

EXPORT-IMPORT BANK *of the* UNITED STATES



REPORT TO THE U.S. CONGRESS
ON EXPORT CREDIT COMPETITION AND
THE EXPORT-IMPORT BANK OF THE UNITED STATES

FOR THE PERIOD
JANUARY 1, 2003 THROUGH DECEMBER 31, 2003

JUNE 2004



EXPORT-IMPORT BANK
OF THE UNITED STATES

PHILIP MERRILL
CHAIRMAN AND PRESIDENT

June 30, 2004

The Honorable Richard C. Shelby
Chairman, Committee on Banking, Housing and Urban Affairs
United States Senate
Washington, D.C. 20510

The Honorable Michael G. Oxley
Chairman, Committee on Financial Services
United States House of Representatives
Washington, D.C. 20515

Dear Chairman Shelby and Chairman Oxley:

Pursuant to Section 2(b)(1)(A) of the Export-Import Bank Act of 1945, as amended, I am pleased to submit the Bank's Competitiveness Report for January 1, 2003 through December 31, 2003.

Sincerely,

A handwritten signature in black ink that reads "Philip Merrill". The signature is written in a cursive, flowing style.

Philip Merrill
Chairman and President

**THE 2004 ADVISORY COMMITTEE'S STATEMENT ON THE
2003 COMPETITIVENESS REPORT OF
THE EXPORT-IMPORT BANK OF THE UNITED STATES**

The members of the 2004 Advisory Committee have reviewed the 2003 Competitiveness Report to Congress and present its statement on the competitiveness of the Export-Import Bank of the U.S. as compared with the other major export credit agencies (ECAs). In the Advisory Committee's opinion, Ex-Im Bank continues to fulfill its objective of providing competitive export credit support.

Specifically, the Advisory Committee notes that the Report provides both comparisons between ECAs of specific program features that are key to competitiveness, and information from Ex-Im Bank's annual survey of exporters and bankers on Ex-Im Bank competitiveness. Further, the Advisory Committee supports the continued use of the "report card" analysis and presentation for "Key Elements" which the Committee believes to succinctly capture a balanced assessment of the Bank's overall competitiveness for these elements. The Committee recognizes that non-financial factors are designed to serve important public policy objectives, reflected by the Bank's overall mission which includes supporting U.S. jobs.

In addition, we fully concur with the assessment that the long term trends in the export credit field center around the ability and willingness of ECAs to provide support in higher risk areas (e.g., sub-sovereign borrowers, non-structured medium term export transactions with unrated borrowers, small business). Moreover, the other area that the Advisory Committee believes was accurately described and represents an additional element on which Ex-Im Bank needs to make a concerted effort is co-financing where the Bank continues to lag behind its foreign counterparts. Thus, in looking ahead, the Advisory Committee strongly urges Ex-Im Bank to aggressively address these challenges to ensure that U.S. exports can compete on a level playing field.

To conclude, Ex-Im Bank continues to play an invaluable role in facilitating and maintaining U.S. jobs. Accordingly, the Bank needs to be constantly aware of and be prepared to respond to the changes and challenges in the marketplace, particularly with regard to its foreign ECA competitors and advantages that they are seeking to exploit.



H. Thomas Kornegay
Chairman

2004 Ex-Im Bank Advisory Committee

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Executive Summary

The 2003 Competitiveness Report provides a comprehensive analysis of Ex-Im Bank's competitiveness as it relates to the medium- and long-term programs during calendar year 2003. This evaluation is based on both qualitative information gathered from a variety of sources, including a survey of and focus groups with exporters and lenders, and quantitative information from sources such as the Organization for Economic Cooperation and Development (OECD) and the G-7 export credit agencies (ECAs).

The findings of this year's report are presented within the framework of major trends in the international marketplace during 2003 and the net effect of these influences on Ex-Im Bank activity and competitiveness during this period. The major trends identified are:

- Activity levels of the G-7 ECAs in the medium- and long-term financing areas reflect a continuing decline as a share of national exports and significant fluctuation in absolute terms over the last several years, with preliminary results for 2003 suggesting a return to more normal levels from a low point in 2002;
- The distribution of ECA financings is shifting to an overall greater concentration of medium-term activity; with long-term financings concentrating in larger transactions and/or riskier markets; and
- Emerging market borrowers are attracting more, and increasingly diverse, sources of financing outside of the traditional ECA environment – a trend that was first reported last year and is continuing steadily upward.

The activities of the G-7 ECAs during 2003 suggest that they have adopted strategies characterized by exploration of niche roles and cooperative relationships with private and other official ECAs.

Core Business Policies and Practices

Overall, Ex-Im Bank is generally competitive with the other G-7 ECAs. In particular, Ex-Im Bank's exposure fees (risk premia) were considered to be generally competitive with our foreign counterparts. In addition, Ex-Im Bank's 100% unconditional guarantee continues to be a very competitive financing product. Finally, Ex-Im Bank's approach to risk is perceived by the exporting community to be generally competitive in most markets. Thus, on balance, Ex-Im Bank levels the playing field with the typical ECA offer in the core business policies and practices.

Comparison of Major Program Structures

Ex-Im Bank's project finance and aircraft programs are considered highly competitive, a ranking that is consistent with last year's report. Co-financing, however, is an area in which Ex-Im Bank lags its European counterparts because of the absence of a full complement of bilateral co-

financing agreements. Finally, the foreign currency program is comparable to the programs offered by other G-7 ECAs.

Economic Philosophy and Competitiveness

As the Arrangement has increasingly codified export credit rules over the last decade, the potential for the use of official financing tools outside the scope of the Arrangement to tilt the playing field has grown. These tools such as untied aid and market windows – can be used to exploit public policy niches that are antithetical to the U.S. export credit philosophy. Our first goal, as was achieved with tied aid two decades ago, is to discipline the use of these tools under the Arrangement. Due to lack of progress in the OECD on untied aid, the Administration is attempting to use the G-7 to initiate OECD negotiations to bring transparency and discipline to the use of this particular tool. Progress in the OECD on market windows has also been difficult, given the lack of hard evidence of competitive harm. While Congress has provided Ex-Im Bank authority to match egregious practices in both areas, these financing tools operate in a grey zone, and evidence of adverse impacts on U.S. exporters in particular transactions has been hard to establish.

Public Policies: Stakeholder Considerations

The existence of the Ex-Im public policy areas stemming from broader USG philosophy and policy can influence the overall competitiveness of an individual transaction in varying degrees, and colors the exporting community's perceptions of Ex-Im's overall competitiveness, as the Bank tends to have more such constraints than other ECAs and, is the only ECA to have economic impact and shipping policies requirements. While economic impact guidelines affect a limited number of transactions, the MARAD/PR 17 requirements impact a somewhat larger number of deals (e.g., non-containerized major capital goods). Consequently, the U.S. exporting community views the public policy requirements as disadvantageous when they arise.

Operational Efficiency

A new factor considered in this year's analysis is the issue of operational efficiency. Ex-Im Bank, like the other G-7 ECAs, has undertaken a number of initiatives aimed at providing better and more effective customer service – especially as a way of differentiating itself in the processing of standard transactions. However, while Ex-Im Bank is not on equal footing with the most advanced ECAs in the development and implementation of infrastructural changes to achieve these goals, it is consistent with the more typical ECA. Nonetheless, a number of participants in the focus groups noted concerns about Ex-Im Bank's case processing time, and the Bank launched a number of initiatives in 2003 to improve customer service and case processing efficiency.

Overall

Similar to last year's report, the 2003 Competitiveness Report presents the summary of Ex-Im Bank's ability to offer comparable financing in a report card format. On a grading scale from "A+" to "F", with "A" being generally competitive (see **Figure 1** below for the competitive definitions of select grades), Ex-Im Bank's core financing programs receive an "A", which translates into being generally competitive with the average G-7 ECA. However, in the economic philosophy and public policy areas, over which Ex-Im Bank has little to no control, survey respondents rated these areas, when present in an individual transaction, as having a negative impact on Ex-Im Bank's competitiveness. Respondents noted in particular, foreign content, tied and untied aid, PR 17, market windows or economic impact, when and if encountered in a specific transaction (with market windows not yet encountered in a specific transaction), tend to offset the competitiveness of Ex-Im Bank's core financing.

Figure 1: Definition of Grades

Grade	Definition
A+	Fully competitive compared to other ECAs. Consistently equal to the (or is the sole) ECA offering the most competitive position on this element. Levels the playing field on this element with the most competitive offer from any of the major ECAs.
A	Generally competitive compared to other ECAs. Consistently offers terms on this element equal to the average terms of the typical major ECA. Levels the playing field on this element with the typical offer from the major ECAs.
A-/B+	Level of competitiveness is in between grades A and B.
B	Modestly competitive compared to other ECAs. Consistently offers terms on this element equal to the least competitive of the major ECAs. Does not quite level the playing field on this element with most of the major ECAs.
B-/C+	Level of competitiveness is in between grades B and C.
C	Barely competitive compared to other ECAs. Consistently offers terms on this element that are a notch below those offered by any of the major ECAs. Puts exporter at financing disadvantage on this element that may, to a certain extent, be compensated for in other elements or by exporter concessions.
D	Uncompetitive compared to other ECAs. Consistently offers terms on this element that are far below those offered by other major ECAs. Puts exporter at financing disadvantage on this element so significant that it is difficult to compensate for and may be enough to lose a deal.
F	Does not provide program (Note: The Exporter and Lender Survey included a grade of "F" in the event no Ex-Im program was available. In the future, the absence of an Ex-Im program will be included in the "NA" category.)
NA	Does not have experience with policy/program.

Chapter 1: Introduction

Background

Pursuant to its Charter (the Export Import Bank Act of 1945, as amended), Ex-Im Bank is mandated to provide U.S. exporters with financing terms and conditions that are competitive with those made available by foreign governments to their exporters. The purpose of this report, which is required by Section 2(b)(1)(A) of the Charter, is to measure the effectiveness of Ex-Im Bank's programs and policies in meeting the competitiveness mandate during calendar year 2003.

Scope

This report compares Ex-Im Bank's competitiveness with that of the other G-7 ECAs, as these ECAs historically have accounted for roughly 80% of medium- and long-term official export finance. In addition, the Competitiveness Report focuses on medium- and long-term export credits, which comprise the bulk of official export finance and therefore are subject to the most intense international competition. Moreover, only a few official ECAs continue to provide short-term financing. Quantitative comparisons and information on each of G-7 ECAs can be found in Chapter 2.

Methodology

This year's Competitiveness Report continues the "report card" methodology introduced in the 2002 Report, in which Ex-Im Bank provides a grade for the competitiveness of its support. The intention of this approach is to individually evaluate the essential components of an Ex-Im Bank financial program and to compare these results with the capabilities of our foreign ECA competitors.

Having evaluated the grading methodology and found it to be successful overall, the Bank adjusted it in two ways. First, the Bank revised its survey of exporters and lenders to enable the U.S. exporting community to grade the Bank's competitiveness (see below for information on the survey). Second, because the economic philosophy and public policy issues do not affect every case – and because not all of them can be compared on an "apples-to-apples" basis with other ECA policies – the Report notes the direction of the potential competitiveness impact on an individual transaction when one or more of these factors is present.

Consistent with previous years' Competitiveness Reports, the Bank's analysis and competitiveness grades draw upon: 1) objective policy, programmatic and procedural information about other ECAs obtained from a variety of sources; and 2) subjective information provided by the survey of the U.S. exporting community and focus groups with exporters and lenders.

Survey Methodology

The Bank is required by its Charter to conduct an annual survey of exporters and lenders to determine their experience in competition supported by official export finance. Ex-Im Bank revised its survey in 2003 to mirror the grading methodology adopted in the 2002 Competitiveness Report. This provided survey recipients the opportunity to provide an assessment of Ex-Im Bank's competitiveness in different financing programs by selecting defined grades from A+ (fully competitive) to F (does not provide program). In future surveys however, the absence of an Ex-Im Bank program will not be segregated as a separate category but instead, will be included in the "NA" category. In addition, survey recipients were asked to note whether certain public policies had a positive or negative impact on the Bank's competitiveness. After each section, recipients had space to provide qualitative comments on each of their responses.

