a report on export credits and the environment that noted a "… positive change in the position of some

Members," and secured agreement that further discussion of this issue should continue in the ECG. The meeting included a presentation by representatives of the WB on its environmental standards and one from US Ex-Im Bank on its environmental assessment methods, both of which were well received. The presentation of the WB noted the benefits of a common approach that included a level playing field among ECAs as well as the fact that environmental considerations could be a key to ensuring long-term sustainability of investments. The US' presentation included a model for assessing the impact of projects that covered the screening and categorisation of transactions. These small but encouraging first steps supported further work and, ultimately, led the ECG to address directly the issue of environment.

In the light of growing political attention being given to the issue of the environment and the G7 imperative for progress, ECG members agreed to hold a special meeting in February 1998, during which they focused two days of discussions on exchanging views on various environmental issues ranging from the appropriateness of attention by ECAs to environmental reviews of projects they were intending to support, to the scope and nature of such reviews. This special meeting, the 77th of the ECG, signalled the beginning of formal negotiations on the part of members to reach consensus on how to address the environment in the context of export credits.

Fundamental questions needed to be answered about how ECAs would handle the issue of environment before members could build consensus on the issue. To what extent should ECAs, whose missions focused on export promotion, address the environmental review of transactions, thereby burdening their exporters with additional requirements when considering financing support? Which transactions should be subject to environmental reviews? What guidelines should be developed and used by ECAs to review projects? Most ECAs reported that they considered environmental impacts only when the potential impact could affect a project's risk profile and the ensuing repayment risk, as opposed to the impact of the project on the environment of the region in which the project would be located, including the impact on human health. In fact, these political and technical questions on the role and scope of environmental reviews would be the subject of numerous discussions and negotiations among ECG members well into the new millennium!

As the ECG struggled with basic questions on the issue of environment and export credits, political negotiators were seeking concrete action. The April 1998 OECD Environmental Ministerial meeting had called for the deepening of "… work on interagency environmental concerns into key economic sectors and into trade and environment." Prior to that meeting, consultations were held with representatives of private sector business groups (BIAC and TUAC) and environmental NGOs (most notably ECA Watch and the Environmental Defense Fund). Responding to calls for action, in July 1998, the ECG adopted a formal information exchange mechanism, whereby members would share environmental information for large (over SDR 100 million) projects;

discussions on the environment issue continued at the subsequent November 1998 and April 1999 ECG meetings. Although the pace of official progress among members at reaching consensus on the challenging issues of the environment was viewed by some to have stalled during this period, some convergence on the subject was emerging. Many members now accepted that ECAs needed to adopt some level of environmental policy in conjunction with their actions and thus discussions turned to the subject of how, and to what degree, ECAs should undertake environmental reviews of projects.

The Communiqué of the G8 Birmingham Summit in 1998 addressed the subject of sustainable economic growth while safeguarding the environment, in particular the reduction of greenhouse gas emissions. NGOs, meanwhile, issued a report warning of a downward spiral if ECAs continued to ignore the environmental effects of their actions and they criticised OECD members, in particular the United States, for their roles in supporting fossil fuel projects that they alleged contributed to global warming.

In 1998 through to the first years of the millennium, governments, ECAs and NGOs of member countries, hosted various conferences and seminars that served to sensitise OECD members to the practical issues related to the environmental effects of projects and the need for environmental guidelines in the area of export credits. Events were held in Canada, Germany, Japan and Sweden that proved useful in raising awareness on various environmental topics, including methods of environmental and social assessment related to projects receiving official export credit support. In some instances, representatives from the business community and commercial banks participated in the events, even as representatives from some ECAs joined with officials of multilateral financial institutions in participating at environmental meetings hosted by the WB and the International Finance Corporation (IFC). Meanwhile, international civil society organisations and NGOs began requesting meetings with various ECAs during which they brought attention to environmental and social issues associated with particular projects for which official export credit support was provided or being considered, and they pushed members to adopt environmental policies and guidelines similar to those of the WB. At the same time, some ECG members began adopting more robust environmental review frameworks, including practices aimed at promoting exports that were considered to be environmentally beneficial.

Throughout 1999, some ECG Members voluntarily continued to exchange information on the environmental effects of multi-sourced projects on a case-by-case basis; this approach evolved from discussions among 12 members (most notably Austria, Germany, Italy, Sweden, Switzerland, the United Kingdom and the United States) on the complex environmental aspects of a highly visible hydroelectric project that involved sourcing services and equipment from the ECAs of these respective countries. The ECA representatives involved in these discussions

used the Environmental Impact Assessment (EIA) that the project sponsor had prepared and distributed as a basis for multiple meetings, during which views were shared regarding the potential environmental effects of this project. As a result of the exchanges, the participating ECAs presented a joint statement to the foreign buyer to address identified environmental and social concerns. In retrospect, the practical experience shared by these members in jointly evaluating the environmental and social issues of a project and identifying potential mitigation measures that they would discuss with the buyer, underscored the importance of reviews by ECAs of the environmental effects of projects for which export credit support is sought. This example of co-operation and consultation on a specific project was reported to the ECG and, subsequently, contributed to efforts to define the scope of environmental reviews that ECAs would be expected to undertake.

Negotiations on the environment intensify

Political pressure continued to mount on the ECG, even a timeline was imposed on G7/8 ECAs: the Communiqué issued at the 1999 G8 Summit held in Cologne contained an explicit and strong message to its ECAs, stating "… We will work within the OECD towards common environmental guidelines for export finance agencies. We aim to complete this work by the 2001 G8 Summit." This Communiqué pushed some G7 members of the OECD to increase their efforts to reach consensus on the issue of environment by setting a clear target date for an OECD agreement.

Consistent with the G7/8 mandates, US Ex-Im Bank's then Chairman, James Harmon, repeatedly broached the issue with his counterparts at the meetings of the G7 Heads of ECAs. However, his requests for progress on an OECD agreement on common environmental standards among these seven repeatedly ended in six votes against and one vote in favour of advancing the issue. Nevertheless, the political landscape around ECAs was changing and good governance issues (once considered separate from trade discussions) were increasingly being associated with finance and trade issues. ECAs would soon feel the impact of those shifts. Still, G7 members remained reluctant to devote efforts within the ECG to the issue of the environment, absent any OECD Ministerial mandate that would be directed to all members.

The Communiqué of the May 1999 OECD Ministerial Council Meeting (MCM), as usual held in Paris, provided the mandate that would re-energise the ECG negotiations on the environment. The Communiqué language from that MCM was unambiguous in its direction to all ECG Members: it stated that the Ministers: "… welcomed the progress towards the OECD Agreement on Environmental Information Exchange for Larger Projects in relation to officially supported export credits and urged that the work continue with a view to strengthening common approaches and to report on progress made at the next Ministerial Council Meeting." Convergence on an agreement identifying elements of environmental review processes and common environmental guidelines among ECAs that had seemed impossible, given the earlier strong resistance to such

policies by most OECD members, now appeared attainable as they set their sights on incremental steps to address the environment at their 1999 and 2000 ECG meetings.

A special session on environment, in the forum of the 82nd ECG meeting in February 2000, included presentations on environmental policies and review procedures undertaken by some ECAs, including EDC (Canada), GIEK (Norway), Euler Hermes (Germany), JBIC (Japan), ECGD (United Kingdom) and the US Ex-Im Bank. Based on a compilation of the elements identified in the various presentations and the results of a mapping exercise, Brigitta Nygren (Sweden), then the Chair of the ECG, and Janet West, Head of the OECD Export Credits Division, facilitated the adoption of a draft Work Programme to guide members in their overall aim of environmental reviews. Additionally, an Action Statement from that 82nd meeting formally committed members to take concrete steps within an accelerated work programme in order to fulfil the OECD MCM mandate; this also committed members to consult regularly with appropriate stakeholders. Indeed, this meeting furthered ECG members' understanding of the issues and it became the foundation for further negotiations on, what would eventually emerge as, an agreement on a set of common environmental guidelines.

Following the February 2000 ECG meeting, the Fourth Meeting of the OECD Round Table on Sustainable Development was held in Paris in late June 2000 that included an agenda item specifically dedicated to the issue of export credits and the environment. The participants to this meeting recalled the related OECD MCM and G7/8 mandates concerning the environment and export credits; they reviewed ECAs' existing practices related to environmental issues and reflected on the attention being placed on the environment within OECD member governments. Differences in the views put forward by environmental negotiators and those of their trade counterparts were apparent, as were differences noted in the approach of various ECAs to the environment. While some ECAs had developed formal quantitative and qualitative guidelines, others had adopted far less structured approaches. However, the Round Table noted that to fulfil the 1999 MCM mandate, ECG members had agreed to hold further special sessions in keeping with their Work Plan resulting from the Action Statement of February 2000.

The June 2000 OECD MCM Communiqué stated that the Ministers: "… welcome the substantial progress achieved in the Export Credit Working Party towards agreement on a Recommendation of Common Approaches on Environment and Export Credit and encourages the Working Party to finalise the work as soon as possible and before the end of 2001." Pressure was now on ECG members from the OECD Ministers, as well as from other sources, to reach a meaningful agreement on the environment within a little more than a year.

It was against this backdrop that ECG members met in September 2000 for yet another special session on the environment at which a first draft of an environment agreement was tabled

which had been drafted by the ECG Bureau and Janet West with support from Christine Tebar Less of the OECD Environment Directorate. Canada presented case studies that illustrated the flexibility of its environmental framework, which was in stark contrast to the more prescriptive environmental requirements being put forward by the United States. The appeal of Canada's more flexible approach of benchmarking some of a project's environmental characteristics to host country and, where appropriate, to a variety of international standards appealed to most ECG members and prompted them to view it as a new starting point for formulating an agreement on the environment and export credits.

To meet the 2001 target date set by the OECD (and G8) Ministers, the ECG continued negotiations through mid-2001. As a result of discussions held at the 91st ECG meeting in June 2001, a final draft of an OECD Recommendation on Common Approaches on Environment and Officially Supported Export Credits was presented in a Chairman's proposal for acceptance by early July 2001. This final draft (which preceded five others) set forth the scope of the Recommendation, *i.e.* officially supported export credits for projects with a repayment term of two years or more, and also contained provisions for the environmental screening and classification of projects. Some members, however, especially the United States, felt that the language in the draft that addressed the environmental review of projects left too much discretion to individual members and provided excessive flexibility with respect to identifying standards against which ECAs would conduct environmental reviews.

Consensus on the proposed Common Approaches required that all ECG members agreed to apply environmental standards or guidelines in a transparent manner to all projects when undertaking environmental reviews. In fact, consensus was not achieved as the United States could not accept the sixth and final draft: the United States stated that acceptance could leave its exporters at a competitive disadvantage. The United States tried to persuade the ECG to continue negotiations but, in response to the 2001 Ministerial deadline, all other ECG members agreed in November 2001 to implement on a unilateral and voluntary basis the common approaches to the environment, designated as Recommendation on Common Approaches on Environment and Officially Supported Export Credits (Rev. 6).

Consensus for a Recommendation on Common Approaches

Despite its shortcomings, Rev. 6 reflected considerable improvement in definition and clarity over the former versions even though it failed to draw consensus among all members on certain critical elements, such as explicit standards for the environmental review of projects. Members agreed that Rev. 6 constituted a good first step, especially since prior to January 2002 many ECAs had no practical experience in the environmental review of transactions they were intending to support with official export credits. Rev. 6 was subsequently made available to interested

parties, including business groups and environmental NGOs, which was an important move in establishing transparency with respect to the environment and export credits.

As a result of the discussions held at meetings during 2000 and 2001, the ECG established a working group of technical environmental analysts and specialists from various ECAs; these became the Environment Practitioners, chaired by Pekka Karkovirta (Finland) who would meet periodically to discuss technical matters associated with the environmental review of ECA-supported transactions. In addition, the Practitioners exchanged information on experiences in reviewing projects. The Practitioners first met informally in September 2002 at the invitation of COFACE (the ECA of France) and, subsequently, in a formal session at the OECD in March 2003 to discuss issues ranging from definition of terms to the scope of environmental reviews and public disclosure of EIAs. It soon became evident that most Practitioners were using the WB Safeguard Policies to benchmark the environmental and social effects of projects, albeit ECAs could use multiple international standards under Rev. 6.

Reports on the Practitioners' work were presented to members at subsequent ECG meetings; the information exchanged and reported served to inform members on a host of environmental issues, thereby assisting in the formulation of decisions on environmental policy as well as later revisions to the Common Approaches.

One of the provision of Rev. 6 required the ECG to: "… review all elements of this Recommendation not later than the end of 2003 in order to enhance it in the light of experience and report to Council", many members began reporting that they were requiring EIAs for Category "A" projects (*i.e.* a transaction which has the potential to have significant adverse environmental impacts) and that they were drawing from WB guidelines in their review of projects. As 2003 approached, key meetings were scheduled to give members an opportunity to report on their experiences and review the provisions of Rev. 6, with a view to providing more detail on environmental standards and requirements for compliance. In April 2003, members agreed to provide recommendations for modifications to Rev 6 that the Chair, Birgitta Nygren, would summarise for discussions at the September 2003 ECG meeting. Members agreed on the need to craft certain revisions that would reflect a balance between environmental stewardship and the requirements of their exporters, while ensuring a level playing field among ECAs.

