FUTURE CHALLENGES

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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.

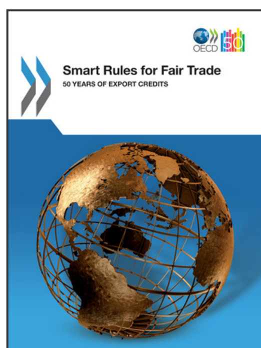
Historically, policy makers faced with this very same decision have recognised that not co-operating and instead competing for exports with financing subsidies is a massive negative-sum game that is costly for all and beneficial for no one. That co-operation, rather than matching and litigation, is the 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".



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