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BRIEF



## Under the Radar: Regulating EU Official Export Credit Support<sup>1</sup>

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The international market for official export credit support for domestic exporting companies is aggressive and unruly. The rise of new ECA players and market innovations challenge the existing framework for promoting a level playing field for official export credit support. For there are now more than 113 national Export Credit Agencies (ECAs), delivering approximately US\$215 billion in total trade-related medium to long term (MLT) official export support in loans, guarantees and insurance to domestic firms' exports of goods, services and investments.<sup>2</sup> In the context of intense competition for export markets and tariff wars, governments have a collective interest in revamping the rules to prevent an export credit subsidy war and race to the bottom in terms and conditions.

Traditionally, an ECA acted as a lender of last resort, operating only in cases of market failure causing a lack of commercial appetite in the private financial sector. As commercial financial markets became more robust in 1980s, the role and significance of ECAs declined. However, when the 2008 financial crisis erupted, ECAs supplied the necessary liquidity to support the international trading system as commercial banks retreated as the main suppliers of export finance.<sup>3</sup> Official export credit agencies were critical 'shock absorbers', supporting the survival of the international trading system.

1. The project leading to this article received funding from the European Union's Horizon 2020 research and innovation program under grant agreement No 770680 (RESPECT). The article is based on a RESPECT working paper available at: <http://respect.eui.eu/publications/>
2. Report to the U.S. Congress on Global Export Credit Competition. 2019. EXIM Bank. p24.
3. Chauffour, JP, Saborowski, C. *Export credit agencies to the rescue of trade finance*. VoxEU. 23 January 2010.



ECAs have since remained as critical cogs in industrial strategies to secure new export opportunities in an environment of global export stagnation. But rather than observing previously accepted principles for export support, ECAs have become increasingly weaponised.<sup>4</sup> These market shifts have unsettled the carefully balanced legal framework that had previously controlled most official export credit support, most of the time. If competition among exporters is based on the most favourable officially supported financial terms and conditions rather than on the price or quality of the goods themselves, it can result in an export credit race to the bottom with significant budgetary and societal implications.

## The Rules

In seeking to avoid a subsidy war and promote the orderly use of export credit support, governments have established two main legal instruments:

1. A 'club' level Arrangement on MLT Officially Supported Export Credits ('the Arrangement'). This is a non-binding 'gentlemen's agreement' negotiated within the OECD, with 9 participants, including the EU representing its Member States. The Arrangement sets the export credit terms and conditions that may be supported by its Participants, including minimum interest rates, risk fees and maximum repayment terms. It also encompasses several 'Common Approaches'<sup>5</sup> requiring ECAs to address anti-bribery, environmental, social and human rights (ESHR) impacts, and sustainable lending to heavily indebted poor countries.
2. A set of multilateral, binding rules contained in the WTO's Agreement on Subsidies and Countervailing Measures (SCM). These are mandatory for signatory countries. The SCM prohibits subsidies that are contingent in law or fact, upon export performance, such as export credit support. The SCM interacts with the OECD Arrangement through providing a safe harbour for those export credits that respect the terms and conditions set out by the OECD Arrangement.

4. Report to the U.S. Congress on Global Export Credit Competition. 2018. EXIM Bank. p24-37.

5. The OECD Revised Council Recommendation on Common Approaches on the Environment and Officially Supported Export Credits. 2019. <https://legalinstruments.oecd.org/public/doc/280/280.en.pdf>

This once-dynamic and interconnected legal framework is now under pressure. The OECD Arrangement's influence over export credit agencies is shrinking in relative terms, both in membership and in scope, just at a time when governments are increasingly seeking to spur domestic growth through exports. ECAs are now largely governed by the WTO SCM - if a Member challenges another Member's ECA instrument. This shift in regulatory balance has both competition and compliance implications.

## Competition Concerns

Under the OECD Arrangement, Participants compete in the market by using the flexibilities permitted under the Arrangement, such as in domestic content requirements and risk appetite.<sup>6</sup> Participant ECAs are lowering the minimum domestic content an export contract must contain and shifting towards riskier markets.<sup>7</sup> Many OECD Participant ECAs are taking a 'whole of government' approach by expanding export support programmes outside of the scope of the OECD Arrangement rules, including investment insurance and market window arrangements. The flexibility of untied financing allows buyers to mitigate some of the financial conditions and due diligence burdens.