Despite persistent differences among members as to how to deal with the environmental issues, a revised agreement on Common Approaches was reached in November 2003 that was acceptable to all ECG members. The provisions of Rev. 6 that had raised objections from the United States were revised based on practical and positive exchanges and contributions from the Practitioners; for example, the revised language called for adherence to the more stringent of local environmental standards or international standards of the World Bank Group.

In addition, the 2003 version of the Common Approaches required ECG members to seek to make environmental information, particularly EIAs, publically available 30 days before final commitment. A milestone within the ECG had been finally achieved: consensus on the terms of an OECD Recommendation on Common Approaches to Environment and Export Credits, nearly ten years after the United States had first raised the issue in the ECG. The Recommendation was adopted by the OECD Council in December 2003.

ECG members strengthen the Common Approaches

The 2003 Recommendation on Common Approaches was to remain in effect for three years before undergoing further review and revision, again drawing from the experiences of members in its implementation. Accordingly, semi-annual meetings of the ECG's Environmental Practitioners were held during this period. Issues that were raised during these deliberations included whether to expand the reference to the guidelines of the World Bank Group by explicitly citing all the relevant Safeguard Policies (as opposed to a selected few) and whether, or to what extent, the newly revised Performance Standards of the IFC and associated Environmental Health and Safety Standards should be referenced. Also of note in this review period was the increasing private sector and project finance business of ECAs that made IFC Performance Standards more relevant to ECA business (as opposed to the WB Safeguard Policies that were directed at sovereign business).

In June 2003, after meeting with officials of the IFC, a group of commercial banks led by ABN AMRO, Barclays, Citi and WestLB AG, formed a group that committed to a set of principles designated as the Equator Principles; these principles included adherence to the IFC Performance Standards for determining, assessing and managing the social and environmental risks in project financing. Soon thereafter, in May 2004, the EKF of Denmark became the first ECA to adopt the Equator Principles, stating that adherence to these Principles did not contradict any of the provisions of the OECD's Common Approaches. The ECG noted that the Equator Principles applied only to project finance deals with a value in excess of USD 50 million, (this value has since been reduced to USD 10 million.). The number of Equator Principle Financial Institutions (EPFI) continued to grow to a total of 70 by the end of the decade and, in mid-2008, China's Industrial Bank became the first Chinese financial institution to join.

In February 2006, a combined meeting of the Environment Practitioners and those of several EPFIs was held in Austria to discuss the approaches of each group to the environmental review of projects. Although differences in the method of screening and classification of projects were noted, it became evident that the process of environment review undertaken by ECAs was generally as thorough as that endorsed by the EPFIs, although not all ECAs used the IFC Performance Standards in their review of private sector project finance transactions.

By the end of 2006, ECG members were approaching agreement to strengthen the 2003 Recommendation on Common Approaches and by June 2007 consensus was reached and the OECD Council adopted the Revised Council Recommendation on Common Approaches on the Environment and Officially Supported Export Credits. There were a number of changes in the revised version, most notably language distinguishing requirements for the environmental screening and review of existing operations as well as language stating that the IFC Performance Standards would be the guidelines used for the environmental review of project finance transactions, thereby aligning with the practice of the EPFIs.

Looking ahead at export credits and the environment

The next review of members' experiences under the 2007 Recommendation will extend into 2011 to provide more time for members to examine additional issues, in particular climate considerations and human rights. Concluding the review in 2011 will also allow the ECG to consider adopting the revised IFC Performance Standards; these are scheduled for approval by mid-2011. Meanwhile, the ECAs of Australia and Canada joined Denmark in becoming an EPFI, further confirming their reliance on the IFC Performance Standards in the review of project finance transactions.

During 2010, ECG members proposed numerous suggestions to enhance and strengthen the existing provisions of the 2007 Recommendation and are currently responding to international attention which is focusing on the issue of human rights that arise in the context of export projects. Members are also discussing supply chain issues in relation to labour rights.

Finally, in what may be one of the most challenging issues currently facing the ECG as it continues to address the environment, interest is mounting with regard to the issue of climate change and the greenhouse gas emissions produced from projects supported by ECAs. Although the United States has been seeking agreement since 2000 to the reporting by ECG members of CO_2 emissions, the multilateral discussion on climate taking place in other forums has impeded this far-reaching action. In 2008, the United States renewed its commitment to the broader global climate change discussions and began pushing ECG members to adopt processes for the tracking and disclosing of CO_2 emissions from ECA-supported projects, now with greater emphasis, as a first step, in informing policy makers about the relationship between such projects and global climate change. Further to this effort, the US Ambassador to the OECD, Karen Kornbluh, announced in 2009 that US Ex-Im Bank had adopted a Carbon Policy that had, as its objective, incentives for the support of renewable energy and low carbon projects while placing additional requirements on high carbon-intensity projects.

The United States is now seeking a multilateral agreement on specific requirements for high-carbon intensity projects and a broader discussion on how to support power generation

technologies with low- to zero-carbon emissions. Climate change issues represent the new frontier for environmental negotiators, both at the OECD and beyond! While some members, most notably those from the Denmark, France and the United Kingdom, expressed support for an initiative within the ECG to address climate change mitigation and greenhouse gas production, many members expressed fear of the possible impact on exports resulting from such an initiative, especially in a time of economic uncertainty. Moreover, concern that climate change initiatives could place OECD members at a competitive disadvantage to non-OECD and, in particular, some G20 countries, fuels objections. In addition, and consistent with objections raised previously regarding ECA action with respect to environmental issues, many members consider the issue of climate change to be beyond the scope of environmental reviews conducted by ECAs.

Nevertheless, the ECG and the Participants to the Arrangement have agreed to a policy workshop on greenhouse gas emissions; the purpose is to provide a much needed framework for discussions to help advance the export credit work in the OECD on global climate change. Climate change is to export credits in 2011, as was the environment to export credits during the 1990s.

Looking back, the impact of the ECG work in the context of the environmental review of officially supported export credits has steadily grown over the years, to a point where reviews conducted by members are often on a par with those of the major multilateral banks. The scope of environmental review on the part of ECG members has become internationally recognised and few can argue that the environmental performance of projects supported by ECAs ranks among the best worldwide. Now, climate change has emerged as one of the latest, if not the greatest, challenges facing us all. Negotiations in the ECG to obtain consensus on revisions to the 2007 Recommendation on Common Approaches that adequately address the global climate issue will be an uphill struggle, albeit one that the ECG, due to the persistence and dedication of its members, will undoubtedly win.

Part VI

CIVIL AIRCRAFT

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RULES FOR AIRCRAFT FINANCING: THE 2007 AND 2011 AGREEMENTS

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On 1 February 2011, a new OECD Aircraft Sector Understanding (ASU) came into force, succeeding the 2007 ASU. Other articles in this book explain the benefits – or shortcomings – of this unique agreement in the international trade arena. However, beyond any technical value of the ASU, one may wonder why such a negotiation took place at the OECD and, more interestingly, how could negotiators reach an agreement in a short negotiating timeframe – two years for the 2007 ASU and one year for the 2011 agreement.

Building upon inside experience of both negotiations, in this article I highlight the key parameters for these two successful aircraft agreements and the lessons that may be drawn for other comparable negotiations.

Why are the disciplines on civil aircraft rules at the OECD?

The aircraft sector is highly competitive and has historically been supported by governments in many ways, ranging from various support programmes for manufacturers to specific support extended to the airline sector.

From the 1950s, the OECD has historically been the forum for designing and implementing disciplines applying to export credit support measures that are extended through loan guarantees, direct financing or interest rate support. The negotiators first designed a general set of measures, known as the "Consensus" (more formally, the Arrangement on Guidelines for Officially Supported Export Credits) back in 1978 and then added a series of sector agreements in the 1980s, one of which was to apply to civil aircraft with effect from 1986. As a matter of practice, the 1986 ASU was considered by its participants as satisfactory, as long as it was able to ring fence each competitor's export support programmes. Once the parties to the 1986 set of disciplines considered

that these were no longer efficient, then they had to be renegotiated. There was no ideological or even theological approach to such renegotiations; rather, increasing competition among more manufacturers, more aircraft models and more buyers made it necessary.

In the meantime, in the late 1990s, Canada and Brazil were just emerging from several years of litigation in the WTO on their respective export credit support programmes, without having established a suitable mechanism to bring sufficient trust and predictability to their dealings with each other. Both Brazil and Canada came to the OECD negotiating table in 2004 and added their efforts to that of the authors of the 1986 ASU with a view to constructing a single set of export credit disciplines to apply to all aircraft. Based on the history of export credits disciplines and on the good experience of some in implementing efficiently these disciplines, all parties were convinced that the OECD was the appropriate forum to open such discussions.

From the start, the negotiators shared a series of common objectives: to modernise an outdated agreement, in particular by making it more inclusive, bringing all players around the same table and strengthening disciplines in order, technically, to level the playing field. Second, the future agreement had to be applicable to a variety of export credit support programmes since no single negotiating party was prepared to give up its own technique and culture in providing official support. Finally, by welcoming Brazil and Canada into the negotiations, the discussions led to confidence building: Brazil, in particular, had to be convinced that the OECD was the appropriate forum for the negotiation of new aircraft rules. And, indeed, this proved to be the case, so much so that when the need was felt pressing to enhance those 2007 rules, the question of the choice of forum was not even raised: all parties accepted that this had to be done within the OECD framework.

What made the aircraft negotiations work?

Looking back to the two series of ASU negotiations (2005 to 2007 and 2010), a number of factors were key to making the OECD a successful forum for establishing export credits disciplines in the aircraft sector:

- A limited number of negotiators: both the 2007 and 2011 ASUs were negotiated among five main active parties (Brazil, Canada, the EU, Japan and the United States). Such format proved to be very efficient since it brought more momentum and trust than bilateral negotiations/settlements and was certainly easier to manage – some Head of Delegations' meetings involved no more than ten people to discuss difficult issues. The absence of free riders also meant that every party had a direct interest in each possible solution found.

- A co-operative involvement of all the parties in finding workable solutions: such involvement encompassed drafting text, providing technical analyses, collecting market data and organising experts' meetings under tight time schedules. This co-operative attitude also revealed the common preference for a mutually agreed settlement, in the form of an ASU, under pressure from ongoing transactions.

- Practical considerations prevailed over ideological positions: the parties concluded a new set of disciplines in 2007 and subsequently agreed to review these as early as 2010, in view of major changes which had occurred both in terms of aircraft models and financial markets. In the 2010 review, the negotiators opted for practical solutions to bridge gaps over difficult issues, such as a common system for rating obligors, setting minimum floating interest rates and resolving real time disagreements.

- The type of legal framework chosen for the two ASUs followed a long established tradition: export credits disciplines have taken the form of Gentlemen's agreements (as explained by Nicola Bonucci in his article herein) and so did the two ASUs. In practice, these agreements are considered politically binding by their participants, but long and complex ratification/approval processes are not necessary, as would be the case for a Treaty. On the other hand, since the ASU brings discipline to a highly competitive sector, the terms of the ASU have to be very specific and sufficiently clear to avoid any future dispute. A high degree of precision, regular review and improvements in the light of experience are all preconditions for creating a predictable environment bringing discipline to sophisticated aircraft transactions.

- An active contribution from interested stakeholders: in the 2007 ASU negotiations, the stakeholder's views were mostly channelled through the Aviation Working Group (AWG) which represents, essentially, aircraft manufacturers and financiers. The AWG renewed its active contribution during the 2010 renegotiation phase and this was supplemented by groups of airlines who provided position papers. Regular formal and informal consultations were held with all the various stakeholders; such consultations will likely not be limited to the negotiation phase but are expected to continue during the implementation and monitoring phase of the 2011 ASU.

What does the 2011 ASU bring to the radar screen of the aircraft business?

Reflecting on the result of the aircraft negotiations in the OECD, it is clear that the 2011 ASU brings added value to the aircraft industry:

- Confirmation that the ASU (and thus the OECD) represents a suitable framework to discipline aircraft export financing: one of the unsaid benefits of the ASU is its capacity

to avoid litigations in other forums. In particular, the ASU is built around the core concept of "real time" solutions to be found when transaction-related discussions occur. At any stage of a deal, any party to the ASU may raise any issue relating to the application of the rules, ask questions to competitors and propose specific terms and conditions that may be suitable for a given transaction.

- Clarity to the conditions of officially supported export finance: the ASU sets out a clear and comprehensive legal framework which is immediately applicable for all aircraft-business players (including manufacturers, banks, credit insurers, services' providers), from the very early stages of a transaction ("campaign stage") to the closure of a financing deal.

- Workable and adjustable technical solutions: the disciplines agreed are based on market practices and are reviewed regularly to check their adequacy.

- An open gate for future competitors: competitors that are not parties to the ASU are invited to join the ASU; a specific accession procedure has been designed for this purpose. Meanwhile, in case of overt competition between an ASU participant and a non-participant, temporary procedures have been put in place to exchange views and find common ground for levelling the playing field.

All in all, the OECD and the aircraft agreements have so far proved to be good bed fellows. The 2007 ASU was a watershed for official export credit support for civil aircraft, as described by Peter Cameron in his article; and the 2011 ASU has been welcomed as an important step towards recognising the interests of a broader stakeholder community, as emphasised by David Berg (ATA) and Mark Verspyck (Air France) in their article. But of course, the journey doesn't stop here!

THE AIRCRAFT NEGOTIATIONS 2004 TO 2007: "THIS WILL NEVER FLY!"