Ex-Im Bank conducted a careful process to evaluate the quality of each survey response. Three surveys were discarded altogether because the respondent did not have any experience with Ex-Im Bank in 2003. Some specific responses were discarded if a respondent graded a program with which it clearly had no experience; the large aircraft and project finance questions were the areas where this most frequently occurred. Additional responses were discarded if they were based on something other than a comparison of Ex-Im Bank's medium- and long-term programs with those of other ECAs. Examples include comparisons with the private sector or comments about the Bank's short-term insurance program. Appendix C provides more information on the survey.

Focus Groups

In addition to the annual survey of the export community, this year's report also incorporates the results from four focus groups held with commercial lenders and exporters. The focus groups provided a venue for members of the export community to supplement their survey responses with anecdotal experience, as well as more comprehensive information on market trends. The focus group discussions, combined with the qualitative comments from the survey, provided invaluable context about the overall environment in which Ex-Im Bank operates and how the Bank compares with its G-7 counterparts. The results of these discussions are included in the "exporter and lender survey results" section of each chapter.

Report

The Report proceeds as follows: Chapter 2 describes the international framework within which official ECAs operated in 2003 and the philosophies and missions of competing G-7 ECAs. Chapter 3 consists of separate sections evaluating Ex-Im Bank's competitiveness in the core financing elements of official export credit support, with a new section regarding operational efficiency. Chapter 4 provides a comparative assessment of how well the financing elements are packaged into major programs (i.e., aircraft, project finance, co-financing and the foreign currency guarantee). Chapter 5 addresses U.S. economic philosophy and competitiveness regarding tied and untied aid and market windows. Finally, Chapter 6 evaluates stakeholder considerations embodied in public policies and the long-term competitive implications of these

policies on Ex-Im Bank activity. The main body of the Report concludes in Chapter 7 with an overall competitiveness report card grading Ex-Im Bank against its G-7 ECA counterparts. The appendices follow the body of the Report, and include a list of the purposes for Ex-Im Bank support, a summary of developments within the OECD, Ex-Im Bank efforts to support renewable energy, and other materials intended to provide greater detail and insights.

Chapter 2: Competitiveness Framework

Section A: Factors Influencing Export Finance

Introduction

This chapter describes the international framework in which official export credit agencies (ECAs) operate. In particular, the multilateral “rules of engagement” governing official ECA activity, market trends, and alternative financing sources together form a dynamic environment that affects how ECAs provide value to their respective exporting communities.

The Playing Field

Historically, the competitive playing field for ECAs has been viewed primarily in financial terms and within the confines of the OECD. Recently, however, ECAs are being pressured to encompass “corporate and social responsibility” (“CSR”) concerns, which include public policy issues such as the environment, thereby adding this dimension to the competitive calculus. A new emerging influence is the higher degree of interest and potential involvement by international financial organizations, namely the IMF and the World Trade Organization. In addition, the promulgation of expanded regulations governing the international banking community known as Basel II and the potential impact these rules could have on the export credit world is briefly discussed. Accordingly, this section outlines the international parameters that deal with official export credit competition, starting with the OECD Arrangement for Officially Supported Export Credits (“the Arrangement”), the World Trade Organization (WTO), the international financial institutions (IFIs; multilateral development banks and the IMF), and Basel II.

OECD: The U.S. government is a Participant to the OECD Arrangement for Officially Supported Export Credits, or the “Arrangement.” While not a formal legal agreement, the Arrangement, which was first implemented roughly 25 years ago, is a set of guidelines developed, agreed to and adopted by the members of the OECD. Specifically, the Arrangement defines the disciplines, principles and procedures by which member ECAs are to provide export credit support with the express purpose of ensuring a level playing field and to minimize government subsidies so that purchase decisions can be made on the basis of market factors such as price, quality, and service. The Arrangement contains provisions for standard export credits to include minimum interest rates, maximum repayment terms, and a risk differentiated exposure fee system for sovereign risk. In addition, special provisions exist for project finance and tied aid, as well as sector agreements for civil aircraft, ships, and nuclear power. The Arrangement has also been incorporated into European Union law and is referred to in the World Trade Organization’s (WTO) Agreement on Subsidies and Countervailing Measures (ASCM), and in this regard provides a “safe haven” from WTO suits for ECAs that follow the interest rate provisions of the Arrangement.

During 2003, the Participants to the Arrangement and the OECD Secretariat undertook a revision of the Arrangement, driven by concerns that the Arrangement could be viewed by the WTO and non-Participants to the Arrangement as discriminatory against non-Participants,

lacking transparency and access to non-Participants, and possibly WTO inconsistent. A revised Arrangement was agreed to at the end of 2003 and was implemented on January 1, 2004. The outcome of this process yielded a document, processes and procedures that are more transparent and accessible to non-Participants and provides for mechanisms to share information more freely with non-Participants on standard export credits.

As the centerpiece of the official ECA world since 1978, the Arrangement has addressed issues as they have arisen, focusing on building and fleshing out a framework within which governments could find mutual benefit in constraining themselves from competing on the basis of subsidies. The U.S. exporting community has benefited regularly and significantly from the repeated expansions of the Arrangement disciplines and today sees a financing playing field that is almost totally level. The main recurring issues relate to resolving whether two practices now defined outside Arrangement disciplines (market windows and untied aid) actually have field-tilting implications and, if so, finding a way to impose the right amount and scope of discipline.

World Trade Organization (WTO): The WTO is a forum for governments to negotiate trade agreements and settle trade disputes. A major focus of the current (Doha) round of negotiations is to ensure that developing countries are not disadvantaged because of their economic status. A component of this issue is export credit subsidies – where a few developing countries that are not members of the OECD have alleged that the OECD Arrangement provides advantages to OECD members at the expense of non-OECD members. As the Doha Round continues into 2005, the issues related to export credits are likely to remain on the radar screen and have the potential to influence the way official export credit rules are established and the parameters within which official export credits are provided.

IFIs: A recently emerging trend that is likely to affect ECAs is the heightened interest by the IMF in the role that other internationally focused organizations (e.g., ECAs, multilateral development banks, and private lenders) might play during a financial crisis. IFIs perceive that there is a role that ECAs could play to ensure the financing for import of critical commodities/inputs to support export-led recoveries in these struggling economies. The IFIs' current focus is on ECAs providing short-term trade finance; however many of the official ECAs have privatized their short-term programs and therefore would have very little to offer unless they were to create a national interest account specifically for this purpose. Ex-Im Bank is one of the few G-7 ECAs that offers an official short-term program with the others being EDC/Canada and NEXI/Japan. Given the profit-making objective of many of the European ECAs, the budgetary constraints that many are feeling, and the associated higher risk of loss in providing financing support to high-risk markets, these ECAs are not inclined to step in during times of financial crisis.

Basel II: A final but potentially significant factor in the importance and roles that ECAs play going forward is Basel II. Basel II refers to the international regulatory standards applicable to the international financial community designed to maintain stable economic and financial markets. The Basel II standards have not yet been finalized and while it is not clear when they will be finalized or when they will actually go into effect, the new requirements are likely to impact if and how the international financial community (e.g., private lenders, insurers, and ECAs) will provide export credit support in the years ahead. To the extent that Basel II provides advantageous (low) capital reserve requirements to official ECAs as compared to their

private counterparts as either lenders, guarantors or insurers (which is a very high and distinct probability), the need and demand for official ECA support is likely to increase somewhat modestly.

Summary: ECAs are dealing with the issues surrounding their appropriate roles in a somewhat volatile and unpredictable environment. Specifically, virtually each and every ECA is trying to redefine its niche based upon its collective government's reading of the tea leaves within the context of its own objectives. With the WTO and OECD Arrangement adding further restrictions to minimize export credit subsidies, ECAs can be expected to look for unregulated, market-like niches in which to gain a competitive advantage.

Long-Term Export Financing Trends

Another critical dimension to be considered in an evaluation of Ex-Im Bank's performance is that the role ECAs have played over the recent past has changed fairly dramatically. In particular, official ECA support for medium- and long-term export credits has been steadily declining as a share of national exports and current activity is more concentrated in the medium term. The many reasons for this decline are discussed below, but simply put, the primary reason is that the private sector has been expanding its capacity and reach very rapidly.

Several long-run trends were identified in last year's Report that seem to be continuing to influence the decline in official ECA support. First, the international bond and syndicated loan market for emerging market borrowers has dramatically increased in the past few years, with borrowers and lenders better prepared and more mature, the net effect being a smoother, more stable environment. Another growing trend is the availability of local currency financing on reasonable terms. This activity is most notable in Asia, and to a lesser extent, Eastern Europe and the former Soviet Union. Consequently, the need for ECA support has been minimized, particularly for sovereign and top tier corporates operating in these markets. However, ECAs are more necessary in situations characterized by:

- Sub-sovereign borrowers;
- Second tier borrowers;
- Less sophisticated, higher risk countries (e.g., Sub-Saharan Africa);
- Multi-billion dollar, controversial and/or "political" transactions that provide greater risk;
- Non-structured medium-term export finance transactions with non-investment grade borrowers; and
- Small business exporters.

As the data in the **Figure 2** demonstrate, G-7 ECA support in the medium- and long-term areas increased in 2003 from a six-year low in 2002. Ex-Im Bank was one of the ECAs that increased its activity, with Japan demonstrating the largest increase. While there are a myriad of factors that have contributed to the volatile nature of ECA support over the last six years, 2003 seems to be a return to more normal levels from a low point reached in 2002, which was most likely caused by a combination of events including a recoil from 9/11, SARs, and the overall world economic malaise.

Figure 2: G-7 New Medium- and Long-Term Official Export Credit Volumes (\$Bn)*

	1998	1999	2000	2001	2002	2003**
Canada	4.5	3.7	4.7	4.8	4.2	4.2
France	8.4	5.5	4.5	6.1	5.3	5.5
Germany	8.3	6.7	10.3	5.7	5.9	5.7
Italy	0.8	1.6	3.3	1.9	1.8	3.3
Japan	9.0	8.1	10.8	9.2	5.7	11.5
U.K.	3.3	5.2	5.8	3.1	4.7	1.8
U.S.	6.6	9.4	9.6	6.8	7.7	8.5
Total G-7	40.8	40.1	49.1	37.6	35.3	40.5
U.S. % G-7	16.1%	23.4%	19.6%	18.1%	21.8%	21.0%

*Source: OECD data (1998-2002 revised from last year's report) and Ex-Im Bank's Annual Report.

**Preliminary results.

Trends in 2003: Focus Group Discussions

This section summarizes the views on export finance shared by the lenders and exporters who attended the four focus group discussions held in connection with this Report.

The overall perception regarding the international marketplace is that term financing risks for the most part have generally improved. However, it was noted that export trade has not fully recovered since September 11 with some countries slower to take on capital investments than others. Moreover, the concentrated competitiveness and limited potential for any one national competitor to dominate in these markets has led some exporters to stretch slightly but cautiously into riskier markets that they might not otherwise seek simply because of the need to generate more business. Further, the larger deals (in dollar terms) are fewer in number, thereby creating a strong sense of urgency to provide every advantage possible. Moreover, globalization continues its trend upward, predominantly driven by a strong and immediate corporate need to survive through lower cost supply chains.