Figure 1 indicates that OECD Arrangement covered MLT activity drop 6% to 54% of total activity, with a commensurate gain in non-arrangement covered export support, including through Development Finance Institutions (DFI) between 2013 and 2017.<sup>8</sup>

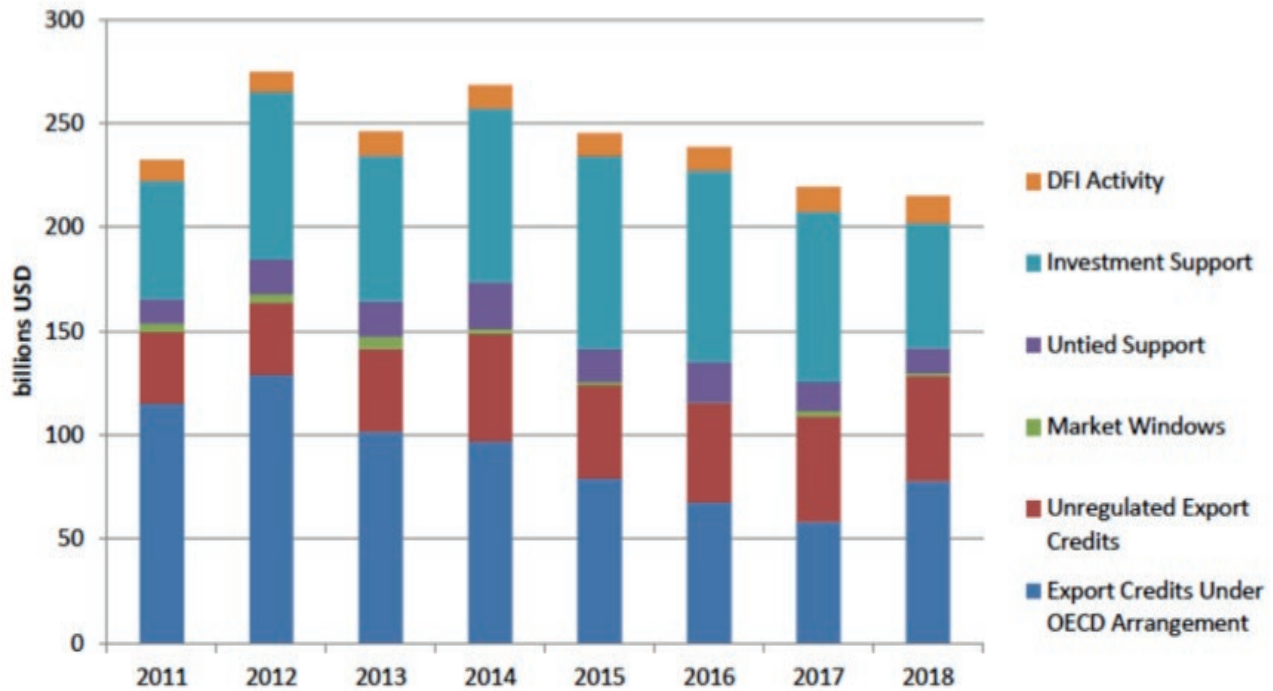
6. Dawar, K. *Happy centennial birthday UKEF: fit for the future?* Discussion Paper. UKTPO, Sussex. 2019.

7. For example, in 2012, 48 percent of transactions reported to the OECD occurred in markets with a credit rating agency (CRA)-equivalent rating of 'B+' or lower. By 2017, that number had increased to 65 percent, led by Italy, Germany, and Austria Report to the U.S. Congress on Global Export Credit Competition. 2018. EXIM Bank. p35.

8. This trend slightly reversed in 2018. Report to the U.S. Congress on Global Export Credit Competition. 2019. EXIM Bank. p24.



**Figure 1. Total of official export and trade related MLT Activity (OECD and non-OECD)**



Meanwhile, China’s power transition has been accompanied by a rise in its trade-related ECA activity,<sup>9</sup> see Figure 2. Moreover, the US-China trade war has caused China’s official export credit financing to increase further.<sup>10</sup> Sinosure has reportedly relaxed its financing standards and local governments are paying insurance premiums to support Chinese exporters.<sup>11</sup>

In 2018, Sinosure’s insurance activities increased 16.7% to \$612 billion and currently include chasing down U.S. importers unwilling or unable to pay mounting tariffs. In 2019 its claims payouts surged over 40% to nearly \$2 billion (Figure 3).<sup>12</sup>

9. Hopewell, K. *Power transitions and global trade governance: The impact of a rising China on the export credit regime*. Regulation and Governance. 2019. John Wiley & Sons Australia, Ltd.