Peter Cameron

Peter Cameron was the lead negotiator for Canada over the course of the two-and a-half year negotiation for the 2007 Aircraft Sector Understanding, which was successfully concluded by OECD member countries and Brazil. Peter Cameron is the Alternate Executive Director for Canada at the Inter-American Development Bank, Washington.

The 2007 OECD agreement on the financing of aircraft with official export credits was a notable accomplishment – not only because it resolved previously intractable differences between countries representing the major airframe manufacturers Boeing and Airbus, it also brought an end to years of litigation between Canada and Brazil on export credit subsidies for their own national manufacturers, Bombardier and Embraer. The agreement is incorporated by reference into the international body of law supported by the WTO. Brazil is a WTO member but not a Participant to the OECD Arrangement on Officially Supported Export Credits. The OECD was the forum for this historic settlement and the OECD's export credits secretariat played a vital role in this success.

An imperfect tool

When I first heard of the possibility of an aircraft negotiation under the OECD Arrangement I was actually excited by the prospect. Or was it scared? The subject is, of course, fascinating. But Canada and Brazil had locked horns on this difficult problem for years of back and forth litigation at the WTO – with both sides claiming victories – and yet no resolution of the underlying problems.

How could the involvement of the governments of Europe, Japan and the United States make this situation better? Canada and Brazil manufacture regional aircraft; Boeing and Airbus export huge aircraft operating on global transportation routes. Europe and the United States themselves had a history of distrust in the aerospace sector which is much longer, and perhaps even more visceral, than Canada and Brazil. And yet for each of these countries, success in the aerospace industry is a matter of vital national interest in which compromise is not possible. It was a daunting prospect indeed.

Perhaps the most hopeful sign was that my OECD counterparts wanted to negotiate at all. I certainly knew they were keen to engage Brazil. But what might this mean for Canada?

The 1986 Aircraft Sector Understanding (ASU), which was annexed to the Arrangement, was hopelessly out-of-date; its Participants' credit practices had evolved along the lines of creative interpretations by government-backed export credit agencies (ECAs) with little regard to the negotiated text in effect at the time.

Despite liberties being taken under the then existing agreement, a balance – albeit imperfect – had allowed governments to maintain credit support for their national champions while avoiding the direct trade conflicts that had engulfed production and research subsidy disputes in the same sector. A strong familiarity among the Arrangement's Participants, an imperfect transparency, and even a modest degree of trust built over many years of OECD co-operation, had been instrumental in helping OECD governments muddle through this potentially volatile policy conflict.

The context

For its part, Canada saw its practices as falling outside the operative ASU terms of the day. This approach relied on Canada's interpretation that its practices were aligned with the market and were, therefore, not subject to terms of the Arrangement – a view that had been fortified by a WTO decision that, in principle at least, supported the Canadian interpretation. But what does market pricing by government-sponsored institutions mean in the dynamic world of aircraft finance?

While other Participants to the ASU saw a clear need for rules, there was an even more active interest in ensuring the compliance of others than in changing any of their own practices. Indeed, with the passage of time, many ECAs, with the encouragement of their airframe manufacturers, had adopted pricing practices to secure whatever advantages could be gleaned under the ambiguous written rules.

And what about Brazil? While not an OECD member, Brazil looked to WTO processes to resolve questions regarding its rights and responsibilities under enforceable international laws. As a new entrant in this highly competitive sector there was no doubt of the importance of engaging constructively with this country – in aerospace certainly, but indeed in many areas of economic co-operation within the OECD family. While having every reason to invite Brazil's participation, and while any one of the Arrangement's Participants was happy to inform Brazil of its "rights" under the Arrangement, no one was able to explain coherently to Brazil exactly what the terms were! Indeed, the more I thought about it, the less probable it seemed that we could ever reach an agreement.

Of course, in any negotiation it is essential to set out principles. Agreeing on principles is easy; putting them into practice can be painfully difficult. But I also knew that, once agreed, it would not be possible legitimately to reject rules that conform to agreed principles on the grounds that you don't want to change your current practices. From my previous hard knocks in OECD export credit negotiations, I was reluctant to take part in this latest negotiation if I didn't believe we could succeed. And it was apparent at the outset that the foundation of any workable agreement would be reliable mechanisms for transparency and clear and binding rules on financing terms. How would Canada's market practices work under such an arrangement? As difficult as this seemed it was clear that the *status quo* was not an option.

The challenges

Our early informal discussions revealed that all parties were talented, earnest and, it appeared, genuine in their willingness to explore openly a principles-based deal that would level the playing field for export credits for civil aircraft. Why should this be so difficult?

Here were just a few of the obstacles:

- We actually knew little about each others' financing practices. An enormous amount of analytical work was needed – and face-to-face discussions among technical experts. I expect many of the negotiators were not even fully informed of their own ECAs' financing practices.

- The products and the buyer markets were vastly different. Did it make sense to crowd every conceivable transaction into the same agreement? Each discussion appeared to bog down into the vastly different experiences of each ECA. Moreover, each ECA had its own way of delivering financing support, including pure cover (fully-backed government guarantees), interest rate support and direct financing.

- No one – possibly with the exception of Brazil – wanted to change their current practices. Until it was apparent that other negotiating teams were prepared to accept change it would be impossible to get a mandate for change from any government.

- There was a lack of agreement from the beginning on basic elements of trade law: do the Participants to the Arrangement have the right to match non-compliant financing terms? Why should the Participants be prevented from offering non-distorting market window financing terms? What about the rights of WTO members not directly participating in the negotiations?

- Although manufacturers were appropriately engaged in the technical discussions, each one had every incentive to preserve their own advantages while finding injustices in the practices of the governments supporting their competitors. Every negotiating team heard tales of injustices – past or pending – that could only be rectified by new, proactive financing commitments at subsidised rates.

- Finally, Governments' role in aerospace has many dimensions – export credits are but one. Multiple programmes may support the same transaction. Sub-national financing would also need to be brought into any agreement to level the playing field. Given Quebec's keen interest in aerospace export sales this was a major preoccupation for me.

Finally, after many months of navigating through these differences, we faced a new question: how would we handle the vestiges of past practices? Existing contracts and commitments had to be fulfilled. Forward financing commitments are typical in aircraft financing and ECAs had adopted a "Home Market Rule" (a practice outside the ASU affecting sales into certain domestic markets). While not endorsed by Canada or Brazil, the desire of the major aircraft manufacturers to maintain practices and historical commitments could risk unravelling the entire agreement. In addition, while accommodating differences and permitting government-backed financing, there was a general desire not to undermine the creativeness of private financing markets. Competitive markets move quickly - how could we know that our terms were not undercutting the benefits of the market?

In hindsight, given all of these difficulties, I wonder how the group was able to succeed!

The lessons learned

So for those who may find themselves in similar impossible situations, here is my advice:

- Be optimistic.

- Get yourself a great negotiating team.

- Be direct and honest with your counterparts.

- Do your homework. Analysis must be fact-based, not strategic. Good and unbiased analysis is the foundation of building trust and a workable agreement.

- Forget about negotiating. Treat your assignment as problem solving.

- Leave your manufacturer at home.

As a lead negotiator, these are the things that you may have some opportunity to control. However, while all of these things are helpful towards finding solutions, they are not sufficient. Here are a few other things you will need on which you can only hope:

- A strong Chairperson (this time it was Nicole Bollen, Netherlands) and secretariat (my heartfelt thanks to Janet West, Jean Le Cocguic and the rest of the OECD team).
- Honest and fair counterparts (in particular the outstanding Brazilian team led by Roberto Azevedo and Marcus da Costa Ramalho).
- Old fashioned good luck (you can never have too much).

Of course, even if we hadn't succeeded, those months and even years of trips to Paris were all worth it. I made many friends from those long meetings – and post-meeting socialising that I won't forget.

Perhaps the sweetest moment of all was on that spring day in Rio de Janeiro in 2007 when I stepped on board that beautiful, sparkling new Embraer 170 aircraft – with fresh Air Canada paint on the fuselage – sitting in the jump seat as the aircraft set out over the skyline of Rio and along the magnificent Brazilian coastline en route to San Jose dos Campos. At that moment, all the turbulence along the long journey of negotiation and compromise were forgotten. Given the opportunity, I'd do it all again!

FROM RIO 2007 TO PARIS 2011: BRAZIL'S PERSPECTIVE ON THE CIVIL AIRCRAFT AGREEMENTS

Marcelo Della Nina

Marcelo Della Nina was the lead negotiator for Brazil over the course of the negotiation for the 2011 Aircraft Sector Understanding, which was successfully concluded by OECD member countries and Brazil. The author is Counsellor at the Brazilian Mission to the WTO, Geneva.

From the start, Brazil was a strong supporter of the negotiations that led to the establishment in 2007 of the then new Sector Understanding on Export Credits for Civil Aircraft (ASU), a Gentlemen's agreement that is annexed to the OECD Arrangement on Officially Supported Export Credits. Though not an OECD member, Brazil took part in the negotiations on an equal footing with other Participants and each and every single provision of the agreement was a result of the discussions held during the ASU negotiating process.

2007 – Rio

Indeed, from a Brazilian perspective, the 2007 agreement was the conclusion of a long process of discussions that included three disputes at the WTO Dispute Settlement Body involving Embraer, the Brazilian aircraft manufacturer, and its main competitor, Canada's Bombardier. Years of effort that mobilised the energies of Brazilian negotiators and diplomacy at different levels – bilaterally and multilaterally – eventually resulted in an agreement that committed the countries hosting the main aircraft manufacturers to a set of rules that effectively provided for a level playing field with regard to official support for the financing of aircraft exports. In a way, it was then only natural that the ASU was officially signed in a ceremony held on the 30th July 2007 in Rio de Janeiro.

The 2007 ASU was also important as it established a set of concepts and rules that allowed for greater transparency and predictability of official support measures. This is indeed a feature highly appreciated

in Brazil by those involved in the official support decision-making process. In particular, as the 2007 ASU actually had two different sets of provisions regarding the minimum premium risk rates and other issues depending on the category of the aircraft, it was especially appreciated that in the case of Category II aircraft – generally referring to regional aircraft, the market niche of Embraer – the agreement provided for a robust risk-based system. This was indeed an essential feature, based on sound technical proceedings that the Brazilian negotiators actively helped to develop and which set the conditions and the limits of official support. This meant that the agreement not only provided for transparency and predictability, but also that official support would be exercised in a way that could legitimately be held as financially prudent.

In hindsight, it is now possible to see how effectively and efficiently the 2007 ASU fulfilled its mission in setting the level playing field for official export credit support for civil aircraft. The system worked well and occasional issues – even the more challenging ones – were discussed and eventually resolved by the Participants in a remarkably expedite manner. Indeed, the fact that governments, ECAs and manufacturers quickly became familiar with the workings of the 2007 ASU should not go unappreciated. It was a clear indication that all interested parties found there was good value in the ASU and that it had passed the reality test.

From the Brazilian perspective, it was therefore a matter of great concern when it became evident by the end of 2009 that the agreement would have to be renegotiated if it were to remain in force. The causes that provoked the renegotiation of the 2007 ASU were of course of an external nature. The launching of a new family of aircraft by Bombardier and the new economic environment that emerged in the aftermath of the financial crisis forced the ASU Participants to face certain issues that in 2007 had been dealt with in a different, easier way. This was particularly the case of the so-called bifurcated system which differentiated between larger and smaller "regional" aircraft.

The task of unifying the ASU could have been achieved by adopting, with adjustments, the technically robust Category II system of the 2007 ASU. It should be noted, for the sake of record, that the Brazilian Delegation maintained this position from the beginning of the negotiating process that resulted in the 2011 ASU. In our view, the assessments then made – both by the Brazilian Delegation and by studies commissioned by the industry – of the performance of the Category II pricing curve throughout the crisis seemed to confirm its technical soundness and, at the same time, to indicate that it remained an adequate basis for addressing the new challenges posed by the launching of the C-Series – a new family of aircraft that effectively blurs the distinction between Category I and II aircraft as set out in the 2007 ASU. Although we remain of the view that this approach would have provided for a simpler way to adjust the agreement to the new reality, Brazil accepted the fact that other Participants envisaged different solutions for the renegotiation of the 2007 ASU.

2011 – Paris

Brazil, therefore, engaged constructively and actively in the discussions for a new ASU, just as we had done in the past. Our contributions were aimed at preserving and strengthening the set of principles that, in our view, was at the basis of the success achieved with the 2007 ASU: prudence, predictability and transparency. As a consequence, it seemed of the essence that the new agreement should again establish a risk-based system of pricing even if it were to incorporate market-reflective tools, as deemed necessary. The Brazilian Delegation was particularly active – and in our view, successful – in proposing ways and provisions in order to strike that balance. The renegotiation also provided an opportunity to improve the operation of different aspects of the 2007 ASU. For example, the introduction of the set of provisions regarding the benefits countries are entitled to in terms of pricing if they are signatories of the Cape Town Convention should be highlighted.

The negotiations that led to the adoption of the 2011 ASU clearly show the high value attached by the Participants – as well as by the industry – to a rules-based system for the provision of official support for aircraft exports. It was a difficult process that led to the renegotiation of virtually the entire agreement. Negotiators had to face the challenge of resolving an issue that could not be addressed during the negotiations of the 2007 ASU: the definition of a single pricing system for all types of aircraft, a technically complex matter full of implications for the industry. Concerned with the possible consequences that the new agreement – and its impact on the so-called Home Market Rule – might have for their business, this time around, airlines, in sharp contrast to their relative aloofness to the 2007 process, developed a strong interest in the negotiations, adding complexity to the negotiators' task of responding to interested constituencies.

