Chapter 5: Economic Philosophy and Competitiveness
Section B: Market Windows

Introduction

Market windows are government-owned institutions that claim to offer export credits on market terms and therefore are not required to apply Arrangement rules, although these institutions may also manage an "official window" that offers Arrangement terms for riskier transactions. While they may operate on a profit-maximizing basis, market windows have traditionally received government benefits that are not available to commercial banks. These benefits include implicit or explicit government guarantees, tax exemptions and equity capital provided by the government. In addition, these institutions condition support on national benefit, which involves some portion of domestic content. Without being subject to the Arrangement constraints of an official ECA or the market limitations of a true commercial bank, market windows pose a potential competitive challenge to both. As the Arrangement has increasingly codified export credit rules over the last decade, market windows' ability to offer flexible terms – such as longer repayment periods or cash payment financing – has enabled them to provide financing on terms that official ECAs cannot offer. When US exporters cannot find similar terms in the market for a specific buyer at a specific time, the playing field has been tilted.

Market window institutions have eluded disciplines in the OECD for years because the key players – Germany and Canada – have resisted all efforts to negotiate parameters or agree to transparency for their market window agencies. In addition, there has been little pressure for the United States to pursue such disciplines in recent years, as most U.S. exporters, some of which now receive market window financing, have provided no evidence of competitive harm from these institutions.

Ex-Im Bank Policy and Practice

Ex-Im Bank does not operate a market window. All of Ex-Im Bank's medium- and long-term transactions comply with the terms and conditions of the Arrangement. In its re-authorization in 2002, however, Ex-Im Bank was given permission by the Congress to match the terms and conditions offered by market windows, regardless of whether such terms are consistent with the Arrangement and even if the market window does not provide sufficient information for Ex-Im Bank to exactly match the terms of financing. The intent of this new ability is to advance negotiations on market windows within the OECD and to level the playing field for U.S. exporters. Ex-Im Bank's matching ability has not yet been used.

G-7 ECAs' Policies and Practices

Only two of the G-7 countries provide market window support: Canada through EDC and Germany through KfW. It is important to note that other G-7 ECAs, including Japan and possibly others, could become market window players should they perceive a competitive advantage to doing so.

EDC

Export Development Canada (EDC) is a Canadian crown corporation that operates on private commercial bank principles (i.e., seeks to maximize profits) while providing export credits for Canadian exporters. By dollar volume, the majority of EDC's business is in high-income countries; in 2003, nearly 70% of EDC's medium- and long-term business was destined to the United States and Europe. Of the markets where EDC would be more likely to compete with Ex-Im Bank, Latin America is the largest, comprising 15% of EDC's activity.

By transaction numbers, however, the picture looks very different. In 2003, over half of EDC's export credit transactions were offered in markets outside the United States and Europe, most of which were in Latin America. While some of these transactions complied with Arrangement rules, the majority were offered on "market terms". Following is a list of non-OECD markets where EDC offered market window financing in 2003 (markets where Ex-Im Bank did over $1 billion of business in 2003 are in bold face; asterisk indicates markets where Ex-Im Bank was closed for at least part of 2003):

> **Algeria**, Barbados, Bermuda, Bolivia, **Brazil**, Chile, **China**, Colombia, Croatia, Ecuador*, Honduras, Jamaica, **Mexico (largest EDC market outside U.S. by number of transactions)**, Panama, Peru, **Philippines**, Qatar, Romania, **Russia**, Saudi Arabia, Singapore, Tunisia, **Turkey**, Ukraine, Uruguay, **Venezuela***, Vietnam

With the decline of the telecom sector, EDC's export finance business has become more diversified across industries. In 2003, mining and infrastructure accounted for 34% of EDC's new medium- and long-term business volumes, followed by 22% for energy and 14% for aerospace. As recently as 2001, telecommunications comprised nearly one-third of EDC's business, but in 2003 the sector fell to only 8%.

In the recent past, approximately 90% of EDC's medium- and long-term export credit business has been offered through its market window, although the percentage may vary from year to year. Applying the general ratio to EDC's medium- and long-term activity over the last five years yields the following (**Figure 22**):

Figure 22: EDC Medium- and Long-Term Activity 1999-2003 ($Bn)

	1999	2000	2001	2002	2003
MLT export credits	4.1	5.2	5.5	5.0	4.2
Market window	3.7	4.7	5.0	4.5	3.8
Official window	0.4	0.5	0.6	0.5	0.4

KfW

Kreditanstalt für Wiederaufbau (KfW) is a financial institution that is owned by the German government (80%) and the federal states (20%). Founded shortly after World War II to support Germany's reconstruction, KfW continues to promote the growth of the German economy in a variety of ways, primarily focusing on domestic investment such as housing finance and support to small businesses. Historically, from 10% to 25% of KfW's annual financing activity falls under the category "export credits and project finance," which includes export credits as well as corporate finance and investment guarantees.