10. <https://www.scmp.com/news/article/2165169/chinas-exim-bank-boost-lending-effort-support-exporters-hit-hard-trade-war> (accessed 19/01/2020)

11. <https://www.reuters.com/article/us-usa-trade-china-insurers/as-trade-war-deepens-a-state-owned-insurer-in-china-helps-soften-the-blow-idUSKCN1VX0L3> (accessed 19/01/2020)

12. <https://www.reuters.com/article/us-usa-trade-china-insurers/as-trade-war-deepens-a-state-owned-insurer-in-china-helps-soften-the-blow-idUSKCN1VX0L3> (accessed 19/01/2020)

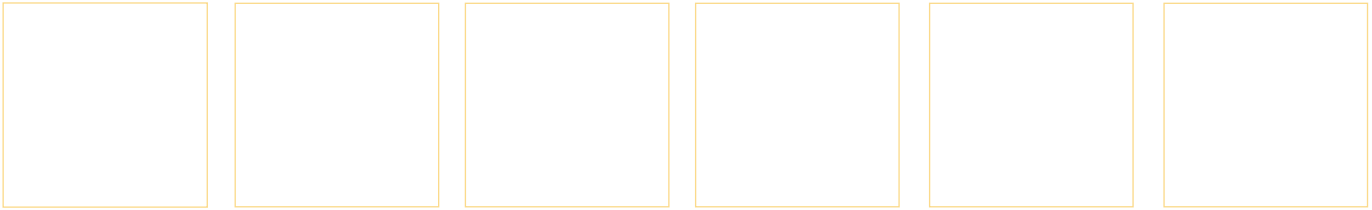


Figure 2. Changes in MLT Export Credit Activity<sup>13</sup>

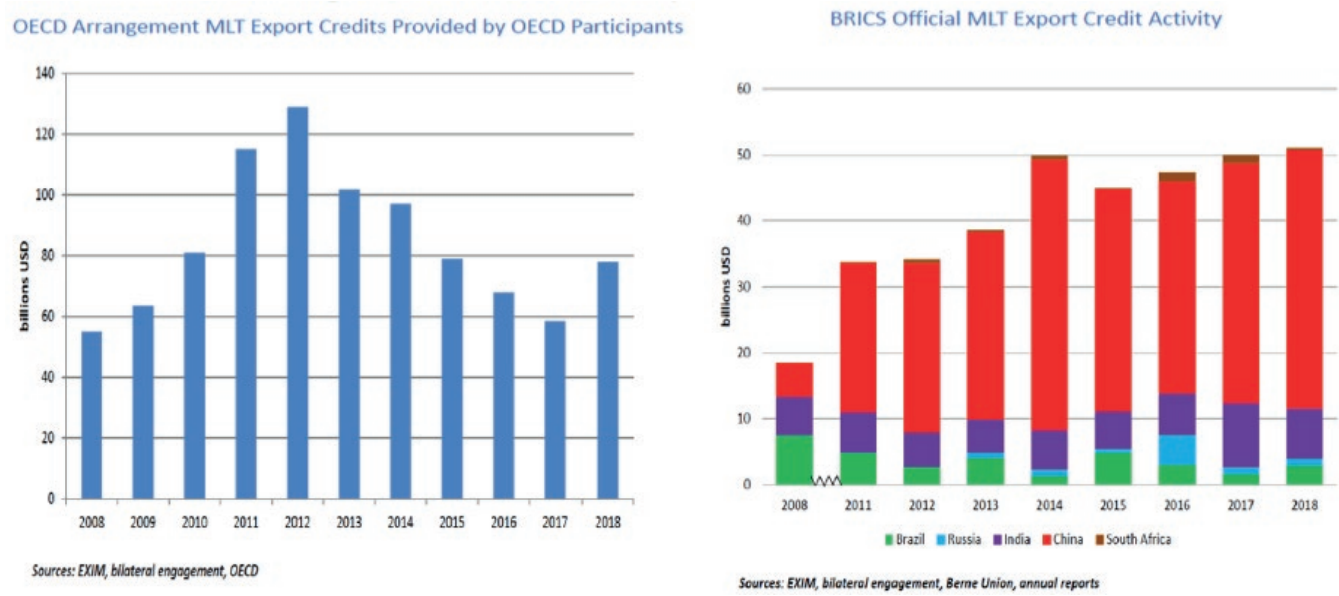
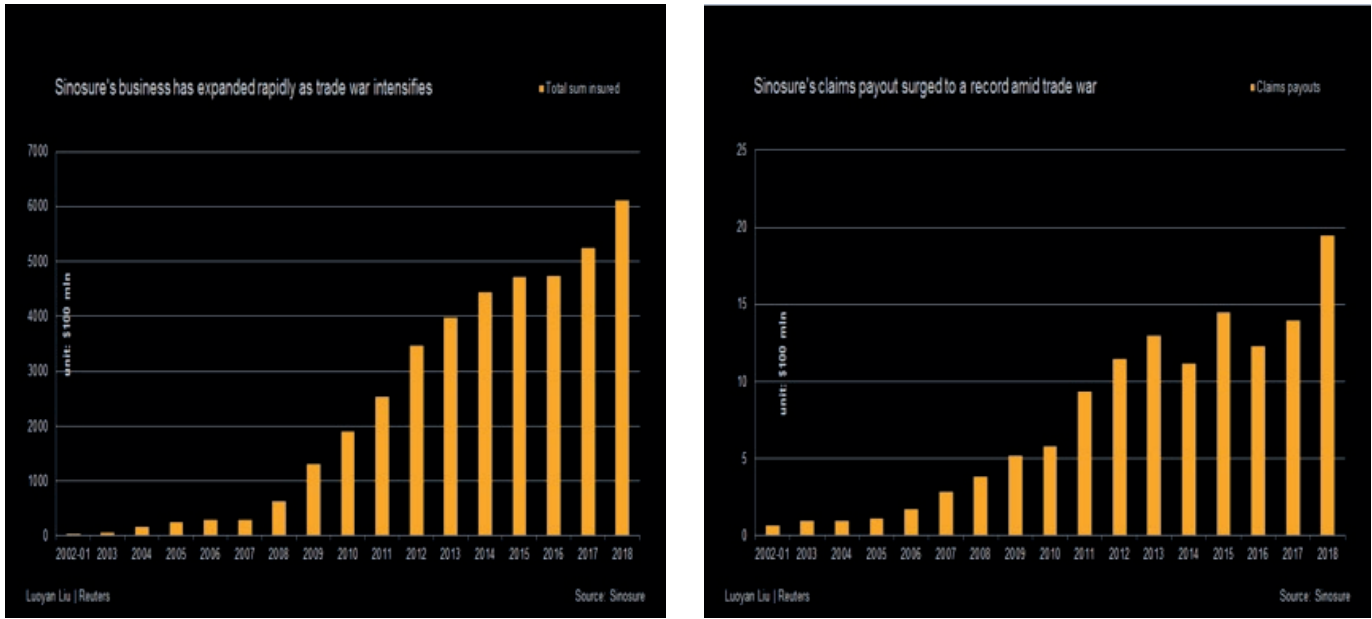
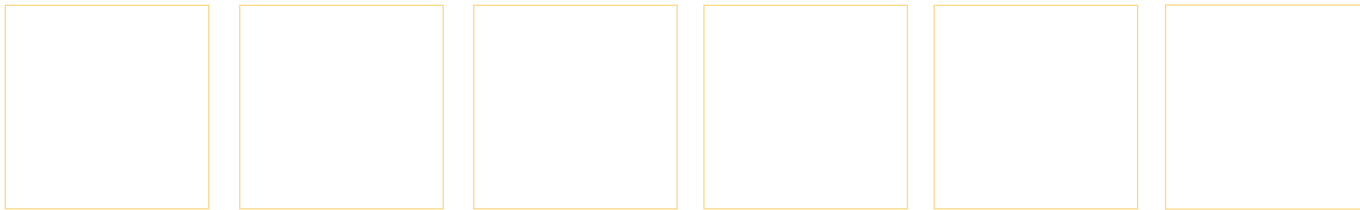