Within the banking industry, the movement toward consolidation, combined with thin profit margins in the area of long-term export finance, seems to have contributed to a smaller population of traditional commercial banks of all sizes able and willing to engage in export credit financing. Ex-Im Bank's 100% guarantee is cited as a factor in some commercial banks' unwillingness to focus on the long-term structured finance segment, as spreads are exceptionally thin. Many lenders who remain in the marketplace have changed fundamental direction and focus, giving heightened attention to the middle market (including the high end of the SME segment). Accordingly, the attractiveness of medium-term finance has gained in importance because:

- The more volatile nature of the buyers (less well known, smaller, in moderate risk markets) allows for more flexible and higher pricing;
- Relationships with U.S. suppliers who are not global provide a more stable customer base with a higher ROI on resources;
- The volume of transactions is much greater (especially in Latin America); and
- Foreign ECA competition for these transactions is thinner and less likely to present a competitive threat (since foreign ECAs tend to be more risk averse).

However, several "old time" export credit lenders have simply closed their export finance divisions altogether, while others have cut their resources down to the essential minimums.

Both exporters and lenders explained that their perception is that the European G-7 ECAs, as well as several mid-sized Scandinavian ECAs, have developed closely coordinated strategies and partnerships with their respective governments, industry, labor and NGOs in the area of export development, including export finance. This team approach seems to be reflected in a common and unified objective to ensure strong and continued national export growth. This approach appears to be different from how the U.S. government and the private sector interact and work toward a common goal. To be fair, the U.S. exporting community recognizes that Ex-Im Bank can only do its part with regard to export finance in trying to bring cohesion to the export development arena. Within this scope, however, they would like to see Ex-Im Bank work more quickly to resolve unusual policy, program and operational issues that affect export transactions and their competitiveness, acknowledging that oftentimes, these unique issues are not within Ex-Im Bank's control alone.

On balance, Ex-Im Bank is viewed as a critical and essential partner to the U.S. exporting community, especially in the higher risk, longer term, large multi-million (or billion) dollar transactions, and to support the SMEs (small and medium sized enterprises). But, in the highly dynamic and sometimes extremely volatile world market of today, ECAs, including Ex-Im Bank, are considered less nimble than they need to be to maximize their utility to the exporting community.

Chapter 2: Competitiveness Framework

Section B: ECAs' Mission and Place In Government

The Role of Export Credit Agencies

The central purpose of an export credit agency (ECA) is to finance domestic exports. However, there are numerous ways for an ECA to accomplish its mission. There are two influences on how an ECA will set its strategy to meet its purpose. The first influence is the OECD Arrangement, which codifies many of the terms that apply to official export credit support, although individual ECAs have significant latitude to pursue their own strategy to support their country's exports. The second influence is the ECA's mission as defined by its sponsoring government, which also impacts an ECA's ability to adapt to changing market circumstances. Both of these factors affect how ECAs will compete with each other in promoting their respective governments' national interests.

The purpose of this section is to highlight the different objectives and strategies of the G-7 ECAs and explore how these differences affect ECAs' competitiveness. First, there will be a brief analysis of Ex-Im Bank's governmental mission and how this affects Ex-Im Bank's ability to respond to market pressures. Following the analysis of Ex-Im Bank is a general description of the roles that the G-7 ECAs play for their domestic governments.

Ex-Im Bank's Mission and Place in Government

Ex-Im Bank is the official U.S. government export credit agency. Ex-Im Bank's mission and governing mandates are codified in its Congressionally approved Charter (Export-Import Bank Act of 1945, as amended). Ex-Im Bank's core mission is to support U.S. exports and jobs by providing export financing that is competitive with the official export financing support offered by other governments. The public policy goal of this mandate is to enable market forces such as price, quality and service to drive the foreign buyer's purchase decision, not government intervention or temporarily exaggerated perceptions of risk. This mandate effectively directs Ex-Im Bank to fill market gaps that the private sector is not willing or able to meet, namely competitive financing (e.g., interest rates and repayment terms) and the ability to assume reasonable risks that the private sector is unable to cover at a moment in time.

To support its core mission, Congress has also legislated that Ex-Im Bank's financing be conditioned on:

- Supplementing, not competing with, private sector financing; and
- The finding of reasonable assurance of repayment.

Decisions on transactions should be based solely on commercial and financial considerations, unless the transaction:

- Fails to comply with Ex-Im Bank's Environmental Procedures and Guidelines;
- Causes an adverse economic impact on the U.S. economy; or
- Does not meet various statutory and executive branch parameters.

All of these directives aim to achieve a public policy goal and reflect the interests of Ex-Im Bank stakeholders, such as NGOs, other U.S. government agencies, labor and financial intermediaries. Hence, Ex-Im Bank is required to strike a fine balance among multiple, sometimes competing, goals and objectives. At the same time, Ex-Im Bank is expected to provide the U.S. exporting community with financing that is competitive with officially supported offers made by our foreign government counterparts – institutions that most often have fewer public policy constraints to evaluate when deciding whether to provide financing support. Given the G-7 ECAs' widely varying missions, the formula with which to compare Ex-Im Bank's competitiveness against these ECA counterparts is neither simple nor direct.

The Mission and Place in Government of Other G-7 ECAs

Although the G-7 ECAs each have unique operating strategies to support their country's exports, their strategies can be generalized into one of three categories. These categories describe the governmental role that determines the differences in levels of activity, products and focus between the G-7 ECAs.

Lender of Last Resort: ECAs with this focus tend to encourage the active participation of the private sector and step in only when taxpayer dollars are needed to meet market gaps. Moreover, lenders of last resort assume a relatively higher level of responsibility for public policy goals as directed by their guardian authorities. Ex-Im Bank can be classified as a "lender of last resort". ECGD is the only other G-7 ECA that compares similarly to Ex-Im Bank in this role.

Private Sector Participant: ECAs in this category are generally profit driven. As a consequence, the risk profile and controls placed on their portfolios tends to be more restrictive (with country exposure limits), resulting in moderate risk-taking. Public policy goals tend to carry less weight for these ECAs because of their private sector orientation. The European official ECAs, most notably Coface and Hermes (but also SACE), act like private sector banks/ insurers because they are private entities that handle the medium- and long-term book of business on behalf of their respective governments. Operationally, these ECAs behave as private sector companies by taking advantage of the efficiencies associated with their private sector side.

Banker for the Country: This type of ECA generally plays a larger role in the implementation of national trade policy, which is reflected in a broader mission (e.g., national content on specific sales is less important) and more expansive responsibilities. A consequence of this broader governmental mission is that these ECAs frequently are more flexible on public policies. Generally, these ECAs are more adaptable regarding business practices. The Canadian and Japanese ECAs view themselves as the only "international" bank in their respective countries.

Chapter 3: Core Business Policies and Practices

Section A: Cover Policy and Risk-Taking

Introduction

Cover policy refers to an ECA's willingness to provide protection against commercial and political risks in a particular market. ECAs' cover policies and risk-taking practices significantly impact an exporter's ability to effectively compete for sales. Cover policy decisions are based on an ECA's underwriting approach and its consideration of whether and how to place limits, in terms of risk type or volume, on the business it can support. Limits on transaction size, repayment terms or total commitments per country are the methods many ECAs use to control the flow of new business.

An ECA's approach to non-sovereign risk is another important aspect of cover policy. Exporters whose ECA is willing to take on new business with entities other than sovereign governments or first class private institutions can enter markets and gain competitive advantages over foreign competitors. While most ECAs have historically covered sovereign, public and major bank business, increasing privatization in the developing world has presented ECAs with increasing requests to cover private risks, ranging from large corporations to small businesses. The scope and depth of an ECA's willingness to cover private sector risk, especially of small private entities, has become a more critical competitive aspect of an ECA's cover policy.

Ex-Im Bank's Policy and Practice

Ex-Im Bank will typically support transactions without size or country limits as long as there is a reasonable assurance of repayment in each transaction as required by the Bank's Charter. One exception is when Ex-Im Bank is statutorily prohibited from doing business in a particular market, generally as a result of sanctions. The goal for Ex-Im Bank is to provide financing for creditworthy export transactions, regardless of destination, when there is foreign ECA-supported competition or when private sector financing is unavailable. In other words, restrictions on the provision of Ex-Im Bank cover in a given market pertain to the creditworthiness of a transaction, as opposed to portfolio controls. Consequently, U.S. exporters and lenders enjoy a competitive benefit from the absence of country and sector ceilings on Ex-Im Bank's cover policy. When Ex-Im is open in a market for a given term, it is generally less risk averse than other ECAs. Ex-Im Bank shows a willingness to cover the risk of smaller, private entities and seeks to minimize the requirement for bank guarantees and other forms of security in order to reduce the associated costs of these guarantees to U.S. exporters.

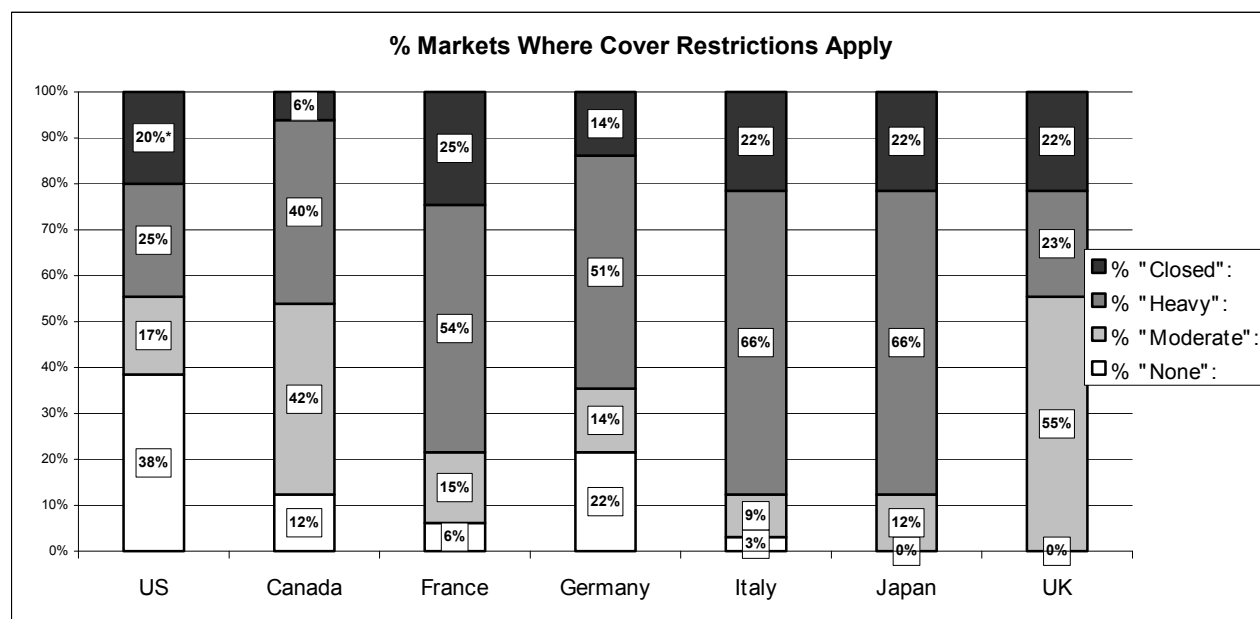
G-7 ECAs' Policies and Practices

Ex-Im Bank and the other G-7 ECAs are equally willing to take on sovereign government risk; however, with respect to private sector transactions, the other ECAs tend to be more risk averse than Ex-Im Bank. They control their risk appetite for private sector business by, for example, imposing country and/or sector exposure limits. In addition, they prefer to focus on

well-known or rated entities (which are usually banks) or rely (by requiring risk-sharing of 5%-20%) on the due diligence and underwriting approaches of the banks they cover. As privatization continues in the emerging markets, the other G-7 ECAs are facing new challenges with underwriting private sector risk – an undertaking with which most have limited experience. Within this context, the other G-7 ECAs do appear to be searching for ways in which they can be competitive while also minimizing the increased risk.

Summary Data

Figure 3: Comparison of Medium- and Long-Term ECA Country Cover Policy



*In 5% of the 65 markets, Ex-Im Bank was closed due to legislative sanctions.

