U.S. TREASURY DEPARTMENT OFFICE OF PUBLIC AFFAIRS

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STATEMENT OF ASSISTANT SECRETARY FOR INTERNATIONAL AFFAIRS CLAY LOWERY BEFORE THE SENATE COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS ON REAUTHORIZATION OF THE EX-IM BANK

Chairman Shelby, Ranking Member Sarbanes, and members of the committee, thank you for the opportunity to discuss the reauthorization of the Export-Import Bank of the United States (Ex-Im Bank). I am pleased to be here with Acting Ex-Im Bank Chairman James Lambright because we are in total agreement on the importance of a strong Ex-Im Bank.

This Administration believes that, given a level playing field, U.S. exporters can compete with anyone in the world. As the lead U.S. Government agency on international economic and financial policy, Treasury leads the U.S. delegation to the OECD export credit negotiations, which are intended to establish that level playing field. Working closely with Ex-Im Bank and other U.S. Government financing agencies, we have successfully developed multilateral rules to reduce or eliminate the use of foreign export financing subsidies. These rules help to protect all U.S. exporters by ensuring that the competition for export sales is driven by price, quality, and service -- and not by unfair government financing. Equally important, these OECD rules protect U.S. taxpayers from having to pay for a subsidy program that would be necessary to counter foreign subsidy programs in the absence of these rules.

<u>Export Financing and the Role of the OECD Arrangement</u>

The OECD members that negotiate these multilateral financing rules are referred to as the Participants to the Arrangement for Officially Supported Export Credits (the Participants; the Arrangement). The Participants are those governments which provide the vast bulk of export financing for capital goods to developing countries. The Arrangement rules are critical to ensuring that the export financing provided by governments promotes market principles, a level playing field, and transparency. As these rules apply to all sources of official export financing, policy agencies such as finance and economics ministries represent their governments among the Participants. In addition to Treasury and Ex-Im Bank, the U.S. delegation includes the Departments of Commerce and State, USTR, USAID, the Trade and Development Agency, and any other agency whose programs or policy role might be affected by negotiations.

Export subsidies are bad economic policy and very costly to taxpayers. They close markets to competition and reduce global economic growth. By distorting trade flows, subsidies also distort the global allocation of resources and reduce international economic efficiency. Exporters who become dependent on tied aid subsidies become less efficient and unable to compete on market terms.

Moreover, using subsidies for export promotion is ultimately self-defeating because when one nation uses subsidy programs to gain a competitive advantage, others naturally follow suit to protect their interests. This inevitably leads to an export subsidy race which harms the international economic system and severely undermines or reverses the gains from trade. This is why successive Administrations have worked in the OECD to negotiate a trade finance environment driven by market forces in which all U.S. exporters can compete.

The Arrangement complements the WTO anti-subsidy rules. The WTO does not restrict the use of aid subsidies -- tied or untied -- because resource transfers from rich to poor countries are important for the latter's development. The U.S. uses the Arrangement to ensure that aid-financed subsidies are really development aid and not export promotion in disguise.

Aid, tied or untied, is normally in the form of official development assistance (ODA) offered by a donor's development ministry and can be in the form of grants or credits. However, tied aid also is a form of export subsidy in which financing is formally linked to the purchase of goods and services from donor-country firms.

The U.S. offers tied aid through USAID, as part of the "Buy America" mandate. However, U.S. tied aid is usually in the form of grants which, dollar-for-dollar, distort trade far less than credits and provide greater assistance to developing country recipients.

Many other OECD donors use tied and untied aid credits in order to leverage more exports while reducing the budgetary cost of aid and thereby increase domestic political support for their aid programs. Before the Arrangement, competitive economic and political pressures resulted in many foreign tied aid credits being de facto export promotion. Since tied aid credit terms are more favorable to the borrower than standard export credit terms, tied aid distorts trade flows in favor of the tied aid provider's firm when the two forms of financing compete.

Under the rules, tied aid is now focused on the poorer countries – those with per capita incomes below $3,255 annually. Wealthier countries like Mexico, Korea and Malaysia are no longer eligible for tied aid. Tied aid is now virtually non-existent in major projects for power (thermal and hydro), oil and gas pipelines, telecommunications, air traffic control equipment, industry and manufacturing. This has enabled U.S. exporters to compete for contracts in these commercial sectors without the concern of confronting tied aid. Instead, tied aid now is used primarily for what are generally regarded as bona fide development projects in sectors such as health, education, water, sanitation, and roads.