The macro-economic circumstances under which the new agreement was negotiated also were very different from those that conditioned the process that led to the 2007 ASU. Mutual understanding had to be achieved so that all Participants could eventually make difficult concessions. And yet the whole process was concluded according to schedule – just one year of negotiations!

Like its predecessor, the 2011 ASU is a good agreement. Under the new economic and industry realities it provides for a level playing field and an overall positive business environment. The conceptual foundations laid down in the ASU signed in 2007 in Rio were preserved, while adjustments reflecting the new circumstances were made in the ASU adopted on 25 February 2011 in Paris.

From Rio to Paris all interested parties – manufacturers, airlines, export credit agencies and banks – have learned to live in a rules-based environment when it comes to official support for aircraft exports. The 2011 ASU reaffirms the engagement of its Participants with the rules of the game and shows that it is possible to adapt to new realities and improve on a success story.

As we look ahead into the future of the 2011 ASU, we should ensure that the agreement remains a dynamic and technically sound instrument, capable of responding adequately to the needs of governments, manufacturers, financial institutions and airlines. And as competition increases in this most competitive sector of world trade we should now reach out and make room in the agreement for the new entrants in the market so that in the future the ASU will continue to provide for a level playing field for all manufacturers in a prudential, predictable and transparent fashion.

THE 2011 AIRCRAFT AGREEMENT: A TURNING POINT?

David Berg and Marc Verspyck

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In 2010, about 40% of civil aircraft deliveries were financed using official export credits. Borrowers included many of the world's most profitable airlines and leasing companies. One may hope that with the entry into force of the OECD 2011 Aircraft Sector Understanding (ASU), this extraordinary displacement of private credit will have reached its high-water mark and government intervention in the civil aircraft market will recede to a much more modest role, consistent with sound public policy and current market realities. Meanwhile, it is worth pausing to examine a few questions that may help assess the effectiveness of the new ASU in the coming years, namely:

- How did the use of official export credits veer so far from their original purpose?
- What does the new ASU accomplish?
- Where do we go from here?

A short history and critique

Programmes to provide official credits to support export sales by domestic manufacturers have their roots in times of economic devastation, going back to World War I and continuing into the post-war period of the 1940s. As originally conceived, export credit agencies (ECAs) stepped in where manufacturers were unable or unwilling to accept political and credit risks associated with international sales, especially in underdeveloped economies. Even large manufacturers were far less globalised and sophisticated in their operations than they are today. Political risks raised by sales to state-owned entities such as in the former Soviet Union, notably emerged as an important new factor in export markets.

On 25 October 1957 the Export-Import Bank of the United States (US Ex-Im Bank) structured the first aircraft export credit transaction – for a Boeing 707. (Interestingly, just a few months before this transaction, the World Bank financed sales of B707s to Qantas Airways and to Air India, demonstrating the perception of official support for aircraft sales as a means to foster economic development.) With the rise of European aircraft manufacturers as competitors to Boeing, Lockheed Martin and McDonnell-Douglas, and eventually the creation of Airbus, the stage was set for worldwide competition that increasingly drew on ECA support simply to win sales, without regard to the financial means or political risks of the buyers. Indeed, fully creditworthy businesses in politically stable countries today are among the biggest beneficiaries of official credits.

The OECD entered the picture in 1986 with the first ASU – which incorporated a Large Aircraft Sector Understanding (LASU) in an attempt to prevent aircraft sales competition between US manufacturers and Airbus from being driven by concessionary export finance terms. With the European Union broadly representing the interests of Europe, the participating parties agreed to a base line of minimum export credit terms. Separately, the governments of the main large civil aircraft manufacturing countries (France, Germany, Spain, the United Kingdom and the United States – the Home Countries) established an informal, unwritten rule to exclude their own airlines from accessing export credits from these other manufacturing countries – the so-called Home Market Rule (HMR). Under the HMR, for example, British Airways could not access export credits from the US Ex-Im Bank to purchase Boeing aircraft and United Airlines could not access export credit from the three Airbus manufacturing countries' ECAs to purchase Airbus aircraft.

Why was the HMR imposed? Because the terms and conditions offered by ECAs for aircraft exports were far more generous than those available in the private markets, while ECAs' mandate was to support exports and not domestic sales. ECA-offers in support of Airbus in the US market would have seriously undercut Boeing's competitive position for domestic sales without it using its own balance sheet; the same would be true of US Ex-Im Bank's support of Boeing sales into European-producer markets. Therefore, if prices were to be kept so far below market, either ECAs needed to finance domestic aircraft sales or there had to be an agreement to regulate competition so as to exclude Boeing/Airbus competition in each other's markets.

How did the financing terms of ECAs become so far out of line with the market? After 1986, ECAs moved to 100% guarantees of buyers' debt (pure cover) as the dominant form of ECA support for large aircraft sales; this essentially made the LASU obsolete for pricing purposes. The impact of this mechanism was to replace the risk ratings of the buyer airline with that of the triple-A rating of the ECA's government in pricing these transactions. Moreover, the 100% guarantee meant that there was no risk participation by the lending institution at all – aircraft sales were priced at pure triple-A risk. A risk fee system was bilaterally agreed between US Ex-Im Bank

(supporting Boeing sales) and the European ECAs (supporting Airbus sales) which provided for a flat 3% fee for risk regardless of the underlying airline risk. In fact, the fee was reduced to 2% if the airline's home government fulfilled the Cape Town Treaty obligations. The official rationale for such a low and uniform fee was that underwriting conditions became increasingly strict as the risk of the airlines rose. But these underwriting conditions were at the sole discretion of the ECAs and were only meant to mitigate airline defaults to the ECAs, not to raise the all-in cost of ECA-financing to market levels to mitigate the imbalances created by the HMR.

The very need for the HMR arose from the stark imbalance between the terms and conditions available from the market for aircraft purchases and those offered by ECAs. The HMR has thus served to protect the balance sheets of Boeing and Airbus and to limit draws on the financial obligations of the Home Countries' governments. The HMR also has enabled the participating governments to avoid the politically sensitive and embarrassing choice of subsidising sales to their own domestic buyers of aircraft, on top of launch and other subsidies already provided to the aircraft manufacturers.

The revision of the 1986 ASU in 2007 was prompted by the desire of Brazil and Canada to resolve their WTO subsidy disputes on regional aircraft through mutual accession to the "safe harbour" under the WTO's Subsidy Code. Some European airlines were also complaining about the HMR rule and the low pricing of ECA financing. Despite these complaints, the 2007 ASU only modestly adjusted fees for large aircraft, due to heavy pressure from manufacturers to stimulate sales and from ECAs for institutional interests in having large aircraft-financing programmes. And both pressures led to incentives to provide more and more ECA financing to airlines which otherwise had access to private markets. This seriously unlevelled the competitive playing field with respect to the Home Market airlines and large aircraft, which were forced to rely on the market both for pricing and availability of financing. The latter point may not be obvious to non-experts, but the certainty provided by ECA cover that financing will be available at the time of order is a huge competitive advantage: it allows ECA customers to ignore a major market risk and more aggressively expand their fleets and coupled with extraordinarily high advance rates, these terms strongly encourage fleet expansion and perhaps have a larger impact on un-levelling the playing field than does low pricing.

Therefore, from the beginning, and from many angles, ECAs' activities produced an unlevel playing field for the Home Country airlines, by artificially lowering the financing costs of those airlines' foreign competitors and encouraging fleet expansion. Although the European and US airlines have protested such unfair competition for at least 25 years, the problem crystallised with the widespread adoption of the "Open Skies" regimes that effectively deregulated international air transport competition and opened Home Market routes to the beneficiaries of massive ECA financing. For example, non-US airlines now carry more than 50% of international passenger

traffic involving the United States. To serve the US market, many airlines have acquired billions of dollars of aircraft financed with loan guarantees from ECAs. Operating under the HMR, the Home Country airlines have no similar access to sovereign-backed loan guarantees. Making the tilt toward foreign competitors even more acute, the ASU terms have been sharply out of step with the market, permitting financings on terms far more favourable than those available to the Home Country airlines.

Like most government-market interventions, the HMR (together with the outdated ASU) has had unintended adverse consequences for large aircraft, in this case causing profound harm to the Home Country airlines. The HRM has allowed airlines of other countries, with whom the Home Country airlines compete, to benefit from three extraordinary advantages: (1) certainty of financing through export credits, (2) lower cost of financing (representing a difference up to about 10% of an aircraft's cost) and higher net proceeds from financings and (3) less dependency on private sector financial markets. These benefits have enabled the beneficiary airlines to achieve significant cost advantages over the Home Country airlines and have encouraged uneconomic capacity expansion, through oversized orders. There is a direct parallel in this experience to the cheap financing that led to the recent real estate bubble which, when it burst, led the United States and the rest of the world into financial turmoil: When aircraft are made artificially cheap and available, the subsidised beneficiaries will buy more of them.

While the HMR is distinct from the ASU, it is closely linked to it because the ASU sets the economic terms for export credits. If the export credit terms permitted by the ASU were to match or approximate the terms and conditions available in the commercial market, then the HMR's distorting effects would diminish or even disappear.

A compelling rationale for change

Recognising the rapid increase in unfair competition resulting from ECA financings for large aircraft, in the post-11 September 2001 period, several airlines sought changes in the ASU rule; only the 2008 financial turmoil, however, induced governments to begin to see this world very differently. At that time, margins on commercial debt skyrocketed, the volume of available credit decreased dramatically and many banks stepped out of the asset finance business. The result was a dangerous imbalance between demand and supply of credit for airlines effectively deprived of access to credit markets. In the wake of the market downturn, the Home Country airlines were forced to park aircraft, to lay off employees, and to take other painful steps to adjust their operations to the market. But ECAs, led by US Ex-Im Bank's unprecedented guarantee of an Emirates Airlines bond issuance in October 2009, supported continued aircraft purchases. Indeed, in its FY2009, US Ex-Im Bank provided USD 8.6 billion in loan guarantees, supporting sales of 143 aircraft to 22 foreign buyers; the European ECAs were as active.

This massive market intervention, at a time when the private markets were signalling a need to reduce capacity, finally prompted action as even the ECAs' governments and some beneficiary airlines recognised the distortion of airline competition resulting from the ASU and HMR. In letters sent on 26 January 2010, nine European airlines took the initiative to flag the issues with their governments and the OECD, and their voices were soon joined by US airlines under the umbrella of the ATA. In October 2010, the nine European airlines and the ATA issued a joint statement calling for a level playing field, higher pricing, control of volume, and greater transparency of official financing activities.

In this context, the rise of competitive aircraft manufacturers located in countries outside the Home Countries created additional complexities that showed inadequacies in the 2007 ASU. These new parameters spurred interest in ensuring that the new round of ASU discussions would comprehensively address the stakeholders' widely differing – and, in some cases, opposing – concerns. Major issues included the definition of, and distinction between, large and regional aircraft, the minimum premium terms (pricing), the maximum official support allowed (loan-to-value ratio) and, as the discussions progressed, transition rules.

Major accomplishments and unfinished business

Under the capable leadership of Chairman François de Ricolfis (France), the government representatives succeeded in negotiating a revised ASU by the 2010 year-end deadline, with implementation from February 2011. Achieving the 2011 ASU required skilful navigation among the many competing and conflicting interests of government participants and industry stakeholders; it was not an easy task. Historically, the European and US manufacturers' interests were dominant and they aligned with most of the participating governments whose airlines also were the beneficiaries of export credits. Governments involved in the ASU discussions had to take a broader view than in the past, i.e. not only looking at the contribution of aircraft exports but also recognising the equally important (and we think larger) economic role of airlines in terms of employment, balance of payment and value added.

From the perspective of the nine European and ATA airlines, the new ASU takes important steps toward recognising the interests of a broader stakeholder community. More specifically, the 2011 ASU significantly reduces the gap between terms available under the ASU and in the market, essentially by doubling the minimum premium rates and modestly reducing the maximum official support; and there is a mechanism for adjusting the terms to changed market conditions. The 2011 ASU rightly distinguishes, in its minimum terms, between the highest rated buyers or borrowers and others. While still containing significant loopholes, the transition terms in the new ASU are more definitive than those in the 2007 ASU.

Nevertheless, while the terms and conditions of the new ASU are an improvement on the 2007 ASU and mark an important directional shift, this new ASU falls short of equilibrium between market financing and export credit financing. Recipients of ECAs' guarantees or loans will still benefit from below-market terms and ECA-subsidised financing will be made available to many borrowers or buyers for which neither commercial nor political risks materially affect their access to commercial markets. Consequently, the export credit framework under the 2011 ASU, combined with the HMR, will continue to distort competition and leave the Home Country airlines at a competitive disadvantage to many of the world's airlines, including airlines that are among their strongest competitors.

Looking forward

The negotiating outcome leaves open important questions about the purpose and role of export credits in the aircraft sector that must continue to be examined in coming years; these include:

- Why should healthy, profitable airlines that can raise financing in commercial capital and credit markets have access to ECA credit? Should not ECA support be limited to beneficiaries that are below investment grade and that have demonstrable difficulty accessing the commercial market due to structural political or financial system reasons?

- Even within the narrow range of cases that might meet such a "needs" test, under what limited circumstances should ECAs facilitate international air transport capacity increases where the commercial markets are discouraging additional sales? Should governments expand export financing for aircraft during economic downturns when such action is contrary to the prudent market response of airlines to reduce capacity in response to evaporating demand?