Figure 3 shows the overall openness of the G-7 ECAs by comparing cover policy in 2003 for a sample of 65 major ECA markets. As illustrated, there is a difference in approach to overall cover policy and the degree to which ECAs are willing to assume unsecured risks. Specifically, Ex-Im Bank is open without restriction in more markets than any of the other G-7 ECAs. Further, relative to its major competitors, Ex-Im Bank generally imposes far fewer restrictions on the provision of cover than other ECAs. Ex-Im Bank is off cover in 20% of the 65 markets; however, Ex-Im Bank was closed for business in 5% of the sample markets due to legislative reasons.

With respect to ECAs' risk-taking practices, **Figure 4** provides a broad characterization of the G-7 ECAs' risk appetite for business with less well-known private entities, as opposed to large corporations or bank guaranteed borrowers.

Figure 4: ECA Risk-Taking Practices

Taking Credit Risk of Smaller, Less Well-Known Private Entities in a Market:				
Never----->		Infrequent----->		Frequent
JBIC and NEXI	ECGD	Coface Hermes Sace	EDC	Ex-Im Bank

Most G-7 ECAs continue to prefer financing well-known or rated entities or rely on risk-sharing to minimize exposure to smaller, private entities. Ex-Im Bank is more comfortable than competitor ECAs taking the risk of smaller, less well-known private entities and does not follow other ECAs in their risk-sharing practices.

Exporter and Lender Survey Results

Due to legislative prohibitions, some respondents cited lost export opportunities in Iran and Libya in the oil and gas sector. On the other hand, most respondents graded Ex-Im Bank's cover policy and risk-taking practices highly, with one noting that "Ex-Im Bank's cover policy is competitive for most of our business development opportunities." On balance, the exporting community seems to believe that Ex-Im Bank is generally competitive, largely due to its relatively greater risk appetite vis-à-vis its foreign counterparts.

Conclusion

In 2003, Ex-Im Bank remained generally competitive in its approach to cover policy and risk taking. Once Ex-Im Bank is open in a market for a given repayment term, U.S. exporters and banks benefit from a lack of country and sector ceilings, such as those used by other ECAs. Additionally, Ex-Im Bank is less risk averse in its willingness to extend credit to smaller private entities, although the other G-7 ECAs seem to be gaining more experience in this area.

Chapter 3: Core Business Policies and Practices

Section B: Interest Rates

Introduction

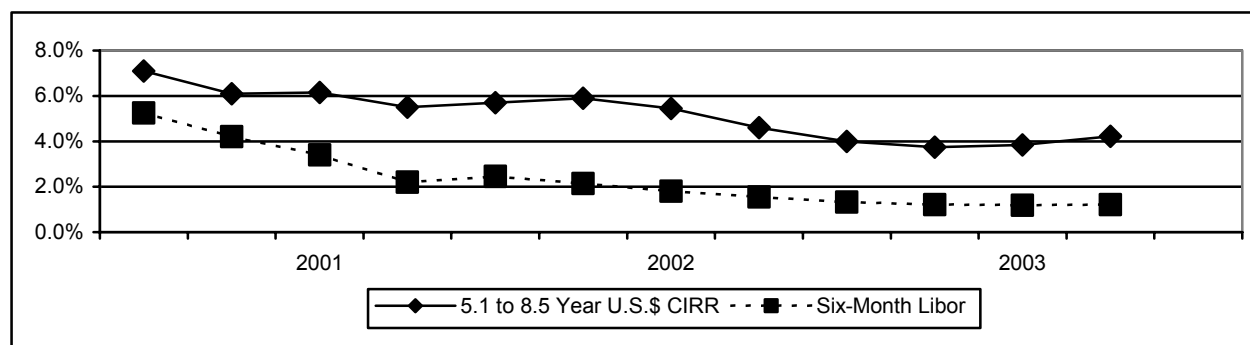
The interest rate charged to a buyer is a central component of an export finance contract's competitiveness. Accordingly, the OECD Arrangement sets minimum interest rates for export transactions that receive official financing support (e.g., direct loans from an ECA) in order to eliminate the use of concessional interest rates as a competitive factor. These minimum interest rates, or Commercial Interest Reference Rates (CIRRs), are fixed, market-related rates that are calculated using a government's fixed rate borrowing costs plus a fixed spread of 100 basis points.

Over the past several years, officially supported fixed interest rates have been of declining importance to overall competitiveness. In 2002, only 34% of ECA long-term financing support used official fixed interest rates (including both direct lending and interest make-up systems) as compared to 53% in 1997 (2003 data is not yet available). This decline is most likely attributable to the lower floating rates achieved in the commercial market as compared to the fixed CIRR. In a rising interest rate environment, however, fixed rates could become more attractive.

Ex-Im Bank's Policy and Practice

Ex-Im Bank provides fixed-rate official financing support through its direct lending program and sets the interest rate using the CIRR procedures detailed in the OECD Arrangement. In fiscal year 2003, less than 1% of the \$7.7 billion authorized under the medium- and long-term programs were direct loans. Interest rates for transactions under Ex-Im Bank's guarantee and insurance programs are set by the lender, not by Ex-Im Bank or by reference to the OECD Arrangement. Buyers tend to prefer using Ex-Im Bank's guarantee and insurance products because of their flexibility and the lower interest rates that can currently be achieved on a floating rate basis (see **Figure 5**).

Figure 5: Comparison of CIRR and LIBOR Interest Rates



G-7 ECAs' Policies and Practices

CIRR support is available under the programs of Ex-Im Bank's competitors. However, not all G-7 ECAs offer CIRR support through direct lending. While Canada, Japan and, very infrequently, Germany offer CIRR support for direct credits the other three – France, Italy and the UK – offer CIRR support through banks, using an interest make-up program (IMU). Under an IMU program, when commercial banks provide direct loans at CIRR rates to borrowers, they are guaranteed a return equal to the cost of borrowed funds plus a margin. Thus, if needed, ECAs "make up" the difference between the agreed return and the CIRR rate. For example, if this return is higher than the fixed rate CIRR, the commercial bank receives a payment from the ECA worth the difference. Alternatively, if the cost of funds plus the margin is less than the CIRR rate, the commercial bank pays the ECA the difference.

Under most IMU systems, the floating base rate of LIBOR or EURIBOR is used. The spreads range from about 40 to 90 basis points. There are no agreed rules on the level of spreads that governments may offer their banks to provide CIRR loans, and the rationale for the level of margin and the purposes for which the margin is intended vary from country to country.

Generally, IMU support is offered to cover administrative costs, but under some programs, the IMU spread is used to provide a pure profit margin to the commercial lender or to cover its liquidity costs. The coverage of credit risk is also a major use of IMU margins, including the risks associated with the portion of the financing package that is not covered by the official financing support. The use of the IMU system has a competitive component to it as the profitability to a private lender can induce more financing either in the form of "side" financing² or better terms on the core financing.

For other G-7 ECAs' guarantee and insurance transactions, the interest rates charged are generally higher than those charged when Ex-Im Bank is providing guarantee support. Banks lending under Ex-Im Bank's guarantee take no risk on the guaranteed portion due to the fact that the guarantee is a 100% comprehensive unconditional guarantee; hence, no incremental "risk premia" is required to compensate for the bank's risk. In contrast, most other ECAs offering pure cover only offer 95% conditional insurance cover. Under a conditional insurance policy, the commercial bank faces documentary risk, i.e., the validity of a claim will not be determined until the claim is filed. In addition, the commercial bank is exposed to credit risk when the ECA cover is less than 100%. Faced with such risks, most lenders add an additional spread over any standard return requirement on official export credits. For instance, spreads on European insurance cover are generally in line with their IMU spreads, varying between 45 and 90 basis points but averaging closer to 70 to 80 basis points.

² Side financing refers to the portion of the contract that is not covered under the official financing package e.g., the down payment.

Exporter and Lender Survey Results

Based on the survey and the focus group findings, the exporting community primarily used the insurance and guarantee programs. They found that the interest rates generated by these two programs were generally competitive. Only one participant noted that the European IMU programs could be slightly more advantageous, but this was not cited as a reason for lost sales in 2003.

Conclusion

Competition between ECAs based on interest rates has been tame for the past several years. While the Bank's 100% unconditional guarantee program generates very favorable interest rates in comparison to the 95% conditional insurance offered by many other ECAs, European ECAs' IMU programs offer spreads to commercial banks that could represent a competitive disadvantage to Ex-Im Bank. Nonetheless, neither of these programs significantly impacts competitiveness, and Ex-Im Bank in 2003 remained generally competitive with its G-7 counterparts.

Chapter 3. Core Business Policies and Practices

Section C: Risk Premia

Introduction

ECAs charge risk premia, also known as exposure fees, for taking the risk of a borrower failing to repay on a transaction. Although many factors influence the all-in cost of an officially supported export transaction, risk premia can be a considerable share of the direct financing costs. In 1999, the OECD adopted the Knaepen Package, an exposure fee agreement that defined the elements for the determination of fees and set Minimum Premium Rates (MPR) for sovereign risk transactions. For non-sovereign transactions, the sovereign MPR serves as the floor in pricing the exposure fees for transactions. However, what an ECA charges for non-sovereign exposure risks above the MPR is not strictly governed by the OECD.

Ex-Im Bank's Policy and Practice

Ex-Im Bank charges the MPR for sovereign risk transactions. For non-sovereign transactions, Ex-Im Bank prices transactions individually and assesses transaction risk by comparing the non-sovereign borrower's risk to the sovereign's credit risk. If the non-sovereign borrower, whether it is a bank or public or private entity, has a similar or better repayment risk compared to the sovereign, the exposure fee charged would be the same as for the sovereign (i.e., the MPR). On the other hand, if the risk is deemed to be higher, then incremental surcharges are added to the MPR. Ex-Im Bank's non-sovereign fees are relatively less expensive than those charged by our major counterparts because risk is priced by the individual transaction rather than by class of borrower.

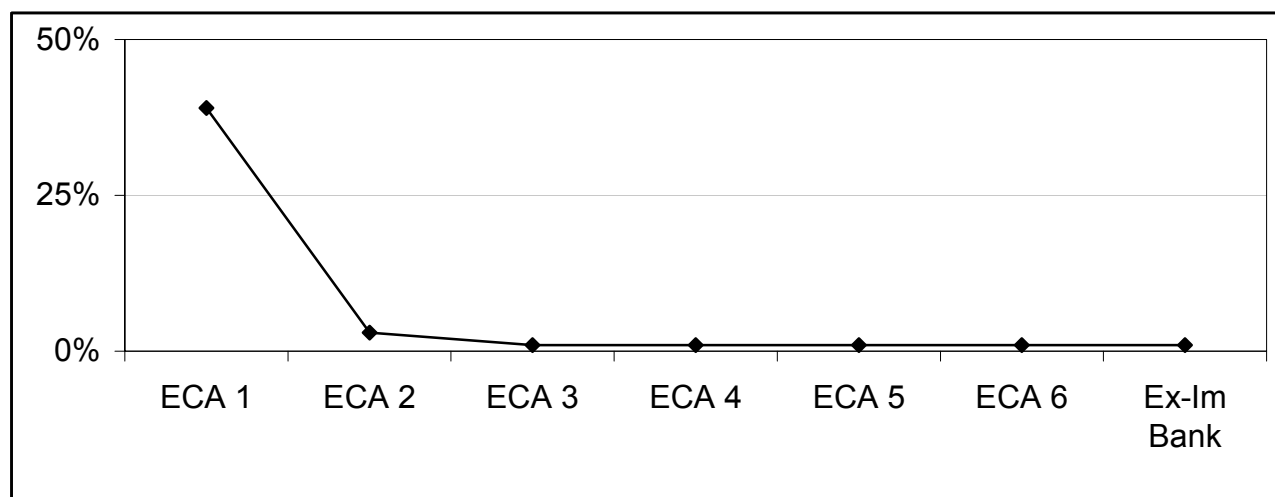
G-7 ECAs' Policies and Practices

For sovereign risk transactions, all G-7 ECAs generally charge the MPR. However, for non-sovereign risk transactions, pricing practices vary among ECAs. Generally, European insurer ECAs tend to add specific surcharges to the MPR for non-sovereign transactions depending on the type of the borrower. For example, a first-rate bank would be charged the MPR plus a surcharge based on its status as a commercial bank, while a private buyer would be charged the MPR plus a higher surcharge based on its status as a private non-financial entity. On the other hand, most non-European ECAs price on a transactional basis (an approach similar to Ex-Im Bank's), assessing a non-sovereign borrower's repayment risk case-by-case.