<u>Recent Negotiating Successes</u>

During Ex-Im Bank's 2002 reauthorization, Treasury reported on the success of disciplining tied aid use and the remaining challenges associated with two other foreign financing practices that distort trade and threaten the level playing field that we seek – untied aid and market windows. Since that testimony, Treasury has continued its work to address these issues in the OECD. (Efforts were highlighted in two reports to Congress in June 2004.) I am pleased to report that significant progress has been made on all fronts, and, as Ex-Im Bank's latest Competitiveness Report shows, neither untied aid nor market windows pose the same challenge that they did in 2002.

Untied aid is aid that may not be formally linked to donor country procurement. Untied aid typically is used for non-commercial projects with a development impact. However, without formal OECD rules on what procedures, practices, and procurement results constitute untied aid for the purposes of exempting it from the tied aid disciplines, donor governments can use untied aid to circumvent the tied aid rules agreed to by the OECD members in 1992 and distort trade in favor of the donor. Examples include requiring aid recipients to use donor-country firms for design and engineering work or requiring a donor-country firm to run the bidding process, thereby creating a de facto bias toward the firms of that country.

Over the last few years, Treasury negotiated an agreement in the OECD that members would stop offering *tied* aid for design and engineering studies for projects that will then be financed with *untied* aid. We firmly believe that this practice provided an unfair technical advantage to donor country firms when bidding for untied aid projects.

In addition, in January 2005, following intensive bilateral discussions with the EC and Japan (the two largest untied aid donors) and a Treasury-led initiative in the G-7, a ground-breaking OECD agreement was reached. This agreement requires that untied aid donors notify the OECD of projects and bidding information 30 days in advance of the start of the bidding process. We believe that this will provide valuable information to U.S. exporters to help them compete effectively for untied aid projects that have averaged $8 billion a year since 1993 and are currently rising. Moreover, donor governments agreed to maintain a minimum bidding period of 45 days to further facilitate participation by U.S. and other exporters. The U.S. makes this project and bidding information available on the Commerce Department's website at web.ita.doc.gov/sif/untied.nsf/.

Furthermore, to ensure that donor governments treat foreign bidders fairly, donors will report the outcome of untied aid bids to the OECD on an annual basis. We will review carefully the results of the transparency agreement later this year to confirm whether U.S. exporters are winning a fair share of these projects. If not, and this new transparency shows that untied aid continues to distort trade, the data will provide a credible foundation for the U.S. to request OECD negotiations for comprehensive rules for untied aid.

We also have seen some progress on disciplining market windows since the Ex-Im 2002 reauthorization. Market windows are quasi-official institutions that support national exports, but because they purport to operate as private sector actors, they are not subject to any transparency or discipline concerning the terms and conditions of their financing. Market windows have the ability to offer financing on better terms than either the private markets or export credit agencies. The two largest market windows are KfW of Germany and EDC of Canada.

Following extensive but inconclusive OECD and bilateral discussions on the issue, EDC seems to be voluntarily shifting its activities toward non-export credit support. KfW has been subjected to an EC-mandated separation of its official and commercial business. We expect this action to result in far greater transparency and market-like discipline on its export financing function. While the potential certainly remains that either institution could offer terms that undercut the OECD rules and the private market, current trends show that significant progress is being made. Nevertheless, Treasury and Ex-Im Bank will continue to monitor the situation closely.

Finally, our success in disciplining tied aid continues since our last testimony. The benefits to the U.S. of negotiating and implementing international rules on the use of tied aid continue to be dramatic. Prior to 1992 -- before the OECD tied aid rules came into effect -- donors offered $10-$12 billion of tied aid annually and the resulting U.S. export losses were estimated to be $2 billion or more per year. Since 1992, tied aid credits have averaged only $4 billion annually – a minimum reduction of 60 percent – and therefore have been cumulatively reduced by about $80 billion.

Treasury estimates that U.S. exports of capital goods are higher by at least $1 billion a year as the result of tied aid rules that reduce trade distortions. Furthermore if the U.S. had competed for these additional exports by using tied aid, the War Chest would have required roughly $300 million annually in additional appropriations – a cumulative savings of $4 billion for U.S. taxpayers since 1993.