- Why shouldn't governments fully align export credit terms, including loan-to-value ratios, with market terms? Should not ECA credit be a facility of last resort only?

- Shouldn't the guarantee be limited to repossession risk, insurance risk and reconfiguration and remarketing risk – since the commercial market is able to lease an asset (one third of the world fleet being under operating lease)?

- Perhaps, most fundamentally, why should governments permit their ECAs to subsidise export sales by one domestic business to the competitive detriment of another domestic business?

These questions reflect the undiminished belief of the Home Country airlines that official export credits no longer have a justifiable role in global aircraft purchasing decisions, except in truly limited circumstances, and that future ASU negotiations must frankly examine how to bring further discipline to this sector. The difficulty of the issues, and the essential need to achieve consensus among all exporters on a subsidy ceasefire, also requires the OECD to maintain the central co-ordinating role on export credit negotiations that it has held for more than 30 years, with more countries taking an active part in the future.

Going forward, we look for continuation of an open and balanced approach with all stakeholders fully consulted. We also believe that increased transparency is imperative to understand the impact of official export credits on airline competition as well as to monitor compliance with the ASU. All stakeholders and the public should know more about volume and beneficiaries, especially because substantial financial obligations of their governments are involved. There should be consistency with the G20's latest recommendations on transparency (including the use of tax havens sheltering special purpose companies).

The airline industry faces many challenges; it is a sector employing hundreds of thousands of workers (more than the aircraft manufacturing industry by far). Our goal is to ensure that to the extent official export credits continue to play a role in aircraft sales, the effect is not to inflate capacity artificially and to benefit some airlines and manufacturers at the expense of others.

In sum, we seek a truly level playing field for airlines and aircraft manufacturers alike. We are confident that an open dialogue within the OECD framework will allow for continued evolution of the ASU towards current market conditions and sound policy choices.

Part VII

CONCESSIONAL AND NON-CONCESSIONAL EXPORT CREDITS

1. *Smart aid rules for development, not export promotion*

2. *Sustainable lending and OECD leadership*

SMART AID RULES FOR DEVELOPMENT, NOT EXPORT PROMOTION

Steve Tvardek

Steve Tvardek was the US government's negotiator for OECD export credit agreements from 1995-2009, and was also its Participant to the Tied Aid Consultations Group from February 1992 to December 2009.

The WTO, in setting out anti-subsidy rules and delegating export credit disciplines to the Arrangement on Officially Supported Export Credits, does not set standards for subsidies associated with development assistance or aid programmes, even if they are trade-related. The view being that these subsidies reflect resource-transfers to poor countries for development objectives and not export subsidies that should be prohibited. As it turns out, aid can indeed be used to promote exports in contravention of the objectives of the export credit disciplines (and the WTO rules) and these issues are addressed in the Arrangement in great detail. No overview of export credit disciplines would be complete without understanding the intensive work on aid programmes, over parts of three decades, to ensure that aid does not undermine the Arrangement's overriding objectives of neutralising financing as a competitive tool, maintaining a level playing field and seeking to eliminate subsidies in official export financing. The Participants to the Arrangement closely consulted the OECD's Development Assistance Committee (DAC) in this work.

Tied aid

When aid programmes are used to finance highly productive capital goods investments/projects in sectors normally financed by private markets or export credit agencies (ECAs), questions rightly arise as to whether such programmes are distorting trade. During the 1980s and early 1990s, there were growing volumes of concessional financing programmes that contractually require aid monies be used in the procurement of goods and services from the donor country. Such

aid is, therefore, "tied" to the aid donor's national exporters. Moreover, the terms of these aid programmes were quite "hard" as initially the concessionality level was as low as 15%, meaning the equivalent of 85% of the aid loan had to be repaid on market-related terms – normally the terms provided by ECAs.

As the rules under which ECAs operated their standard business were continually tightened to reduce subsidies in national export credit programmes, concerns began to arise that the growth of tied aid financing for major export contracts was increasingly determining the outcome of important export competitions and distorting trade flows. The two fundamental characteristics of the tied aid problem that made these programmes so problematical were: (1) they were focused on the largest, most rapidly growing developing economies which were becoming major markets for capital goods sales more generally, and not on the poorer countries and (2) they were financing highly capital-intensive projects such as power plants, telecommunications systems and commercial and industrial plant and equipment that are traditionally the subject of intense international competition. In effect, these capital goods sectors in high growth markets were being spoiled for commercially-based competition between nations by the use of proliferating and growing tied aid programmes.

The view was increasingly held that pressures for export promotion, now severely limited by rules governing ECA programmes, had shifted to national aid programmes. Tied aid became a major issue both technically and politically, was featured prominently on numerous OECD Ministerial agendas and in their Communiqués, and was the subject of letters exchanged between Heads of State and numerous bilateral meetings between senior economic and trade policy officials. The defence of such tied aid programmes was: (1) balanced development included a place for capital intensive investments and aid was as good a financing source as any and (2) political support by industries benefiting from such tied aid business allowed donors' aid programmes to be larger than their political processes would otherwise allow.

The timeline of the Participants progressively addressing the tied aid issue is laid out in Janet West's article and interested readers will find a much more detailed discussion of this work in the OECD publication "*The Export Credit Arrangement, Achievements and Challenges 1978-98*". In a nutshell, a series of agreements among the Arrangement's Participants raised the minimum level of concessionality (MCL) or aid component required for such tied aid programmes from 15% to 35% by 1989 for donors that chose to use soft loans or mixed credits for their aid programmes. It may seem counter-intuitive to attempt to resolve a trade distortion problem resulting from aid subsidies by requiring an increase in the level of the subsidy. However, there were multiple objectives at stake. The Participants sought to reduce tied aid trade distortions but also wanted to promote legitimate development aid, not prohibit it. Higher levels of concessionality required a larger budget sacrifice for a given amount of national exports and made it more costly to use

aid subsidies for commercial objectives. It was a typical economist's solution! If there is an activity that one wants to discourage, tax it and the level of the activity will be reduced. At the same time, developing countries would be getting a much more valuable aid product through larger required resource transfers.

In addition, these MCL increases were built upon a new, mathematically modern and market-based way of calculating concessionality that further increased the financial costs of meeting any given concessionality requirement (more below). The Participants' work on these issues was done in close consultation with the DAC, although the latter has retained its traditional method of calculating concessionality – in its parlance, the "grant element", creating a major policy divergence between the two bodies on the fundamental issue of what should be considered "aid" for purposes of multilateral rule-making.

However, the economists who designed the tied aid solution, over-estimated the power of taxation to reduce pressures for export promotion, and underestimated the creativity that would be applied to how disciplines could be circumvented and the incidence of the tax shifted. More fundamentally, they also did not account for the longer-run benefits of governments using the same subsidy tool that private businesses use to establish a market presence and develop brand recognition and technical standards – the strategy of a "loss leader". Such an initial subsidy could actually be a profitable investment in winning subsequent commercial competitions. Therefore, despite the new tax on tied aid, the practice remained a financially rational investment in promoting exports and domestic employment. And finally, developing country governments sought to benefit from these exporter pressures on OECD governments and increasingly demanded concessional financing as a *quid pro quo* for selecting a supplier's bid.

Therefore, in the aftermath of a significant increase in the MCL, in both nominal terms and further as measured in real market-based terms, the flows of trade distorting tied aid continued. The narrow budget issue was circumvented by reducing the concessionality level of aid to the poorest countries, and using the savings to pay the new tied aid "tax" on capital goods aid to the richer developing countries – an ironic and irrational aid allocation outcome as well. In effect, this practice and its discipline encouraged new aid distortion to finance continued trade distortion. The law of unintended consequences, as well as the axiom that no good deed goes unpunished, were prominently on display.

So in 1989, the same year the final increase in the MCL to 35% kicked in, the Arrangement's Participants were back at the negotiating table. By late 1991, after almost three years of extremely difficult negotiations and high-level political frictions, a novel, but analysis-intensive, methodology to allocate tied aid and official export credits had been agreed in principle. Projects that should be able to generate revenue streams sufficient to service loans on the standard

export credit terms of ECAs (dubbed commercially viable projects) would be ineligible for tied aid unless ECA-financing was not otherwise available for such a project. In addition, the higher income developing countries, those whose *per capita* GNI put them above the World Bank's threshold for lower middle income countries were ineligible for all trade-related tied aid. Symmetrically, the poorest, least developed countries remained eligible for all tied aid. But to promote development objectives while countering the negative effects of tied aid, the required MCL was increased to 50%. Finally, the rules allowed grants and near grants (MCL greater or equal to 80%) without restriction to any project or recipient as this level of MCL made trade distortions extremely unlikely. The objective is to maximise total financing for development by preventing aid from cannibalising market-term financing for projects that can support market terms. This allows aid to focus on projects that have high economic returns but poor real cash flow returns – public/social goods and other outputs subject to economic externalities.

The agreement included extensive transparency procedures including *ex ante* notification to all Participant of an intention to offer tied aid, as well as a challenge-review-consultation process that could be invoked. An eligibility decision by the Participants had to be taken on a proposed transaction subject to the consultations process before any tied aid offer could be made. This agreement was called the Helsinki Package and was finally concluded in December 1991, for implementation from February 1992.

The precise degree of discipline that would result from the implementation of the tied aid rules of the Helsinki Package was largely negotiated over the following four years in the course of project-by project technical debates leading to case-by-case decisions on individual projects. Building on the analyses, debates and individual project eligibility decisions, methodologies were established, *de facto*, on the key analytical issues. For instance, any analysis had to be able to define the scope of the project entity to which the capital goods exports were to be attributed and from which the revenue stream would be estimated. For instance, in the most extreme case, the argument for a project's tied aid eligibility was that the generators for a power plant were delivered to the port; sitting at the port they generated zero revenues. Combined with the repayment obligation on the concessional loan, the net cash flow of these aid-financed generators was hugely negative and, therefore, the project could not possibly be considered commercially viable and was, in fact, a highly commercially non-viable project. Of course, at the same time both generators and whole power plants were commercially financed around the world by banks, investors, and ECAs. While only that particular donor supported this analytic approach, clearly, a project entity had to be agreed.

It was also necessary to decide the best technical measure of cash flows and, therefore, the net revenue streams, among other things. The measurement of cash flows was defined by modern financial analysis and, further, by the in principle agreement that the analysis be done

at market-based prices (in the developing country). Estimating these prices required substantial work and debate on each transaction because few developing countries allow the market to dictate domestic prices; it was also necessary to measure the economic price (or shadow prices) of inputs and outputs for a particular project in a particular developing economy context so as to have a subsidy-free analysis of commercial viability or non-viability. This created a whole new hybrid methodology of economic cash flow analysis.

Between March 1992 and December 1995 alone, 84 projects had been analysed in great detail by the newly formed Tied Aid Consultations Group, a sub-group of the Participants to the Arrangement. This work – the accumulation of project by project decisions by the Consultations Group – set the basic boundaries for allocating projects between aid agencies and ECAs. The "*Ex Ante Guidance for Tied Aid*" formalised the interpretation of these consultations conclusions' broad boundaries and was first published in 1996. It was subsequently up-dated in 2003 and 2005.

In all, thousands of projects have been reviewed and 110 projects have been examined in detail by the Tied Aid Consultations Group as of mid-June 2011. However, while hundreds of projects continue to be reviewed annually, only nine projects have been challenged and debated in Consultations Group over the last 10 years as fairly clear lines between project characteristics considered commercially viable and commercially non-viable are now in place. This means that there is general agreement among the Participants that tied aid-financed transactions no longer systematically or significantly distort trade. Nevertheless, the tied aid rules and mechanisms remain in place in the Arrangement to ensure that this major success is preserved.

Untied aid

Untied aid can be trade-related but, unlike tied aid, has no formal (contractual) requirement for the recipient to purchase the goods and services from the donor country – hence the name "untied aid". During the 1980s/early 1990's and beyond, concerns existed among some Participants to the Arrangement that untied aid programmes could be implemented in such a way as to make them *de facto* tied aid. Any manipulation of these programmes to this end would circumvent the tied aid rules and undermine the important gains achieved.

If manipulation were to occur, it would not only circumvent the tied aid rules that demarcated projects into eligible and ineligible categories based on their characteristics, it would effectively roll back the key MCL agreements of the mid/late 1980s, saving the aid donor budget money as trade was distorted. This is because untied aid is allowed to escape the 35% concessionality floor set in the 1980s and, instead, only has to meet the DAC minimum of a 25% grant element requirement. Thus, untied aid not only contains a nominal MCL that is almost 30% below that required for tied aid, the two measurements of concessionality themselves were, and remain,

fundamentally different. The DAC uses a 1960's era formula with a fixed discount rate of 10% to define the present value of an aid loan, while tied aid uses a current market-based discount rate that is often only half as large. Without going into the mathematics of measuring concessionality (the discounted present value of a stream of loan repayments to be deducted from the original loan amount), the DAC approach is normally much more generous to the donor as the higher the discount rate, all else equal, the higher the measured concessionality level. The higher the concessionality measurement of any loan and repayment stream, the lower the necessary real budget resources needed to achieve the given concessionality threshold.

On the other hand, truly untied aid provides an efficiency benefit to the aid recipient compared to tied aid by allowing it to purchase the most cost-effective goods. Academic evaluations of tied aid procurements in the 1980s concluded that tied contracts resulted in prices that could be up to 20-30% above those in which effective bidding procedures were used.