Summary Data

Figure 6 compares average exposure fee surcharges for the G-7 ECAs for sovereign transactions underwritten in 2003. As seen below, with the exception of one ECA, Ex-Im Bank and most other ECAs charge exposure fees at or slightly above the minimum premium rate allowable for sovereign risk transactions.

Figure 6: Average MPR Surcharges on Sovereign Risk Transactions*



*2003 preliminary data

Figure 7 shows that the ECAs' impose surcharges for non-sovereign risk transactions, although some ECAs price by borrower class while others use a transactional risk-assessment approach.

Figure 7: Sample MPR Surcharges on Non-Sovereign Risk Transactions*

Sample Market	ECA	Average Surcharge
Mexico	ECA 1	121%
	ECA 2	15%
	ECA 3	22%
	ECA 4	21%
	ECA 5	9%
	ECA 6	51%
	Ex-Im Bank	5%
Turkey	ECA 1	119%
	ECA 2	3%
	ECA 3	10%
	ECA 4	10%
	ECA 5	39%
	ECA 6	53%
	Ex-Im Bank	1%

Exporter and Lender Survey Results

The exporting community views Ex-Im Bank's exposure fees for sovereign and non-sovereign risks as generally competitive, with several respondents noting that Ex-Im's approach to accepting and pricing sub-sovereign risk could be more flexible.

Conclusion

The Knaepen Package placed a sovereign floor on exposure fees, thereby reducing competition between ECAs based on risk pricing. Ex-Im Bank typically charges the MPR for sovereign buyers, making the Bank competitive with other G-7 ECAs in sovereign exposure fees. Additionally, contrary to many European ECAs, the Bank does not rigidly apply surcharges for non-sovereign fees according to buyer type, generally resulting in competitive exposure fees for private and public non-sovereign buyers. Overall, Ex-Im Bank's exposure fee pricing practices are generally competitive with those of other G-7 ECAs.

Chapter 3: Core Business Policies and Practices

Section D: Operational Efficiency

Introduction

An emerging component that can affect an ECA's relative competitiveness is its ability to provide effective and efficient service to its customer base, particularly in terms of response time on pending transactions. As ECAs' programs and features more closely converge on the core financing elements and program features, opportunities for competitive distinctions have diminished, leaving the quality of customer service (and all that this entails) as one area where differences can yield either a positive or negative outcome, depending on which side of the table one sits. Consequently, ECAs – especially the European and Canadian agencies that have a more commercial orientation -- have devoted varying degrees of effort in recent years to differentiate themselves based on the quality of customer service. The level of interest in operational efficiency by ECAs is evident in what, how and to what degree ECAs have modified their operating philosophies, procedures, processes and organizational structures.

Hence, this new Chapter to the Annual Competitiveness Report summarizes the efforts undertaken by the major ECAs and compares Ex-Im Bank initiatives with those of our major ECA counterparts. The findings are based on data generated by a Berne Union survey of ECAs regarding "operational efficiency." A copy of the survey template is attached as Appendix L.

Operational Efficiency and ECAs

In addressing operational efficiency within the context of the G-7 ECAs, certain assumptions need to be made with regard to their collective objectives. Specifically, ECAs:

- As official government entities, have limited budgetary resources for human and support capital (systems, physical plant, business development expenditures);
- Have statutory, regulatory, and national interest factors to adhere to or consider; and
- Must meet certain institutional goals and objectives.

Within this framework, ECAs must balance and allocate their limited resources using a variety of means/tools and capabilities to fulfill their stated missions. Thus, even though ECAs have different philosophical and national interest objectives (as discussed in Chapter 2B) and deploy different strategies to meet these objectives, the fundamental challenge is the same: do the best that you can with what you have, and always be looking for alternative approaches that leverage and maximize your resources.

Over the past several years, ECAs have begun to focus more intensely on achieving greater operational efficiency as a way to provide improved customer service. With respect to Ex-Im Bank, a key reason for focusing on operational efficiency as a competitiveness factor is based on Ex-Im Bank's desire to provide comparable and competitive response time on transactions for its customers. Hence, this chapter attempts to evaluate steps taken by Ex-Im Bank to

address this concern, the impact on exporters' competitiveness, and compare Ex-Im Bank with our major competitor ECAs.

G-7 ECAs: Operational Efficiency

As **Figure 8** illustrates below, each G-7 ECA has recognized the importance of operational efficiency in varying degrees and each has implemented strategies and measures to improve in this key area and the multiple components comprising "operational efficiency." (It is interesting to note that many of the non G-7 ECAs have also demonstrated considerable attention to the issue of operational efficiency for customer service and risk management reasons.) While not all of the G-7 ECAs conduct formal and routine customer service surveys, they all make the effort to solicit the views of their customer base. In addition, the use of metrics by the ECAs seems to range from the extensive, very formal (ISO certification) to the "limited in scope but measurable" metrics. In this regard, customers in the G-7 countries seem to be concerned about:

- Information requirements for applications and related documentation;
- Case decision making and claims processing response time;
- Better on-line access and information from the ECAs via websites; and
- Staff knowledge and resourcefulness.

In response, the most common metric developed by ECAs concerns response time on case processing, decision making and claims resolution. In addition, ECAs have for the most part evaluated the problem areas and have instituted remedies designed to alleviate the most important efficiency aspects. Many of these efforts appear to have been moderately successful. In particular, the most common initiatives undertaken include:

- Implementation of new on-line, automated information technology/case processing and risk management capabilities – some fairly sophisticated and comprehensive, while a few are either in the systems development process or are limited in capabilities/functionality;
- Reorganizations of units or entire organizations; and
- Improved websites.

Almost all of the G-7 ECAs reported complaints from customers regarding slow response time, but none reported any confirmed lost sales as a result of slow response time. Finally, while both quality (e.g., sound underwriting and/or adherence to legal or policy requirements) and quantity (e.g., speed of response, volume of cases processed) are important to the G-7 ECAs, quality is clearly the more important focus with speed of response a secondary factor. Ideally, the ECAs want to meet each criterion fully, but recognize that the dominance of quality is critical to their organization's stature, reputation, and financial credibility.

Ex-Im Bank vs. G-7 ECAs

Ex-Im Bank's competitive position on operational efficiency would seem to be consistent with the typical ECA, while a few ECAs who have devoted years to enhanced customer service. Ex-

Im Bank is in the process of developing an on-line case processing capability for short and medium term transactions with a particular emphasis on providing expedited decisions for small and medium sized enterprises. EDC and SACE, on the other hand, have comprehensive systems in place, which have proven to be very effective in achieving their customer service goals, particularly with regard to timely responsiveness to cases and inquiries. A primary objective of Ex-Im Bank's recent reorganization is to accomplish similar goals. For example, Ex-Im Bank has established strategic account relationships with key exporters and lenders designed to provide close cooperation and a comprehensive understanding of the customers' needs. In the claims processing area, Ex-Im Bank contracted claims review services which have reduced the backlog of pending claims, allowed for a faster review and claim decision process, and enabled asset management staff to focus on the final review and address underlying claims issues. In 2003, Ex-Im Bank also re-designed its web site to improve customer and public access to information. Finally, Ex-Im Bank acquired the services of a process engineering firm to evaluate the medium-term case processing system and to identify areas for improvement.

Exporter and Lender Focus Group Comments

Participants in the focus group meetings expressed concern that Ex-Im Bank provides slower customer service in the medium- and long-term area than that provided by the Bank's G-7 counterparts. The participants expressed a belief that Ex-Im Bank's "slow processing time" may be a function of one, several or all of the following factors: inefficient internal business processes, public policy/legal issues requiring additional time to address, or a different philosophy regarding wholesale vs. retail support (e.g., delegating authority vs. internal case processing).

Conclusion

On balance, Ex-Im Bank is close to generally competitive in terms of its overall operational efficiency in the medium- and long-term areas as compared to its G-7 counterparts. While participants in the focus groups noted some concerns, the Bank has undertaken initiatives to improve turn-around time and customer service. In addition, the Bank has received positive feedback from customers over time, including receiving Trade Finance Magazine's "Best Export Credit Agency" award for 2003.

Figure 8: Comparison of Major ECAs' Steps to Improve Operational Efficiency

Factor/ ECA	Better Customer Service? (1&2)	Metrics? (3)	Steps Taken to Meet Metrics(4)	Measure Metrics? (5 & 6)	C/S Surveys & Results? (7)	Response time complaints (8)	Quality vs. Quantity (9)
Coface	YES - Application info req. - Volume of support docs. - Speed: app process, decision & claims - Availability of online app - Staff availability - Availability of Website info & call center - Case sensitive info	YES -Time Metrics: who, how, what, when (ISO 9001)	Limited identification of problem areas and steps taken to address	YES - ISO audits of procedures and reorg that resulted in ISP 9001 certification	YES	YES – Rarely	Need both for ISO
EGGD	YES - Speed: application process & decision	YES -4 working days (WD) for prelim response -10 WD general inquiry - ackn claims -2 WD claims due date or 10 WD if liable	-Underwriting reorganized by sector -New info management system - Customer Service Charter avail online that outlines metrics & complaint procedures - Seminars		YES - 2003 -Cover -Price -Products -Service	YES – Rarely	Both
EDC	YES - Speed: app process, decision & claims - Availability of online app - Staff availability - Availability of website info, call center & regional offices - Better communications w/customers	YES -Speed for all: 1.5 days & 2 days for SMEs	- Extensive online case process info - Off-line SME toll free - Newsletters - Workshops - More communication w/customers - Regional & int'l presence	YES Annual responsiveness Staff resourcefulness Risk Pricing Service Loyalty	YES - annual Response time met; now on value added Better/more communications w/customers & expanded presence	YES - Occasionally	1 st Quality 2 nd Quantity/speed
Hermes	YES - Application info req. - Volume of support docs. - Speed: application process & decision - Availability of website info	NO - no new metrics	- On-line/IMT for ST in 2003, w/ possible expansion to MLT - Contact persons for UW & SME issues		NO - informal dialogue ongoing w/ exporting community	YES - Occasionally; complaints regarding environmental case processing (sensitive cases)	1 st Quality 2 nd Quantity/speed
Japan	YES - Speed: app process, decision & claims - Application info req - Availability of online app - Availability of website info - Staff availability	YES 5 work days to ackn all correspondence	- New on-line/IMT 2005 - Reorganization at each website	YES – bi-annual self checks	YES - improved	YES - occasionally	1 st Quality
SACE	NO	YES : # of new SME customers	-New IMT -Increased avail online info -Reorganization	YES : # of SMEs	YES - Annually surveys customers about products, service, price, web, claims, and private sector comps	Data not available to answer.	Rely on customer info vs. own due diligence
US Ex-Im	YES - Application info req - Speed: app process (MT primarily) - Legal reqrmts./timing - Availability of website info	YES : 80% of MT w/in 20 days	- New IMT in development - Reorganization - Strategic relationship w/ exporters & banks - Claims processing improvements - Outside process engineers - New website	YES	YES	YES – Occasionally	1 st Quality 2 nd Quantity

Chapter 3: Core Business Policies and Practices

Section E: Ex-Im Bank's Core Competitiveness

Overall, Ex-Im Bank's core business policies and practices were graded an "A", meaning that Ex-Im Bank was generally competitive with the other G-7 ECAs. **Figure 9** illustrates how Ex-Im Bank fared competitively on sub-elements of each program, in addition to an aggregate grade for each program. The grades are derived from both the survey results and the Bank's analysis of how it performs in comparison to its G-7 counterparts.