Figure 3. Sinosure's Increase in Business and Claims Payouts Amid Trade War



13. Report to the U.S. Congress on Global Export Credit Competition. 2019. EXIM Bank. pp20-21.



## Compliance Concerns

Do ECAs play by the rules? Data to assess this is both difficult to obtain and based on self-reporting. For OECD Participants, even where OECD terms and conditions remain applicable, it is not self-evident that Participant ECAs are complying with them. This is particularly with respect to *matching*. Matching is a deterrent mechanism that permits OECD Participants to match the terms of another ECA offer, from other Participants and also those ECAs operating outside of the terms of the Arrangement. However, non-Participants are only able to obtain information on a reciprocal basis from individual Participants on specific export credit offers. Consequently, it is not possible to evaluate the final terms and conditions of a matched offer, or the extent to which matching takes place between both Participants and non-Participants.

Since 2011, the EU Member States produce annual ECA Activity Reports as self-reporting exercises. They all report compliance with the OECD Arrangement and Common Approaches guidelines. Consequently, the European Commission has also reported full compliance by Member States' ECAs with Union objectives and obligations. This view has been formally contested.<sup>14</sup> Indeed, given the current ECA reporting, transparency and evaluation requirements, it is difficult to take the EU Member States' self-assessments at face value.<sup>15</sup>

Multilaterally, the WTO SCM prohibits official export credits if they are *provided at rates below those which they actually have to pay for the funds or if they borrowed on international capital markets in so far as they are used to secure a material advantage in the field of export credit terms*.<sup>16</sup> Significantly, under paragraph 2 of Item (k) Annex I Illustrative List, there is a safe harbour for those export credits provided by Members who are a party to an agreement that, as described, includes the OECD Arrangement. This explains why previously, when most ECAs were Participants, disputes over export credit subsidies in the WTO were rare.

14. See EU Ombudsman Complaint: *The European Commission's failure to evaluate the compliance of Member-States Export Credit Agencies with the EU's objectives and obligations, in particular on human rights*. Wednesday | 27 April 2016 CASE 212/2016/JN.

15. Dawar, K. Official export credit support: competition and compliance issues. *Journal of World Trade*. (forthcoming, June 2020).

16. WTO SCM Annex I Illustrative List of Export Subsidies. Item (k).

Slow-paced WTO litigation is strategically unattractive partly because of the nature of fast-paced export credit support instruments. Moreover, the WTO DSU has pronounced that matching under the OECD derogation is not covered by the WTO safe harbour provision.<sup>17</sup> So if matching below Arrangement terms is widespread, a prisoners' dilemma occurs: litigation could trigger tit-for-tat retaliation. There has been no adjudication as to whether the WTO SCM permits the imposition of countervailing duties against export credit subsidies that do not fall under the Item (k) safe harbour, but are permitted under the OECD Arrangement.<sup>18</sup>

## Conclusion: Escaping the Prisoners' Dilemma

WTO SCM rules on export credit subsidies were not designed to be the primary regulator of ECAs. They do not include detailed financial requirements or appropriate monitoring and enforcement mechanisms; nor do they address due diligence and sustainability requirements.

Prevailing strategies of competing with the new and biggest ECAs while tacitly agreeing to avoid claims in the WTO have significant budgetary, competition and sustainable development implications. This is recognised. Since 2012, the International Working Group on Export Credits (IWG) has been negotiating a successor undertaking to the current OECD Arrangement, in sense of Item (k) of Annex I SCM, but without apparent success.<sup>19</sup>

Trade wars and increasing defaults could serve to strengthen the collective interest in concluding the IWG negotiations successfully. The European Commission can also set a gold standard by more rigorously evaluating longer-term export credit activity - as it does for short-term support under the EU State aid regime. This would safeguard compliance with Union objectives and obligations, while ensuring the clean hands necessary to break out of the current prisoners' dilemma and pursue litigation in the WTO.

17. Panel Report, *Canada – Aircraft Credits and Guarantees*. Para. 7.177.

18. See Coppens, D. *How Much Credit for Export Credit Support under the SCM Agreement?* *Journal of International Economic Law* 12(1), 63–113. 2009. p. 66.

19. <http://www.itamaraty.gov.br/en/press-releases/20872-20th-meeting-of-the-international-working-group-on-export-credits-september-17-19-2019> (accessed 19/01/2020)

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