While some Participants and their national exporters believed that untied aid was at least sometimes used as an export promotion tool, others did not support this view and alternatively highlighted the higher aid quality of untied aid. Some wanted untied aid to follow the tied aid rules of the Arrangement and others thought this unnecessary and harmful to domestic aid programmes. Therefore, the Participants, in Solomon-esque fashion, decided rather to undertake a transparency exercise to monitor the *de facto* procurement situation in untied aid programmes. This transparency was initiated in 2004 on a two-year trial basis and renewed regularly ever since, and currently runs through 2012.

The untied transparency agreement requires *ex ante* and unclassified notification of upcoming untied aid offers which may be distributed to national exporters to enhance information about the aid and encourage the broadest participation in the contract bidding. The agreement also sets international competitive bidding as the competitive mechanism where the contract is large enough to make this cost-effective. Following the bidding and contract award, additional transparency is provided about bid-winners and their nationality to be able to assess if contract awards are broadly distributed between donor firms and non-donor firms, the Participants, non-Participants and developing countries, including the recipient, in a way broadly parallel to market-determined outcomes.

That this "trial basis" transparency agreement has been renewed four consecutive times since 2006 demonstrates that its participants are satisfied that transparency appears sufficient for untied aid to be considered part of the level playing field among financing mechanisms that they been built. The Secretariat annually analyses the outcome of this transparency just as it analyses the affects of the tied aid disciplines.

Sustainable lending

The Principles and Guidelines to Promote Sustainable Lending Practices in the Provision of Official Export Credits to Low Income Countries, agreed by the Working Party on Export Credits and Credit Guarantees (ECG) can be seen as a mirror image of the rules described above on tied and untied aid, insofar as they ensure that the provision of non-concessional export credits is not at odds with development objectives. As noted in some earlier articles, excessive competition can have perverse negative effects, and export credit competition for business in the poorest countries is a good example. Therefore, the Participants in close co-ordination with the International Monetary Fund (IMF) and the World Bank (WB) co-operate to ensure that export credits are only provided for exports/projects that contribute to the specific development programmes designed by these institutions to promote growth within a framework of sustainable debt service management. (It is interesting to note that the IMF and the WB have adopted an almost identical methodology to that used by Participants with regard to measuring MCL).

It should be clear that unbridled ECA competition can lead to the unsustainable build up of debt and debt service, leading to defaults and the need for multilateral debt forgiveness. Debt forgiveness, ironically and temporarily, increases the creditworthiness of these poor countries. This provides a window for new ECA credits with the expectation that the earliest creditors will get paid, leaving the later ones holding the bag when the next round of defaults and debt forgiveness occur (a kind of FIFO export/repayment strategy – first credits in, first payments out). Without co-operation among development agencies and ECAs, such competition becomes a vicious cycle, mires the poor country deeper in poverty, and forces taxpayers to perpetually fund losses (defaults and debt forgiveness) for the benefit of these cycles of exporter sales.

Herve Joly of the IMF contributes an article dealing with this problem and ECA co-operation in more detail, as does Nicole Bollen (ex-Chair of the OECD export credit committees) in her article.

Conclusion

The work over the years to discipline tied aid programmes and to create a transparency mechanism for untied aid has served to preserve the level playing field among OECD Participants' ECAs and aid programmes, while avoiding trade distortions, promoting sounder aid policies and building confidence among governments. This work has effectively diffused political and trade frictions in a constructive, collaborative, and technically sound way. Co-operation in promoting sustainable lending in the poorest countries manages potentially destructive competition, promotes development and avoids financial crises. These are more examples of the broad success that has been achieved through co-operation and compromise in constructing a "smart" rules-based export credit system to rationalise competition among competitors and partners while promoting efficient development within a better managed and more efficient global economy.

SUSTAINABLE LENDING AND OECD LEADERSHIP

Hervé Joly

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The financial situation of many low-income countries improved substantially in 2005 to 2006, following the implementation of the Multilateral Debt Relief Initiative (MDRI)[1], which delivered debt relief beyond that provided under the Heavily Indebted Poor Countries (HIPCs) Initiative. Lower debt levels, strengthened macroeconomic fundamentals and improved prospects in low-income countries increased – or renewed – their attractiveness to a broader range of creditors, including export credit agencies (ECAs). At the same time, many low-income countries wished to accelerate borrowing to address their development needs.

The joint IMF/World Bank debt sustainability framework

While this situation was a much welcome development, concerns were expressed at the time that a new borrowing boom could end up hindering development if resources were not well used. In particular, many observers pointed out that while the macroeconomic situation of low-income countries was much better, other economic circumstances remained largely unchanged and budgetary, project, and debt management capacities in these countries still presented weaknesses. It was also recognised that most outlays related to the Millennium Development Goals did not, by nature, generate sufficient cash flow to governments in the near term to service debt on market terms.

In response to this situation, the International Monetary Fund (IMF) and the World Bank (WB) undertook to improve their main instrument to analyse debt vulnerabilities in low-income countries – the Debt Sustainability Framework (DSF). However, it was clear that the effectiveness of the DSF ultimately depended on a broader use by debtors and creditors of the results of debt sustainability analyses conducted with the framework. Such a broader use of debt

sustainability analyses would facilitate communication and co-ordination between creditors and borrowers, and among creditors.

In 2006, the use of the DSF by creditors was expanding but still limited. It was actively used by a few multilateral creditors and donors, but to a much smaller extent by others, in particular ECAs and commercial creditors. The use of the DSF and its results was (and remains) an individual choice for each creditor. The DSF has no institutional or contractual basis and does not seek to bind creditors around a given course of action such as an overall lending envelope for a borrowing country, or the appropriate degree of concessionality or the relative priority of investments; its main objective is to allow creditors and borrowers to make informed decisions about the preferred financing strategy. The ultimate responsibility for such decisions rests with borrowing governments and it is, therefore, most important that governments understand debt sustainability analyses and use them to define their borrowing strategy. Nonetheless, broadening awareness among creditors of the concept of debt sustainability and of the results of IMF/WB assessments in specific countries was seen as a way to facilitate creditor co-ordination through a shared understanding of the impact of individual lending decisions on a debtor's overall debt outlook.

In the course of 2006, IMF and WB staffs intensified outreach on the DSF with traditional official lenders, including ECAs from OECD countries. Many ECAs acknowledged that, although officially supported lending to low-income countries represented a small part of their total portfolio, it could be large in relation to the recipients' budgets. Therefore, increasing non-concessional lending to low-income countries could put debt sustainability at risk. It was recognised that debt sustainability analyses could inform ECAs' country risk analysis and provisioning decisions. Some ECAs were making efforts to develop lending practices that took into account the results of debt sustainability analyses.

In 2007, a small group of ECAs, with the critical support of the Chair of the OECD Working Party on Export Credits and Credit Guarantees (ECG), Nicole Bollen (Netherlands) and the OECD export credit secretariat, set out to design voluntary principles on sustainable lending to low-income countries, which would be consistent with the commitments made by OECD countries as members of the IMF and WB. Principles were approved by all the ECG members in early 2008, and have been implemented since.

The OECD agreement on sustainable lending to low-income countries

The ECG agreement – Principles and Guidelines to Promote Sustainable Lending in the Provision of Official Export Credits to Low-Income Countries – acknowledged that concessional lending generally remained the most appropriate source of external finance for the majority of low-income countries.

The Principles committed OECD ECAs to observing the IMF's and WB's policies on non-concessional external borrowing in low-income countries. Other commitments included taking into account the latest debt sustainability analyses jointly produced by the IMF and WB. And for any large transaction with a repayment term of two years or more, ECAs also agreed to seek assurances from government authorities in the respective low-income country that the transaction would be in line with the country's agreed borrowing and development plans. Finally, the ECG agreement cemented existing arrangements between ECAs, the IMF and the WB regarding the sharing of information on official export credits provided to the countries subject to the Principles and Guidelines.

A notable aspect of the negotiation was the effort made by OECD ECAs to reach out to non-OECD countries that had been invited to participate in a number of meetings.

The IMF and the WB welcomed this OECD agreement as an important contribution to maintaining debt sustainability in low-income countries; the agreement clearly supported their call for all creditors to adhere to sustainable and transparent lending practices. The agreement was also an example of excellent co-operation between the IMF, the WB and the OECD. The design of the Principles, indeed, required frequent interaction between the staffs of these three institutions as well as ECAs. The implementation of the Principles was also facilitated by new procedures to inform ECAs of applicable IMF and WB policies in those low-income countries covered by the Principles.

The Principles remain very topical today, in a world where low-income countries face the challenge of addressing their large infrastructure gaps in a sustainable way.

Note

1. The Multilateral Debt Relief Initiative (MDRI) provides for 100% relief on eligible debt from three multilateral institutions to a group of low-income countries; the initiative is intended to help these countries advance toward the United Nations' Millennium Development Goals, which are focused on halving poverty by 2015.

Part VIII

PREMIUM FEES

1. *Premium: The least understood rules of the Arrangement*

2. *New rules for export credit premium fees*

PREMIUM: THE LEAST UNDERSTOOD RULES OF THE ARRANGEMENT

Michael Gonter

Michael Gonter is a Senior Policy Analyst in the Export Credits Division of the OECD and played a pivotal role in facilitating the two OECD premium agreements, the latest of which comes into force in 2011.

The low-hanging fruits always get picked first – and if one is lucky – somebody else will climb the ladder later to finish the job for you.

By the time I arrived on the OECD export credit scene in 1994, the low-hanging export credit fruit (relatively straightforward albeit politically sensitive disciplines on *e.g.* maximum repayment term, minimum interest rates) had indeed already been "selected, and a group of unlucky "experts" (including myself) were asked to pick up the ladder and come up with rules to address a complicated issue that had eluded all previous rule-making attempts – premium for credit risk. In 1997, we succeeded in reaching agreement on rules for minimum credit risk premium rates (the so-called Knaepen Package) that took the form of country-specific floor rates; these rules were incorporated in the Arrangement on Officially Supported Export Credits. As such, the rules for minimum premium rates (MPRs) did not directly address the component of credit risk attributable to the borrower's creditworthiness (commercial risk), which in many cases accounts for the lion's share of the risk of non-repayment.

Later, in 1999, just as the rules of the Knaepen Package came into force, I joined the OECD's export credit secretariat; in this new capacity I was asked to "hold the ladder" for those brave enough to try and secure what had looked to be completely out of reach at the end of the Knaepen Package negotiations; comprehensive rules addressing the full credit risk spectrum, including commercial risk.

Others have written about this topic and much of what needs to be explained has been explained. Pierre Knaepen (Belgium), the first Chairman of the Premium Experts Group – which was set up by the Participants to the Arrangement – provided a detailed account in the export credit publication "*The Export Credit Arrangement, Achievements and Challenges 1978-1998* (produced in connection with the 25th anniversary

of the Arrangement) of the first round of negotiations that led to the 1997 Knaepen Package. David Drysdale (the third and current Chairman of the Premium Experts Group) writes in this publication on the ensuing negotiations (which started under the Chairmanship of Detlev Malzkuhn of Germany) that eventually led to the 2010 Malzkuhn-Drysdale Package.

In their articles, both Pierre and David have explained the wider context against which the premium rules were developed and the motivations behind establishing such rules, so I do not think that it is necessary to cover this ground again. My intention in writing this article is rather to provide a broader picture of why the rules turned out as they did and their practical impact on those who make use of official export credits – using plain English, but I make no promises here!

What's the big deal about premium and why are rules needed anyway?

A likely response to any "what's the big deal about" question is, of course, money. And when it comes to official export credits, the premium rate charged by an export credit agency (ECA) more often than not is the largest component in the overall price of financing and, consequently, a significant factor in the total cost of an export that is passed on to an overseas buyer. Thus, a high premium rate has the potential to make a transaction economically non-viable, whereas a very low premium rate can transform a losing export contract bid into a winner. Of course in practice, an institution that charges high premium rates may be criticised by its clients but will not be viewed as a problem by its competitors, whereas an institution that charges low rates will be popular with its clients and viewed with suspicion by competitors. So, in the first instance, premium rules are needed to ensure that nobody benefitting from official export credit support (exporters, banks, foreign buyers) is too happy and that the famous "level playing field" of the Arrangement is maintained.

On the other side of the coin from those who benefit from OECD members' official export credit programmes (and whose happiness needs to be managed), there are others whose potential unhappiness is a source of concern; the first being taxpayers who are on the line if red ink appears, and the second being non-OECD governments who are concerned that their exporters could be placed at a disadvantage. Luckily (at least for taxpayers or anybody else who does not like subsidies), such concerns are addressed – at least in part – by item (j) of Annex I (Illustrative List of Export Subsidies) of the WTO Agreement on Subsidies and Countervailing Measures (ASCM), which states that export credits should not be provided "… at premium rates which are inadequate to cover the long term operating costs and losses of the programmes." This means that in addition to the very practical shared desire among OECD members to neutralise the cost of official financing as a factor in export competition, there is an international legal obligation to avoid the obvious subsidisation of official export credits by way of low premiums.

Generally, although the case for establishing disciplines on premium rates charged by ECAs was clear, whether or not it would actually be possible to establish practical rules was not!

Why are the rules so complex?