Figure 9: Grading of Ex-Im Bank's Core Competitiveness

Key Elements	Grade
Cover Policy	A
Scope of country risk	A
Depth of non-sovereign risk	A
Breadth of availability (e.g., restrictions)	A-/B+
Interest Rates	A
CIRR	A
Insurance cover	A
Guarantee cover	A
Risk Premia	A
Sovereign	A
Non-Sovereign	A
Operational Efficiency	A-/B+
Total Average Grade	A

Chapter 4: Comparison of Major Program Structures

Section A: Large Aircraft

Introduction

The economic and strategic importance of the civil aircraft manufacturing industry within the United States and Europe, together with the significant cost of large commercial aircraft and the long useful life of large commercial aircraft has justified a separate Annex to the OECD Arrangement setting forth the terms of, and procedures for, ECA-supported aircraft financings (the Civil Aviation Annex). The section of the Civil Aviation Annex that pertains to "large aircraft" is known as the Large Aircraft Sector Understanding, or LASU, with "large aircraft" defined as airplanes with 70 seats or more¹. Today there are two primary producers of large aircraft in the world: Boeing in the United States and Airbus SAS (Airbus) in Europe; however, in the future, both Bombardier in Canada and Embraer in Brazil will also produce "large aircraft" (i.e., regional jets with at least 70 seats). Accordingly, the current participants to the LASU are the United States and the European Union, which, in this context, represents the interests of France (Coface), Germany (Hermes) and the United Kingdom (ECGD) (collectively, the "Airbus ECAs"), the primary locations of Airbus production; however, in the future, Canada (EDC) and Brazil (BNDES and SBCE²) may become more involved in the LASU.

The LASU establishes the terms and conditions of export credit support that OECD governments can extend to buyers of large aircraft. It sets a minimum cash payment of 15%, an interest rate structure for ECA direct loans (set at 120 basis points and 175 basis points over 10-year Treasuries for 10- and 12-year repayment terms, respectively) and a maximum 12-year repayment term. The Civil Aviation Annex also sets forth the terms of, and procedures for, ECA-supported financing of spare engines and spare parts related to large aircraft. The LASU bans ECAs from providing support for large aircraft into producer country markets (also known as "home market countries", which currently includes the United States, France, Germany and the UK and, as a result of a separate agreement between the Airbus ECAs and Ex-Im Bank, Spain). Finally, the LASU prohibits tied aid financing for large aircraft.

As illustrated in **Figure 10**, Boeing and Airbus have accounted for approximately equal shares of large aircraft orders over the past five years; however Airbus has received more orders than Boeing in four out of the most recent five years. The results during the past five years reflect the highly competitive nature of the large civil aircraft manufacturing industry.

Figure 10: Orders of Large Commercial Jet Aircraft

	1999		2000		2001		2002		2003		Total	
	#	%	#	%	#	%	#	%	#	%	#	%
Boeing	391	45%	611	54%	334	47%	251	46%	250	47%	1,837	48%
Airbus	476	55%	520	46%	375	53%	300	54%	284	53%	1,955	52%
Total	867		1,131		709		551		534		3,792	

¹ Comparably sized aircraft configured for cargo operations are included in the definition of "large aircraft".

² BNDES (Brazilian Development Bank) and SBCE (Brazilian Export Credit Insurance Agency) are the two official providers of export credits for the Brazilian government. They operate similarly to Japan's JBIC and NEXI, i.e., BNDES provides direct loans and SBCE insurance coverage, often for the same transactions.

For several years, Boeing and Airbus have been the only manufacturers of large aircraft. However, as noted above, recently the regional jet manufacturers in Canada (Bombardier) and Brazil (Embraer) have begun producing large aircraft (i.e., regional jets with 70 or more seats). Although to date the primary market for both regional jets manufactured by Bombardier and Embraer has been U.S.-based airlines, the trends that led to regional jet purchases in the United States – bringing passengers from smaller cities to hub airports and more point-to-point flights between smaller city pairs – are likely to spread to markets overseas, where these large regional aircraft will be competing with the smallest U.S.-manufactured large aircraft. Accordingly, Ex-Im Bank will closely monitor the terms and conditions offered by the Canadian and Brazilian export credit agencies (i.e., EDC and BNDES/SBCE) in Ex-Im Bank's traditional aircraft finance markets. Moreover, if discussions to update the LASU begin in 2004, the United States expects that both Canada and Brazil will take part in these discussions.

Ex-Im Bank's Policy and Practice

Ex-Im Bank support for large aircraft transactions is provided almost entirely through its guaranteed loan program. Under this program, Ex-Im Bank provides a 100% unconditional payment guarantee of the repayment of principal plus interest at the contractual rate. As a result, this program results in attractively priced financing on the Ex-Im Bank guaranteed portion of the transaction.

In January 2003, Ex-Im Bank announced that it would reduce by one-third (1/3) its exposure fee on asset-based aircraft transactions for airlines based in countries that adopt, ratify and implement the Cape Town Treaty (including certain optional provisions). The Cape Town Treaty is an international treaty that will facilitate asset-based financing and leasing of large commercial aircraft by reducing the risk in cross-border asset-based aircraft financing. Ex-Im Bank believes the decrease in risk due to the improved legal environment resulting from the adoption and ratification of the Cape Town Treaty justifies the exposure fee reduction. During 2003, airlines in three countries (Panama, Ethiopia and Pakistan) qualified for the exposure fee reduction with respect to the export of a total of 13 aircraft. Unless otherwise extended, the exposure fee reduction incentive is currently set to expire on September 30, 2004.

Airbus ECAs' Policies and Practices

The Airbus ECAs made three major changes to their aircraft financing programs in 2003, all of which should result in a more "level playing field" between Ex-Im Bank supported Boeing aircraft and Airbus ECA supported Airbus aircraft. First, during 2003, both Coface and Hermes began offering a 100% unconditional guarantee for aircraft finance. Historically, both Coface and Hermes had offered a 95% conditional insurance product, which resulted in higher interest rates than under Ex-Im Bank's and ECGD's 100% unconditional guarantee programs.

Second, in the past, if the buyer entered into a purchase contract with Airbus, the Airbus ECAs allowed buyers of large aircraft to "lock-in" a fixed interest rate up to three years prior to the delivery of the aircraft at no cost to the buyer and without any obligation to use such "locked in" fixed interest rate financing. Beginning in 2003: (1) the Airbus ECAs abandoned this "free"

interest rate lock, which had provided a potential significant advantage to Airbus over Boeing and was quite costly to the Airbus ECAs; and (2) the buyer of the aircraft must now use the Airbus ECAs' pure cover program, which enables the buyer to choose either a fixed or floating interest rate but does not permit the buyer to set the fixed interest rate far in advance of the delivery date for the aircraft at no cost to the buyer.

Third, during 2003, all of the Airbus ECAs generally began to charge a one-time, 3% upfront risk premia on their financings of large aircraft.

Taken together, all three of these changes in the Airbus ECAs' financing practices related to large aircraft should result in a financing package that is more similar to that offered by Ex-Im Bank. Thus, the opportunity for either the Airbus ECAs or Ex-Im Bank to gain a competitive edge due to advantageous financing techniques appears to be fading.

Summary Data

Several factors contributed to a very challenging operating environment for airlines during 2003, although some of these factors had improved toward the end of the year: the outbreak of SARS during the winter of 2002-2003; the uncertainties leading up to the hostilities in Iraq; the continuing terrorist threat to the international airline industry; major airline bankruptcies in the United States and Europe; soaring fuel prices; and competition from low-cost airlines. This environment resulted in a contraction in or, in some cases, a total withdrawal from, the commercial aircraft finance market by private sector financial institutions. In addition, given that many of these factors had a direct, negative impact on airlines based in the United States, Boeing (and Airbus) delivered an unusually high percentage of their aircraft to airlines outside of the United States. This is evidenced by the increased percentage of deliveries of aircraft to foreign buyers during 2003 as shown in **Figure 11**. During 2003, Boeing delivered a total of 281 commercial aircraft (down 24% from the prior year) of which 153 (or 54%) were delivered to foreign buyers. Exports (by number of aircraft deliveries) have accounted for a growing portion of Boeing's deliveries since 2001, exceeding 50% for the first time in 2003. While the percentage of Boeing's foreign sales supported by Ex-Im Bank averaged approximately 25% between 1999 and 2001, it increased to 41% in 2002 and to 48% in 2003.

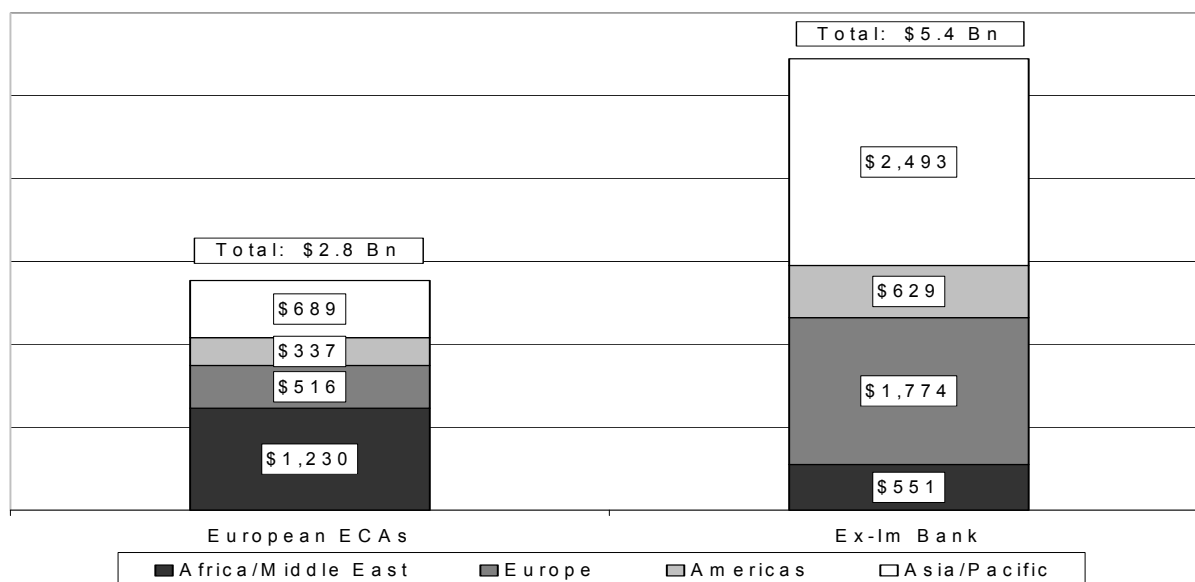
Figure 11: Deliveries of Boeing Commercial Jet Aircraft

	1999		2000		2001		2002		2003		Total	
	#	%	#	%	#	%	#	%	#	%	#	%
Domestic	356	57%	283	58%	363	69%	203	53%	128	46%	1,333	58%
Foreign	264	43%	206	42%	163	31%	178	47%	153	54%	964	42%
% Foreign supported by Ex-Im Bank	27%		27%		23%		41%		48%		32%	
Total	620		489		526		381		281		2,297	

As shown in **Figure 12**, Ex-Im Bank and the Airbus ECAs financed the export of approximately \$8.2 billion in large aircraft during 2003. Ex-Im Bank supported the export of more aircraft

during 2003 than during any year in Ex-Im Bank's history except for 1999,³ even though the overall number of Boeing aircraft that were delivered during 2003 (281) was down significantly from its all time peak in 1999 (620). In 2003, Ex-Im Bank accounted for \$5.4 billion (or 66%) and the European ECAs accounted for \$2.8 billion (or 34%) of the \$8.2 billion total ECA supported exports of large commercial aircraft.