Generally, 60% of KfW's "export credits and project finance" has been offered as export credit support; while that percent dropped to 34% in 2003, the long-term trend is expected to be closer to the historic average. KfW's export credit business is provided both on Arrangement terms, with official export credit insurance coverage by Hermes, and on market window terms. The market window support (roughly 60%-70% of the export credits) is considered to be exempt from OECD rules. Applying a market window figure of 65% to KfW's export credit activity over the last five years yields the following (**Figure 23**):

Figure 23: KfW Medium- and Long-Term Activity 1999-2003 ($Bn)

	1999	2000	2001	2002	2003
MLT export credits	4.9	6.1	5.6	3.3	2.0
Market window	3.2	4.0	3.7	2.1	1.3
Official window	1.7	2.1	1.9	1.2	0.7

Of KfW's export credit activity in 2003, 66% went to Europe, 15% to Asia, 9% to North America, 8% to Latin America and 1% to Africa. While a breakdown of KfW's export credit activity by industry is not available, KfW's support is very often used to finance Airbus aircraft, supplementing the capacity available from Hermes, Coface and ECGD for official aircraft export credits. For example, KfW states on its web site that it will provide the 15% cash payment financing that official ECAs, including Ex-Im Bank, are prohibited from supporting according to Arrangement rules.

Concern that Germany's state banking system (of which KfW is a part) was putting European commercial banks at a competitive disadvantage led to an investigation by the European Commission. In 2002, as part of a settlement with the Commission, Germany agreed to separate KfW's economic support activities from its commercial business. KfW announced the new structure at the end of 2003. By 2008, there will be two entities offering export and project finance:

- A 100% KfW-owned, arms-length subsidiary called KfW IPEX-Bank has been formed to execute the bulk of KfW's traditional export and project finance activity. KfW IPEX-Bank will be subject to taxation and German banking regulations. It will support exports from Europe, not just Germany, and will build its ability to lead syndicated underwritings. It anticipates doing EUR8-10 billion of total business volume annually. Until 2008, KfW IPEX-Bank will operate as an independent unit of KfW.

- KfW, now called KfW Bankengruppe, will offer export credits primarily in syndicates with a maximum permissible share of the syndicate according to whether it is leading (50%) or following (75%). KfW may offer export finance on its own only in the riskiest markets.

It will take some time to determine the competitiveness impact of this restructuring. In the interim, market window activity will continue to be monitored and bilateral discussions are taking place in an effort to increase transparency.

Summary Data

Combining the two estimates for EDC and KfW yields an average total market window volume in the neighborhood of $7.0 billion per year over the last five years (see **Figure 24**). The majority by dollar volume is destined to the United States and Western Europe where Ex-Im Bank does little business. However, there is a segment of some $1 to $2 billion per year in market window activity in middle to upper tier LDCs (especially in project finance). Excluding any Boeing impact for the Airbus sales into the United States (with KfW support), this estimated volume is the area of potentially greatest impact on Ex-Im Bank's competitiveness as measured in this report.

Figure 24: Market Window Activity 1999-2003 ($Bn)

	1999	2000	2001	2002	2003
EDC	3.7	4.7	5.0	4.5	3.8
KfW	3.2	4.0	3.7	2.1	1.3
Total	6.9	8.7	8.7	6.6	5.1

Exporter and Lender Views

In the survey and focus groups, only the large U.S. exporters were able to comment on experience with market windows, and their views depended on their ability to shift production from one country to another. Large U.S. exporters who do not have exporting production facilities in other countries viewed market windows as a competitive threat. According to one, "In this time of severe financing market capacity constraints, KfW gives [their] customers additional capacity over and above that available from the European ECAs that is not available to [U.S. exporter] customers."

Conversely, large U.S.-based multinational exporters now cite market window institutions as one of a variety of financing tools available to them rather than as a competitive threat. Both EDC and KfW have aggressively approached major U.S. multinational exporters in search of business, and several U.S. multinationals have dedicated relationship managers at EDC. One exporter noted that it has concluded multi-million dollar contracts in Europe and Asia with KfW and EDC support. Ex-Im Bank's authority to match market windows is, as a result, not seen as necessarily a useful tool. U.S. multinational exporters view this authority as intended to shut market windows down, and they have no interest in biting the hand that is increasingly feeding them. To the extent that Ex-Im Bank matching support has been sought, it has primarily been in Western European countries where Ex-Im Bank's additionality requirements often prevent it from doing business.

In sum, whether market windows are seen as a potential threat or, more often, as an alternative source of financing, survey recipients found market window institutions to have a negative impact on Ex-Im Bank's competitiveness.

Conclusion

With minimal transparency and U.S. exporters not providing detailed information about market window activity, the market window issue has become an exercise in shadow boxing. On the one hand, no smoking gun could mean that there is no competitive impact on Ex-Im Bank and U.S. exporters. On the other hand, there is great potential for competitive harm in government-affiliated institutions providing export credits not in compliance with the Arrangement and shrouded in darkness relative to how closely the terms adhere to market norms. While Ex-Im Bank's ability to match market window transactions could be a useful tool in one-off competitive situations, the lack of progress on market window negotiations in the OECD makes the Bank solely reliant on this tool for combating market window transactions. Therefore, the United States remains potentially less competitive in any case when market window institutions are tilting the playing field.