In the first place, the assessment and pricing of risk is a mixture of art and science which is complex by nature. Anyone who has ever shopped around for insurance knows that premium rates – for insuring what should be the same risk – may differ enormously. In the first place, different people (or companies) are more or less risk averse and some may demand a higher return than others for the risk that they take. Some people are better at assessing risk and may be more comfortable accepting a lower premium for some transactions if they decide to underwrite a risk. Moreover, it's impossible to compare insurance premium rates without taking into account the specific qualities of each (*e.g.* will the health insurance company pay for my broken leg due to a skiing accident or did I miss this exclusion in the fine print of the policy). Hence, the basic nature of assessing and pricing risk is not conducive to the establishment of a simple system.

On top of this, however, in order to bring people to the table, it was necessary to establish some ground rules; first and foremost this meant agreeing that no country would be forced to change its system (although the premium rates generated by each system were certainly open for discussion). This inevitably led to an incredibly complicated system. Direct lenders wanted to charge premium as a margin on the interest rate; insurers wished to charge premium on an up-front basis at the time the policy is issued, and some even insisted that they might like to charge some transactions up-front and others as a margin. This led to the establishment of intricate calculations by which every possible way that premium could be charged could be transformed into an upfront fee for comparison with the minimum rates established. But that's only the beginning. What about risk mitigation? How could we compensate for the quality and percentage of cover provided (*i.e.* the residual risk)? How could we account for the fact that premium charged as a margin may never be collected if there were to be a default (*aka* the dreaded "premium at risk" debate which brought to mind an Escher drawing)?

Other complications arose due to decisions taken by the negotiators. Perhaps the best example of this was the decision – reflecting the classic insurance approach – to express the MPRs on an up-front (instead of on a margin) basis. This added further complexity in the form of *e.g.* currency-differentiated discount rate conventions. Add to this that the system was being built to provide an MPR regime for official export credit business in general meant that there had to be a premium rate for every possible tenor, adjusted to address the factors mentioned above. And lest I forget, it is very difficult to construct a rational and mathematically coherent premium rate structure in terms of tenor when the system is based on up-front rates!

Thus, the combination of a tricky topic (risk assessment and pricing), the ground rules of the negotiations (no changes in ECAs' practices would be required), some decisions taken by the negotiators and the broad scope of business that needed to be addressed, all conspired to create the complex system that was first established when the original premium disciplines of the Knaepen Package came into force in April 1999 – and expanded in 2010 when the Malzkuhn-Drysdale Package was agreed.

The basic characteristics of the premium rules

As it was in the beginning, so it remains that the basic building block of the premium rules is a set of minimum (floor) premium rates; these MPRs are determined by certain characteristics of each credit. The difference between the 1997 and 2010 premium packages is that in the latter the MPRs reflect both country risk as well as commercial risk, with the country risk element of the premium being a function of a common country risk classification (for which there is no room for discretion), while the buyer risk portion is determined by way of a self-selected buyer risk classification (that is subject to considerable discretion). Although the determination of the applicable MPR for a particular transaction is now subject to a significant amount of discretion, as before ECAs remain free to charge rates in excess of the MPRs. The following is how the premium rules now work:

- Holding all other factors constant (*e.g.* tenor, percentage of cover, the type of official export credit product), the lowest possible rate for a transaction is determined by the country risk classification to which it is exposed; in effect this maintains the concept of a hard "floor" that was established under the Knaepen Package[1].

- Starting from the country risk anchor, ECAs are now obliged to assign a buyer risk classification to each transaction according to the buyer risk classification scheme of the Malzkuhn-Drysdale Package. The classification carries with it a premium surcharge (which is zero for sovereigns and the very best buyers in a country) which in combination with the hard floor yields the applicable MPR.

- ECAs are then free to charge a premium rate at or above the applicable MPR.

Of course this is only the basic structure of the system – hence the reference above of "holding all other factors constant" – and it should come as no surprise that the factors which determine the precise applicable MPR for a given transaction are numerous. If you would like to know more about them I invite you to visit any number of ECAs' websites that provide premium calculators that could keep one occupied for hours!

A more important aspect of the premium rules is transparency. Although transparency was an integral part of the Knaepen Package, I think that it is fair to say that it has been elevated to the level of a discipline in connection with the Malzkuhn-Drysdale Package, as a counterbalance to the amount of permitted discretion involved in assessing buyer risk. For instance, prior-notification (a non-proscriptive, but otherwise highly annoying, obligation) is required whenever the risk of a buyer is assessed as equivalent to a sovereign risk, or when the ECA's assessment of an entity is better than its rating by private agencies (such as Moody's or Standard & Poor's).

What next?

As far as we in the export credit secretariat are concerned, we will be attempting to put in place the tools needed to let people know if the system is working appropriately, and to answer the following (non-exhaustive) list of questions:

- Are there wild variations in buyer risk assessment between ECAs for the same buyer?
- Do some ECAs systematically assess buyers more favourably than other ECAs (*i.e.* did some ECAs provide an inordinate number of notifications)?
- Now that MPRs have been established for different buyer risk classifications – which to the outside world might appear to be commonly-agreed rates – have the premium rates charged by ECAs on the whole increased, decreased or remained stable?
- Is the requirement to apply market pricing in the lowest risk markets being respected?

Although the answers to some of these questions may come more quickly than others, time will be needed to see the results of the system. In my opinion, however, the fact that the new premium rules now contain a common risk-language may pave the way towards a less complicated and perhaps more market-oriented system in the future. To this end, we can't rest on our laurels. We have to ensure that the export credit rules on premium do exactly what the negotiators intended: contribute to the elimination or minimisation of subsidies in governments' export financing programmes and maintain a level and transparent playing field so that competition is constructive, not destructive.

Note

1. The possibility of applying a premium rate lower than the floor rates does exist; however, the scope for doing so is extremely limited and the premium could never be more than 10% lower (*e.g.* if the sovereign rate is 3.00%, the lowest possible rate would only be 2.70%).

NEW RULES FOR EXPORT CREDIT PREMIUM FEES

David Drysdale

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There have been many wars which have provided notable opposing factions. There was the Trojan War between the Greeks and Trojans. Later there was the Punic Wars between Rome and Carthage. More recently there was the American Civil War between the North and the South. But none of these conflicts come close to the esoterica of the Premium Wars!

The Knaepen Package – the opening

In 1997, new disciplines on minimum risk premium were integrated into the Arrangement on Officially Supported Export Credits. These disciplines, known as the Knaepen Package (named after the Chairman of the Premium Working Group[1] from 1994 to 2000, the late Pierre Knaepen of Belgium), came into force on 1 April 1999. Implementation followed several years of intensive work by the Participants to the Arrangement and their Working Group of Premia Experts[2] from the time the Participants agreed to a Declaration of Principle and Mandate[3] for the Group's work in September 1994.

The Knaepen Package set minimum fees for country credit risk for all transactions, a major step in promoting a level playing field in the provision of officially supported export credits, prior to which the Arrangement provided no disciplines on risk fees. The lack of rules on premium meant that export credit agencies (ECAs) were free to charge whatever risk fees they wanted for the insurance, guarantees and loans that they offered. This free-for-all premium approach created competitive tensions because some ECAs charged risk-based fees, while others used a flat-based fee system (that is, the same fee level for all borrowers) and some charged no fees at all for the credit risk.

The fundamental building block of the Knaepen Package was a set of minimum premium rates (MPRs) that were intended to reflect

country and sovereign buyer credit risk (*i.e.* the best buyer in the country which, in the vast majority of countries, is the sovereign) but had the effect of creating a floor premium rate for all transactions (sovereign, corporate, project finance) within a given country. In practice, the actual premium rates charged by the Participants for specific transactions are often above the MPRs; for the most part this is because the Knaepen Package left the pricing of any surcharges for non-sovereign buyers to the discretion of each ECA.

In addition, under the Knaepen Package, the Participants created a system for assessing and harmonising country credit risk and classifying countries into seven risk categories. The country risk classification system estimates the country credit risk, *i.e.* the likelihood that a country will service its external debt. The system uses an econometric model based on quantitative indicators (*e.g.* financial, economic and payment experience indicators of the borrowing countries), then it adjusts these based on qualitative factors (such as political factors not included in the quantitative econometric model). The model is used by country risk experts (economists from the OECD member countries' ECAs), who meet regularly to rank 140 plus countries into the seven risk categories. Subsequently, these country classifications became known as the "OECD classifications" and now are recognised under Basel rules as classifications that can be used by banks to calculate reserve requirements for sovereign risks.

The Malzkuhn-Drysdale Package – peace at last?

The latest premium package, agreed in 2010 and known as the Malzkuhn-Drysdale Package, represents many years of negotiations first, under the chairmanship of Detlev Malzkuhn of Germany (from 2000 to 2007) and then, after Detlev's tragic passing in early 2008, under my chairmanship with a new mandate agreed in April 2008.

The latest Package recalibrates the country credit risks rates set by the Knaepen Package, which had remained static since they were implemented in 1999. But, more importantly, the new Package, whose disciplines are related in the main to transparency measures, provides a common framework for the pricing of buyer credit risk. These new disciplines have been designed to strengthen further the level playing field for exporters by addressing the key issue of buyer credit risk that previously was not subject to specific disciplines under the Arrangement. The new disciplines of the Malzkuhn-Drysdale Package will be implemented by its Participants on or before 1 September 2011.

These new disciplines are also important for purposes of protecting official ECAs from programmatic attacks under the WTO's Agreement on Subsidies and Countervailing Measures (ASCM). The ASCM provides that an official (*i.e.* offered by or on behalf of a government) export credit that is dependent on export performance (*i.e.* is tied to national goods being exported) is a prohibited subsidy if the export credit provides a "benefit to the borrower", that is, if the cost

of the financing is lower than that which the buyer could obtain in the commercial market. Under item (j) of Annex I to the ASCM, the Illustrative List of Export Subsidies, the provision of export credit guarantees and insurance "… at premium rates which are inadequate to cover the long-term operating costs and losses of the programmes" is a prohibited export subsidy.

The Participants to the Arrangement negotiated the premium disciplines specifically to comply with item (j) of the ASCM and the country risk MPRs were the first step in that process. With the addition of buyer risk disciplines, the premium fee system is complete in that it provides a framework for the pricing of all risks. While individual export credit transactions could be challenged as providing a benefit to the borrower, and therefore be deemed prohibited subsidies, the existence of a comprehensive risk-based pricing system makes programmatic challenges more difficult.

Finally, the Arrangement is the international benchmark for export credit financing rules as recognised by the ASCM, which incorporates the Arrangement as a "safe harbour" under item (k) of the Illustrative List. For this reason, many non-OECD ECAs have modelled their financing terms on the Arrangement.

Buyer risk framework – all-inners versus add-onners

What is so difficult to agree about a buyer risk framework for export credits, one asks? Why did it take over a decade to do so? Isn't it a simple case of setting up a risk scale, assigning a price to that scale, determining the risk of the buyer, and setting the fee? Of course not! There is the little issue of whether you are an "all-inner" or an "add-onner".

An all-inner believes that each risk rating, such as a Moody's or Standard and Poor's rating, has a quantifiable risk associated with the rating; that risk in turn should result in a price to reflect that risk. So all a risk-based pricing system needs is a list of ratings (*e.g.* AAA through C) and a price to go with each rating; the nature of the buyer is irrelevant and sovereigns, corporate credits and project credits can all be placed on this risk scale. The all-inners were comfortable risk rating each buyer on an absolute risk scale and pricing that risk.

In contrast, an add-onner believes that a buyer risk is relative to the best buyer in its country. A great buyer is the best buyer in the country, with most sovereigns being the best buyers in their respective countries. Other buyers are good, bad or ugly and, therefore, are more risky than the best buyer; so the fees they are charged for official support carry an add-on to the MPR for the country concerned.

Why this difference? It all has to do with how particular ECAs have developed their own credit rating and pricing systems. Many ECAs built their fee systems using an add-on approach of,

for instance, the MPR for the best buyer, the MPR plus 10% for commercial banks or public borrowers, the MPR plus 25% for a non-bank corporate, etc. Once the system was built they did not want to reinvent the process. This allowed those ECAs to treat private borrows in various risk categories so that there was no need to rate the individual buyer on a particular scale. This system also represented a portfolio approach to risk.

It is important to note that there is limited commonality of buyers supported by ECAs collectively. ECAs support thousands of medium and small buyers. Thus, it is unrealistic to have a buyer-risk expert group to rate all buyers – as opposed to rating all countries of which there are fewer than 150 countries to be rated.

The resolution

So how to resolve this diversity of approach in setting common rules for buyer risk? Simple, make sausage! The Malzkuhn-Drysdale package represents a compromise framework that allows each ECA to continue its approach to underwriting and risk pricing. It also provides a framework against which each ECA must report its pricing. The goal is that collectively, ECA pricing will converge on the agreed framework for those borrowers common to multiple ECAs. Annual reporting of all transactions and their pricing will facilitate comparison of actual practice and reveal major differences. The competitive concern will focus on whether different ECAs providing support to the same non-sovereign buyers price their support differently.

Time will tell whether the sausage tastes good. Even if it is not quite perfect, the Participants are a very active negotiating group, with refinements on agreements being standard practice following a period of implementation to gain experience and data. Shared experiences are very useful in bridging differences in approach. Maybe one day, after the differences between all-in and add-on camps have faded into memory, we might even be in a position to replace the sausage with something that is less complicated and more appealing to a refined palate!