Figure 12: 2003 ECA Support for Large Commercial Aircraft by Region



Exporter and Lender Survey Results

Exporters and lenders generally find Ex-Im Bank's aircraft financing program to be quite competitive with the Airbus ECAs' aircraft financing program. In particular, Ex-Im Bank received very high marks for its Cape Town Treaty initiative, in which it offered to reduce exposure fees by one-third (1/3) for asset-based transactions for airlines based in countries that ratified and implemented the Cape Town Treaty (including certain optional provisions). Ex-Im Bank's willingness to guarantee loans denominated in currencies other than U.S. dollars is also viewed as highly competitive with respect to the financing of large aircraft.

There are three areas where Ex-Im Bank does not fully meet the competitive needs of exporters. First, Ex-Im Bank's foreign content policy has been a source of concern for some time, with one respondent noting that the rules "mildly disadvantage" U.S. exporters. A second continuing problem, although not as significant a threat in 2003 as in previous years, is KfW's market window support (see Chapter 5, Section B) for Airbus, which provides additional financing capacity on top of that already available from the Airbus ECAs⁴. Finally, U.S. engine manufacturers and overhaul service providers find the long-standing U.S. government "Airbus Policy" – preventing Ex-Im Bank from financing any U.S. content on any Airbus aircraft – to be

³ The 1999 peak occurred as a result of: (1) the need for Ex-Im Bank aircraft financing following the Asian financial crisis in 1997-1998; and (2) a very large aircraft financing for a Middle East airline.

⁴ As explained in Chapter 5, KfW is undergoing a reorganization, the competitive implications of which are as yet unclear.

a competitive disadvantage (Airbus ECAs will finance U.S. content on new Airbus aircraft and European content on Boeing aircraft). One survey respondent indicated that after-market services and engine refurbishment deals had been lost to ECGD-supported competition due to this policy. With the exception of this one survey respondent, which graded the Bank's large aircraft financing program negatively due to the effect of the Airbus Policy on component sales, Ex-Im Bank's large aircraft program users found the Bank either fully or generally competitive with its European competitors

Conclusion

Ex-Im Bank continues to provide aircraft financing support that is competitive with that provided by the Airbus ECAs. Aspects of Ex-Im Bank's standard export credit support that are generally viewed as competitive, such as exposure fees and foreign currency guarantees, contribute to the competitiveness of Ex-Im Bank's aircraft finance program. The potential competitive hindrances to Ex-Im Bank's aircraft finance program, as noted by the U.S. exporting community, are the Bank's foreign content policy, market windows and Ex-Im Bank's inability, for larger U.S. government policy reasons, to finance U.S. content on Airbus aircraft.

The two competitive dynamics to watch over the next year are the impact of the Airbus ECAs' program changes and the emergence of Bombardier and Embraer into the large aircraft sector. Ex-Im Bank expects large aircraft competition based on export credit financing to be neutralized with the Airbus ECAs' abandonment of the three-year fixed interest rate lock and Coface's and Hermes' introduction of the 100% unconditional guarantee program for aircraft export credits. On the other hand, Brazilian and Canadian large aircraft exports that receive official export credit support – which might not necessarily comply with the Arrangement – could provide a competitive challenge to the smaller jets offered by both Airbus and Boeing.

Chapter 4: Comparison of Major Program Structures

Section B: Project Finance

Introduction

Limited recourse project finance refers to the financing of large-scale, long-term infrastructure and industrial projects based upon a financial structure where repayment is sought from future cash flows generated by the project. Export credit agencies have been providing support for limited recourse project finance transactions since the early 1990s.

Most ECAs offer support for project finance transactions and, for transactions where products are sourced from multiple countries, ECAs cooperate to establish structures that fairly balance the risks between ECAs and other financial partners.

Ex-Im Bank's Policy and Practice

Ex-Im Bank's project finance program was created in 1994 and quickly became a competitive program. Since then, Ex-Im Bank's project finance program has evolved over the years based on experience gained as well as customers' needs and expectations. Currently 100% comprehensive guarantees during the construction period and 100% comprehensive guarantees or direct loans during the repayment period are available under the project finance program. Another attractive feature of Ex-Im Bank's project finance program is the absence of project or country ceilings. Ex-Im Bank continues to be one of the most active of the G-7 ECAs in its willingness to offer the flexible terms available for project finance transactions under the OECD Arrangement.

Overall, the competitive features of Ex-Im Bank's project finance package are:

- 100% U.S. government-guaranteed support for all risks (political and commercial) during both the construction and repayment periods;
- Willingness to utilize the project finance flexibilities allowed under the OECD Arrangement;
- Maximum availability for capitalization of interest during construction (IDC); and
- Financing of local country costs.

G-7 ECAs' Policies and Practices

Across the board, ECAs offer very similar coverage for project finance transactions. All provide cover for at least 90% of the political and commercial risks during the life of the project, support local costs up to the amount of down payment, and capitalize the interest that accrues during the lengthy construction period. The only difference between ECAs is in the quality of coverage they provide. Ex-Im Bank and ECGD offer unconditional guarantees, EDC and JBIC offer direct loans and the four other G-7 ECAs (Coface, Nexi, Hermes and SACE) all offer conditional insurance. See **Figure 13** for a comparison of ECA program features for 2003.

Figure 13: Comparison of ECA Project Finance Program Features

	Product & Related Conditions**	Comprehensive Pre-Completion Cover	Comprehensive Post-Completion Cover	IDC up to 100%	Local Costs up to 15%	OECD Project Finance Flexibilities		
						First Repayment	Repayment Profile	Repayment Term
Coface (France)	95% Below Standard Insurance		✓	✓	✓	✓	✓	✓
ECGD (UK)	100% Above Standard Guarantee	✓	✓	✓	✓	✓	✓	✓
EDC (Canada)	Standard Direct Loan	✓	✓	✓	✓	✓	✓	✓
Euler-Hermes (Germany)	95% Below Standard Insurance	✓	✓	✓	✓	✓	✓	✓
JBIC (Japan)	Standard Direct Loan	✓	✓	✓	✓	✓	✓	✓
NEXI (Japan)	97.5% Below Standard Insurance		✓	✓	✓	✓	✓	✓
Sace (Italy)	95% Below Standard Insurance	✓	✓	✓	✓	✓	✓	✓
US Ex-Im Bank	100% Above Standard Guarantee	✓	✓	✓	✓	✓	✓	✓

**Conditional insurance products where post-default interest is not covered are considered "Below Standard." Conditional insurance products or direct loans where post-default interest is covered are classified as "Standard." "Above Standard" refers to unconditional coverage.

Exporter and Lender Survey Results

Only a handful of survey respondents had any experience with Ex-Im Bank's project finance program. Within this limited group, recommendations focused on Ex-Im being more flexible in its approach to structuring projects as well as offering a more expedited process. In addition to the survey respondents, project sponsors, who are responsible for the development and procurement decisions in project finance deals, are highly complimentary of Ex-Im Bank's Project Finance Division and feel that the Bank is easy to work with.

Conclusion

The project finance industry is cyclical in nature and is affected by the strength of the world economy and of key industries. Thus, over the past five years, there has been a high level of volatility in the number and dollar volume of project financings. Despite the volatility in the worldwide project finance arena, Ex-Im Bank continues to be a significant player in the ECA project finance arena. Ex-Im Bank's project finance program is therefore fully competitive with those offered by the other G-7 ECAs.

Chapter 4: Comparison of Major Program Structures

Section C: Co-Financing “One-Stop-Shop”

Introduction

“One-stop-shop” arrangements allow an exporter to market a single ECA financing package to a buyer interested in procuring goods and services from two (or more) countries. Without co-financing, the parties would need to secure separate financing contracts with two (or more) ECAs to ensure support for exports from various countries. The location of the largest share of the sourcing and/or the location of the main contractor will generally determine which ECA leads the transaction.

The lead ECA provides the applicant (buyer, bank or exporter) with export credit support for the entire transaction. Behind the scenes, the follower ECA provides reinsurance to the lead ECA for its share of the procurement. Thus, the lead ECA is able to provide a common documentation structure, one set of terms and conditions, and one set of disbursement procedures for the entire transaction. All parties benefit from the administrative ease of a streamlined financing package. As use of intra-European and international co-financing has grown, exporters continue to confirm that availability and ease of co-financing has become an important and measurable competitive issue.

Ex-Im Bank’s Co-Financing “One-Stop-Shop” Arrangements

In 2001, Ex-Im Bank signed one-stop-shop bilateral agreements that allow the Bank to either lead or follow in a co-financing transaction with ECGD (UK) and EDC (Canada), and initiated discussions with other G-7 ECAs to sign bilateral agreements. During 2003, Ex-Im Bank continued to gain experience by processing transactions under these co-financing arrangements. In addition, Ex-Im Bank approved a number of “one-off” co-financing transactions with GIEK (Norway) and Coface (France).

Ex-Im Bank negotiations for bilateral framework agreements with Hermes (Germany) and Coface led to the resolution of many outstanding issues and continued to evolve during 2003, but no agreement has yet been reached on the bilateral provisions to be included in a framework agreement. Specifically, two technical issues remain unresolved and continue to stymie bilateral negotiations to conclude framework co-financing agreements with the major insurer ECAs. First, in the event of a default, insurer ECAs have been unable to agree to provide Ex-Im Bank with the right to obtain an assignment of rights to the **entire** Ex-Im Bank guarantee portion of the debt – not just the installment that triggered the default.

Second, Ex-Im Bank’s foreign currency program requires the borrower to accept the conversion of the debt into a U.S. dollar obligation in the event of a default. That is, Ex-Im Bank would pay out the guaranteed lender in the foreign currency of the loan, and subsequently Ex-Im Bank would convert the debt to a U.S. dollar obligation. Other ECAs do not take foreign currency risk. However, foreign ECAs have accounts in certain foreign hard currencies (e.g.,

euro and yen accounts), add a surcharge onto transactions denominated in a foreign currency or cap their liability to a specific amount of foreign currency.

As Ex-Im Bank policy and practice in both of these areas differs from insurer ECA policy and practice, the ECAs continue to search for a technical solution that will allow co-financing framework agreements to be concluded that would ensure compliance with internal (and U.S.) policies, while at the same time be acceptable to other ECAs. Nevertheless, Coface and Ex-Im Bank have been able to approve one-off deals in the absence of a framework agreement. Discussions with SACE (Italy) to establish a bilateral framework agreement have been positive. [Note: On March 22, 2004, Ex-Im Bank and SACE entered into a bilateral framework co-financing and reinsurance agreement that could serve as a model for future agreements with other insurer ECAs.]

Unlike most other ECAs, Ex-Im Bank does not require a formal bilateral framework agreement before considering co-financing transactions. Thus, Ex-Im Bank will process co-financing requests for transactions with ECAs on a case-by-case basis.

Figure 14 details the one-stop-shop co-financing transactions that the Bank has authorized in 2003. In summary, the Bank authorized six co-financing transactions (three long-term and three medium-term) in Turkey, Brazil, Mexico and Russia, totaling approximately \$75 million.

Figure 14: Ex-Im Bank “One-Stop-Shop” Co-finance Transactions in 2003

Ex-Im Bank & Co-financing ECA	Market	Project	Amount
France: Coface	Turkey	Power Plant	\$45 million
France: Coface	Turkey	Power Plant	\$13 million
Norway: GIEK	Turkey	Power Plant	\$13 million
Canada: EDC	Brazil	Agricultural Aircraft	\$460,000
Canada: EDC	Mexico	Concrete Pumps	\$420,000
France: Coface	Russia	Automated Teller Machines	\$2 million

G-7 ECAs' Policies and Practices

As shown below in **Figure 15**, the bulk of co-financing agreements exist among the European ECAs who have signed multiple framework agreements between themselves and have been processing co-financed transactions since 1995. These agreements were originally designed to help European ECAs manage their exposure. In addition, most ECAs have seized upon the administrative efficiency that results from the one-stop-shop for export financing as a means of improving their customer service and competitive image.