<u>The War Chest</u>

Continued success in the OECD rules based approach to tied aid as well as untied aid and market windows is dependent in large part on Treasury's ability to use the War Chest as a policy tool. Removing that role would undermine U.S. credibility and deter cooperation from our OECD partners. More importantly, this would seriously weaken the U.S. position in any effort to negotiate new rules, such as those for untied aid, and to enforce the existing rules. A weakened U.S. position in the export financing disciplines arena will almost certainly raise the cost to the U.S. taxpayer of protecting U.S. exporters against unfair foreign subsidies.

Congress created the tied aid War Chest in 1986 in order to provide the Administration with leverage to negotiate economically and developmentally sound tied aid rules in the OECD. The War Chest was also intended as a means to enforce these rules and leverage additional market-opening negotiations, as necessary. As a result of Treasury-led negotiations, the comprehensive set of tied aid rules outlined earlier took effect in 1992, providing a better balance between the development and commercial objectives of the OECD donor governments.

The selective use of War Chest funds to enforce tied aid rules has worked exceedingly well in reducing trade distortions and leveling the playing field for U.S. exporters *at virtually no cost to the U.S. taxpayer*. As a result of this success, foreign tied aid programs have been pushed out of most areas of commercial competition, and the demand by U.S. exporters for tied aid matching has declined dramatically. Despite this decline in demand, the War Chest remains an important tool in the U.S. policy arsenal. Treasury uses the War Chest as leverage not only to enforce existing rules on tied aid and other trade-distorting activities but also to negotiate new rules as needed -- as may be the case for untied aid.

While we refer to tied aid "rules," *they are not legally binding*. They are *voluntary*, as are all the export credit rules under the Arrangement. Other donors have voluntarily addressed U.S. concerns and agreed to stop or limit their financing for the types of capital projects that the U.S. has argued should be ineligible for tied aid credits. The tied aid projects that our OECD partners are now financing are specifically permitted under the rules and are less distorting to trade.

Given the voluntary nature of the Arrangement, the U.S. must be careful how it decides to implement its matching policy. An insufficiently judicious policy on use of our tied aid would give our OECD partners an incentive to abandon the Arrangement and expand the scope of their tied aid programs to include larger, more commercial projects. This would create a vicious cycle of increasing tied aid from all parties and generating a larger demand for the War Chest. The gains that the successive Administrations have worked to achieve over the last fifteen years would quickly unwind.

This is not to suggest that the U.S. should never match any tied aid offers. Some tied aid projects pass the OECD eligibility test but can still create longer-term advantages for foreign exporters by setting technical standards, providing brand name recognition, allowing maintenance and repair capabilities to become established, etc. Any of these elements can tilt the playing field for future commercial sales. War Chest matching is a vital tool to ensure that tied aid is not used, intentionally or unintentionally, to tilt longer-term competitive conditions against U.S. exporters. Treasury fully supports using the War Chest in such instances.

In addition, the tied aid rules have two systemic shortcomings. The first relates to small projects below $3 million and the second relates to projects in the railway and mass transit sectors. Small projects are exempt from the tied aid rules in order to minimize the administrative burden of the rules. However, some OECD members used this exemption aggressively to finance small commercial projects in violation of the spirit of the rules. In response to this, Treasury has been clear that it automatically supports using the War Chest to match small commercial projects.

Passenger railway and mass transit projects also meet the eligibility rules because they are highly capital intensive, meaning their costs are normally not recouped from their own earnings over the term of an export credit agency (ECA) loan. In addition, their revenues are limited because they are often unable to charge the full economic value of their services. Therefore, Treasury has been clear that such projects are frequently good candidates for War Chest matching, and just such a matching offer was approved earlier this year.

In conclusion, this policy-based approach to matching foreign tied aid offers allows us to protect U.S. exporters from unfair use of tied aid, while recognizing the legitimate development objectives of foreign aid programs. It is in the interest of U.S. exporters and taxpayers that the War Chest remain a tool to leverage the broader, rules-based approach. The current Treasury/Ex-Im Bank tied aid principles and procedures were put in place in close cooperation with Congress in 2002, are working well, and have not produced a single disagreement between the two agencies.

I appreciate the opportunity to appear before you today and look forward to your questions. Thank you.

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