Notes

1. The Working Group of Experts on Premium and Related Conditions, a subgroup of the Participants to the Arrangement, comprised of technical experts from all the Participants to the Arrangement, including EU Member States.
2. Also known as the Premium Experts. Long debates raged on whether the plural of premium should be premiums or premia. The OECD Style Guide switched from premia to premiums in 1999, so the technical group's name was changed to the Premium Experts to avoid the taboo term.
3. This mandate created the Premium Experts Group and tasked them with developing a set of guiding principles for premium such that the premium charged should converge, should not be inadequate to cover long-term operating costs and losses and should be risk based.

Part IX

CONCLUSION

1. *Future challenges*

FUTURE CHALLENGES

Steve Tvardek

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I hope that the authors and articles herein have provided the reader with a perspective on (1) how official export credits work is done at the OECD, (2) how, what initially would appear to be, a small niche in the complex matrix of international competitive balance is, nevertheless, extremely sensitive and technically complex, (3) how this work continues to evolve and (4) how much energy and talent have been and continue to be devoted to the development of "smart" export credit rules. Many of the articles preview future challenges within the specialised areas of export credit work. It is clear that the work programme going forward will be no less challenging than that which built the system in use today, particularly because the issues are more good governance and less financially oriented and, therefore, less purely technical and more politically sensitive.

Going forward there are three distinct sets of challenges that need to be met. The first is to preserve the gains made to date within the existing boundaries of the disciplines. The second is to ensure that these boundaries evolve to meet changes in financial markets, buyers' financing needs, and government policy objectives. The third is to widen the scope of multilateral co-operation by including the major emerging-market governments in the work of building and operating the multilateral export credit rules system.

Preserving the gains

There are serious challenges to preserve the gains to date within the existing scope of the export credit disciplines. Changes in financial markets, diversification of supply chains and the emergence of new sources of official export financing raise a new set of challenges. There is a very real danger that governments, through their export credit agencies (ECAs) will continue to adhere narrowly to the existing rules

but nevertheless apply them in ways that ultimately undermine the fundamental objectives of these rules. What does this mean, and how could this happen?

Currently, the Participants to the Arrangement have a clear obligation for their export financing to conform to the rules of the Arrangement, including any financing packages built from diverse national export financing vehicles. However, they currently have only a good faith obligation not to support a multinational financing package that would collectively undercut the rules through participation by a non-Participant offering non-conforming financing. Practically speaking, global supply chains now reach deeply into major emerging markets and increasingly provide the opportunity for a Participant to offer financing for its particular export in parallel with that of a non-member. Such combined financing (*e.g.* for a large project or jointly produced aircraft) could directly compete with exports and financing from another Participant, or group of Participants, for the same project/sale. It is, therefore, important that the Arrangement is broadened to include a formal obligation to prohibit its Participants from participating in co- or joint- or parallel financing with any non-compliant offer. Such an action will create strong incentives for all to ensure that such offers conform to the Arrangement's rules rather than to pressure other Participants to offer non-conforming terms themselves.

In the same good faith vein, there is a need to ensure that any officially supported domestic import substitution programmes do not undercut the rules of the Arrangement and become a *de facto* protectionist mechanism. This threat is most clearly seen in the context of possible ECA-financing into markets in direct competition with domestic industries where the national ECA is prohibited from offering competitive financing and where the national manufacturer is disadvantaged by the Arrangement-consistent offer of the foreign ECA. Any domestic financing programme or domestic ECA-matching offers need to be constrained so as not to undercut the terms and conditions of an Arrangement-compliant offer.

Another challenge in this regard is previewed by the new Aircraft Sector Understanding (ASU); that is the challenge to improve further the market orientation of the Arrangement's disciplines. This means that floating rate official financing mechanisms that already exist need to be recognised and regulated. Also, premium – both in terms of the minimum rates applicable by country and, more importantly, the actual all-in rates applied by ECAs under the new Malzkuhn-Drysdale disciplines – must be reviewed regularly and more systematically linked to market data where such reliable data exists.

Finally in this category, we need to make sure that programmes that finance national exports, either *de facto* or *de jure* are not used as a competitive tool for commercial advantage, whether or not they are provided by the official ECA. The main disadvantage of strong and effective rules is that over time competitive pressures can develop to create new programmes that are

technically outside the rules, or existing programmes outside the rules can develop mechanisms that *de facto* finance national exports. Such programmes could take the form of investment financing vehicles that actively finance exports along with investment, or financing that is not *de facto* linked to national exports but could be implemented to this end. Other possible vehicles are export financing programmes that claim to be pure market financing vehicles but could be operated to undercut the market and the Arrangement for competitive advantage. All these mechanisms need to be monitored so as to preserve the relevance and effectiveness of the Arrangement.

To assist with this self-examination, later this year, the Secretariat will compile an inventory of all OECD members' credit programmes that could be used to finance exports; the Participants to the Arrangement will then be invited to discuss the inventory and decide if the scope of the Arrangement needs to be expanded to capture those programmes which are currently outside the rules but which should be inside; or if such programmes merely need to be transparent and monitored.

Ensuring the boundaries evolve

The second major category of challenges is quite comprehensively addressed in the various articles in which authors describe work in fields such as premium, aircraft, environment and sustainable lending. Current working methods of meeting in plenary session three times a year, and more often if necessary, and the process of being constantly open to discuss, analyse and agree new disciplines as needed, should insure that the disciplines remain up-to-date with market developments and shared policy objectives.

Widening the scope of multilateral co-operation

However, the third category of issues is overarching and does not deepen or expand the scope of export credit disciplines. However, it may be the most fundamental challenge of all if we are to preserve our high level of multilateral co-operation in neutralising financing as a competitive tool, complementing, not crowding out, the private markets and maintaining the level playing field that has been carefully built over the years.

This biggest single challenge facing the current system of export credit disciplines is that posed by the growth and development of emerging market economies (principally Brazil, China, India and South Africa) with major export sectors, and governments that do not currently join in applying the export credit disciplines – mainly for historical reasons. The export credit rules were developed by OECD member governments only because they were the world's earliest primary exporters of the capital goods that were economically and financially suitable for medium- and long-term financing. It was these governments who first had to ensure that export

credits supported efficient competition and did not, instead, become a tool merely to export unemployment along with capital goods.

These rules, *i.e.* the Arrangement on Officially Supported Export Credits, albeit "soft law", are highly serious commitments made at Ministers' level and have in turn been embraced by the WTO Agreement on Subsidies and Countervailing Measures (under Items (j) and (k) of the Illustrative List). Such WTO treatment requires that these rules are transparent and unbiased and can be used equally by all governments; the Participants to the Arrangement have been careful to ensure that the latter meets these requirements. Therefore, so long as the disciplines of the OECD-housed Arrangement are followed, regardless of the government providing the financing, such financing meets the WTO anti-subsidy test and is deemed not to be a prohibited subsidy.

So our priority challenge is how to address promptly the situation of the asymmetry of commitments with respect to multilateral export credit disciplines; this challenge offers diametrically opposing options, but hopefully with only one clear choice for the benefit of the Participants and non-Participants alike. This is the option whereby non-Participants actively join the Participants in operating and managing the export credit disciplines of the Arrangement and fully participate in the design and evolution of these disciplines over time as full and equal partners, *i.e.* as a full Participant. This is the option in which multilateral co-operation in an efficient and orderly system for national export competition is preserved and destructive financing competition is avoided.

A discussion on why this is the only tenable option is best illustrated by applying crude logic to the alternative option, characterised by conflict rather than co-operation. This outcome begins either with a decision by the Participants not to offer the major emerging market governments full partnership and ownership of the export credit rules, and/or the emerging market governments deciding not accept such an invitation to finance their exports in conformity with agreed disciplines. Should this financing undercut the Arrangement's disciplines, the OECD participating parties would be disadvantaged and effectively face two choices: (1) undercutting their own rules while matching non-member financing, and/or (2) litigating in the WTO. In fact, the only rational choice would be both to match and to litigate. This would eliminate any competitive benefit that a more generous financing offer would receive from undercutting rules, while litigating to incentivise compliance/co-operation on common rules. Also, matching would most likely be done in close co-ordination and consultation with other Participants to the Arrangement to ensure that it is used collectively to encourage non-member co-operation within rules and not merely to chase export business unilaterally with more generous terms. A third possible choice, that of the Arrangement's Participants protecting the rules at the cost of exports, jobs and growth, is essentially slow economic suicide and not a real option.

A lack of mutual co-operation between Participants and major emerging-market governments would, therefore, introduce – at least temporarily – a cycle of WTO litigation and destructive financial competition that would seriously undermine efficient and fair export competition. Subsidised financing would become the norm, budgets would be strained and political friction and protectionist pressures would build.

Historically, policy makers faced with this very same decision have recognised that not co-operating and instead competing for exports with financing subsidies is a massive negative-sum game that is costly for all and beneficial for no one. That co-operation, rather than matching and litigation, is the better course is not merely a theoretical proposition. The history of Brazil/Canada WTO litigation is recounted by a couple of authors and documented in thousands of pages of WTO litigation reports. The outcome of WTO litigation is the official sanctioning of trade restrictions being levelled against the offending party – an outcome directly contrary to the fundamental objective of open markets promoted by co-operative competition, and which have been the fuel for economic growth in the post-World War II period. In the end, litigation resulted in both parties deciding, instead, to eschew litigation and to join the OECD-housed Aircraft Sector Understanding (ASU) in 2007, and subsequently to maintain full Participant status in the 2011 ASU revision. It should be noted that Brazil, not an OECD member, and without taking on any unrelated obligations, was welcomed as a full ASU negotiator and Participant in the design and implementation of these two aircraft agreements.

Of course, the Participants to the Arrangement have a symmetric challenge with regard to their non-member counterparts: they need to make mutual interest and co-operation an attractive option for emerging-market governments. Therefore, the Participants need to ensure that there are no artificial barriers, not merely to close co-operation on export credits with emerging market governments but also to full membership in the export credit rule-making bodies. Those governments that have major programmes which are *de facto* governed by the export credit rules (*via* WTO recognition of the Arrangement), properly, should have a say in their implementation and evolution. And when faced with specific interest, the Participants have already shown such flexibility in the ASU context. The Brazil model is one to be replicated to expand further multilateral co-operation, continue to neutralise government financing as a competitive tool, respect market based pricing and maintain a level and transparent playing field for an efficient and open trading system.

Brazil's participation in the ASU was a welcome experience all around. Brazil's article describing its highly positive experience in these negotiations should allay any fears by other non-members that they might not be treated fairly as full negotiating partners should they choose to join formally the export credits work. This would be true whether or not this work was in select sectors such as commercial aircraft or the overall Arrangement.

As part of the effort to maintain a level, transparent, and market-based playing field, a tremendous amount of work, energy and compromise has essentially resolved, among Arrangement's Participants, the competitive issues with respect to aid programmes – both tied and untied – as I describe in my article. This work has not merely reduced trade distortions, it has substantially strengthened the developmental quality of aid while maximising the total financing available to promote development. However, as already mentioned, there remains a serious incongruity in the measurement and discipline of aid financing between the Development Assistance Committee (DAC) on the one hand, and the Participants and the IMF/World Bank on the other. The current formula in the DAC allows financing with much lower levels of real concessionality to be called "aid" than is allowed by the Arrangement or required by the IMF/World Bank. In doing so, the DAC actually provides governments who choose not to respect the tied aid disciplines or provide untied aid transparency the opportunity to argue that marginally subsidised capital goods exports represent "aid" and therefore cannot be challenged in the WTO. This incongruity actually creates a powerful commercial disincentive for the governments of emerging economies to co-operate with OECD-supported aid financing disciplines, while undermining WTO anti-subsidy disciplines. Therefore, modernising the DAC measurement system for "aid" to that used by the Participants and the IMF/World Bank is, in my view, an urgent priority to incentivise this co-operation and improve development quality.

The final message is that much work, ingenuity, goodwill and co-operation are required to ensure that the gains achieved to date are preserved and enhanced. Human nature, competitive economic pressures and evolving financial markets being what they are, export credit work must necessarily remain a priority for governments and policy makers. "Smart" rules need to evolve and adapt to changing circumstances so as to remain "smart".

ORGANISATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT

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Smart Rules for Fair Trade

50 YEARS OF EXPORT CREDITS

On the 50th anniversary of the OECD, we examine the organisation's unique work in regulating and rationalising governments' use of export credits in support of exports, jobs, economic growth, national interests, multilateral co-operation and sound economic policies. OECD export credits work is one of the basic building blocks of the ever growing structure of global trade agreements that aim to maintain open and efficient markets. The objective is to eliminate subsidies and unfair practices in the economic competition that forms the foundation of a healthy and dynamic global economy.

The elimination of official financing subsidies in international trade is a vital part of the broader trade policy agenda, since financing is the life blood of trade flows. Delegated to the OECD by the WTO, the OECD-housed work allows trade to flow efficiently for aircraft and other capital goods while other trade policy work and litigation continue at the WTO.

The export credits work at the OECD is described in this collection of essays. It is however about much more than the series of agreements described herein. It is more fundamentally about the governments and their people – policy makers and experts – who gather at the OECD to collectively build a system of export credits disciplines that is fair, transparent, adaptable and effective. The export credit secretariat pictured below represents only the latest in a long line of OECD staff committed to facilitate and advise this work.

The OECD's motto on its 50th anniversary – "Better Policies for Better Lives" – reminds us that, in the end, policies are at the centre of human well-being. Export credits work is about promoting these better policies by developing "smart rules" that open markets and maintain a level playing field and by bringing people and governments together to this end.

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