Figure 15: G-7 Co-financing “One-Stop-Shop” Agreements (as of December 2003)

	Ex-Im	ECGD	EDC	Hermes	Coface	SACE	NEXI
Ex-Im		X	X				
ECGD	X		X	X	X	X	
EDC	X	X			X		
Hermes		X	X		X	X	X
Coface		X	X	X		X	X
SACE		X		X	X		X
NEXI				X	X	X	

When determining which transactions are eligible for co-financing, most ECAs agree that this program can be used across sectors and transaction size. While certain ECAs prefer to use co-financing for larger transactions, no fixed dollar limits currently exist on Ex-Im Bank co-finance transactions. In addition, due to the complex nature of project finance transactions, ECAs typically do not use the one-stop-shop to support exports to non-recourse projects.

Exporter and Lender Survey Results

About half of the survey respondents who commented on co-financing indicated that Ex-Im Bank's lack of signed bilateral agreements makes the co-financing program less competitive than its foreign counterparts. In particular, several exporters and lenders remarked that the lack of co-financing arrangements diminishes Ex-Im Bank's competitiveness vis-à-vis the other G-7 ECAs. On a positive note, several survey respondents rated Ex-Im Bank as competitive with (and sometimes more competitive than) its ECA counterparts in terms of Ex-Im Bank's willingness to consider co-financing transactions absent a bilateral agreement.

Conclusion

Ex-Im Bank's co-financing program is less available (and, to that extent, is less competitive) than the programs of most of the other G-7 ECAs. The lack of signed bilateral agreements with insurer ECAs is the main contributor to the Bank's disadvantage vis-à-vis foreign export credit agencies. Nonetheless, Ex-Im Bank has addressed transaction-specific requests for co-financing. In this regard, Ex-Im Bank is unique in that it will consider co-financing transactions absent a bilateral framework agreement.

Chapter 4: Comparison of Major Program Structures

Section D: Foreign Currency Cover

Introduction

Over the past several years, foreign currency financing has become an increasingly important competitiveness component of ECA programs. Foreign currency support works in the following way. A commercial bank (or in the case of EDC or JBIC, the ECA) extends an export credit denominated in a foreign currency to a foreign importer. In the case of ECA insurance or guarantees, the interest rate applicable to the foreign currency transaction is negotiated between the borrower and the lender, and the ECA provides political and commercial risk coverage for both the interest and principal. Where the ECA provides a direct loan, the applicable CIRR for the currency will be charged. Because hedging markets are very thin and prohibitively expensive in the medium- and long-term, the existence and utility of ECA coverage has a competitive effect on a buyer's sourcing decision.

For the sake of clarity, it is necessary to define several terms used in this discussion:

- "Domestic" currency: the currency used in the ECA's country.
- "Local" currency: the currency used in the importer's country.
- "Foreign" currency: any currency other than that used in the ECA's country.
- "Hard" currency: the legal tender of industrialized countries, such as the U.S. dollar, Japanese yen, Swiss franc and the euro (and its precursor currencies), all of which tend to have global acceptance as a medium of exchange and savings.
- "Soft" currency: the currency that is used only in the buyer's country or region, such as the Mexican peso, South African rand and Indian rupee. Soft currencies are, by definition, also local currencies.

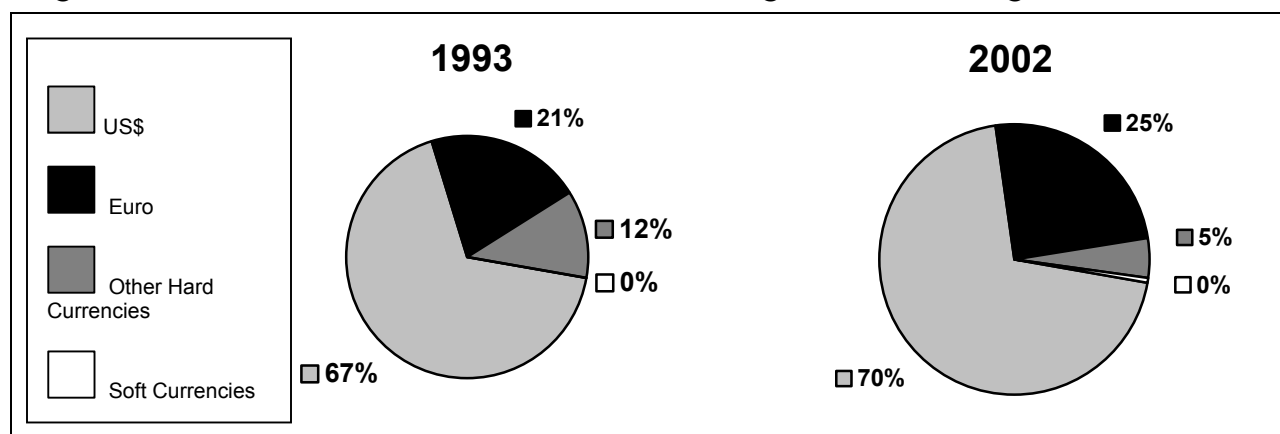
Trends in Foreign Currency Cover

With the adoption of the euro, there has been a consolidation in the hard currencies supported by ECA financings, as illustrated in **Figure 16** below. Nearly 10 years ago, in 1993, 88% of OECD long-term financings were in U.S. dollars or a European currency, while today around 95% of OECD long-term financings are in dollars or euros. Until recently, an ECA's ability to offer support for dollar financing was sufficient, but in today's competitive environment, where ECAs have harmonized and reduced much of the subsidy in official export credits, an ability to provide financing in local currencies is emerging as a differentiating factor among relatively homogeneous ECA offers.

As a result, there has been a modest movement towards increasing local currency financing. In 2002 (2003 data is not yet available), \$90 million and 35 transactions (less than one percent) of OECD long-term financings were denominated in a local currency, as opposed to \$20,000 and 3 transactions in 1993. The breadth of currencies supported has increased as well, as globalization has intensified and widened demand for local currency financing. In 1993 the two local currencies supported were the U.S. dollar and the Singapore dollar, both "hard"

currencies. In 2002 the local currencies supported were the U.S. dollar, the Slovakian koruna, the Czech koruna, the Malaysian ringgit, the United Arab Emirates dirham, and the South African rand – a mix of “hard” and “soft” currencies. This increase in demand appears to stem from importers’ decision to introduce the financial management technique of matching the currency of their borrowings with the currency of their revenue stream.

Figure 16: Distribution of Currencies for ECA Long-Term Financings



Ex-Im Bank’s Policy and Practice

For more than two decades, Ex-Im Bank has provided comprehensive guarantee and medium-term insurance coverage for foreign currency denominated transactions. Ex-Im Bank originally established this program to enable U.S. exporters to meet buyer demand for yen-priced offers, but demand has increased the number of currencies that Ex-Im Bank is willing to cover.

Despite the significant interest in soft currency deals, Ex-Im Bank authorized one medium-term soft currency transaction and two short-term soft currency transactions in 2003. The medium-term transaction was for a line of credit in Mexican pesos for a Mexican airline, while the short-term deals were for sales denominated in Mexican pesos and Czech koruna. Ex-Im Bank did, however, authorize over \$2 billion in hard currency financings: \$2 billion for aircraft sales (5 euro deals, 1 Canadian dollar deal, 1 Australian dollar deal) and \$1 million of euro financing for an export of medical equipment. Thus, over 15% of Ex-Im Bank’s authorizations in 2003 were for transactions denominated in a foreign currency.

G-7 ECAs’ Policies and Practices

Availability of support for local currency transactions, pricing and limits on exchange risk are the three main factors that differentiate the G-7 ECAs’ foreign currency support. As noted above, all of the OECD ECAs provide support for hard currency deals, as the standard currency of trade is the U.S. dollar, followed by the euro. More than half of the OECD ECAs have supported transactions in the importer’s local currency. However, only a handful of ECAs have supported transactions in a soft currency. **Figure 17** shows soft currency transactions supported by OECD ECAs from 2000-2002. None of Ex-Im Bank’s G-7 competitors has supported a soft currency transaction, although six of the smaller OECD ECAs have done so.

Figure 17: Soft Currency Transactions Supported by OECD ECAs, 2000 - 2002

ECA	Number of Soft Currency Transactions	Country of Soft Currency Transaction
OeKB (Austria)	1	Slovak Republic
EGAP (Czech Republic)	1	Slovak Republic
EKF (Denmark)	1	Czech Republic
GIEK (Norway)	1	Latvia
EKN (Sweden)	1	Malaysia
ERG (Switzerland)	1	United Arab Emirates
Ex-Im Bank	1	South Africa
Total	7	

Generally the ECAs do not change their pricing for transactions denominated in hard currencies, although several ECAs evaluate the risks inherent in such transactions on a case-by-case basis and reserve the right to add a surcharge to their fee. The practice is mixed on the soft currency transactions.

The Arrangement's premia rules allow for a discount of the minimum premium for those transactions that: (1) are denominated in a local currency; (2) are not subject to transfer risk; and (3) maintain the obligation in the local currency throughout the life of the transaction (e.g., payments made after a default are still made in the local currency). ECGD's foreign currency program meets the criteria for the local currency discount, and ECGD is willing to discount the premium on a local currency transaction. Most other ECAs are unwilling to discount the premium, as they believe that some local currency transactions have other risks that offset or negate the benefit of financing in a local currency. In fact, most would add a surcharge for a soft currency transaction. From 2001-2003, there have been just three soft currency premia discount notifications, two from Ex-Im Bank and one from Sweden.

Of those G-7 ECAs willing to support local currency transactions, all but EDC limit their exposure to exchange risk at the time of default. The mechanisms used vary by ECA, but transactions are structured to maximize the ECA's ability to collect enough payments after an event of default to ensure that the recoveries, when exchanged into the domestic currency, equal the ECA's cost of paying the claim (i.e., the amount of domestic currency the ECA had to spend to pay the claim in the local currency).

Figure 18 summarizes the foreign currency experience of the G-7 ECAs.

Figure 18: G-7 ECA Medium- and Long-Term Foreign Currency Transactions

	Exchange Risk Accepted by ECA?	Hard Currency Transactions Approved	Soft Currency Transactions Approved
EDC	Yes	USD, EUR, GBP, JPY	None
Coface	No; fix exchange rate at time of default	USD, JPY	None
Hermes	No; fix exchange rate at time of claim payment	USD, JPY, GBP	None
SACE	Yes	USD, JPY	None
NEXI	Yes	USD, EUR	None
ECGD	No; cap liability in British pounds	USD, EUR, AUD, JPY, CHF	Omani rials, Thai bahts*
Ex-Im Bank	No; convert obligation to dollars at time of claim payment	EUR, JPY, CAD, AUD	Mexican pesos, Egyptian pounds, Czech koruna, South African rand, Indian rupees**

*For non-export credit transactions, ECGD has also supported Indian rupees, Hong Kong dollars, Malaysian ringgits, Egyptian pounds and Pakistani rupees.

**In response to inquiries, Ex-Im Bank has indicated a willingness and ability to support Malaysian ringgits, Thai baht, Israeli shekels, New Zealand dollars, Singapore dollars, Chinese renminbi, Brazilian real, Turkish lira, Korean won, Russian rubles, Philippine peso and CFA franc. Ex-Im Bank will also consider other currencies as inquiries arise.

Exporter and Lender Survey Results

Ex-Im Bank received a limited number of comments on the competitiveness of its foreign currency cover. The exporter who most regularly uses the program wrote: "Ex-Im Bank continues to be flexible regarding foreign currency guarantees." Thus, in comparison to the other G-7 ECAs, Ex-Im Bank is generally competitive.

Conclusion

In sum, Ex-Im Bank's foreign currency program is generally competitive with that of other ECAs. Ex-Im Bank is a leader among the G-7 ECAs in the offering of local currency cover, and it is competitive with other ECAs in pricing local currency cover and in its limitations on taking exchange risk after default.

Chapter 4: Comparison of Major Program Structures

Section E: Ex-Im Bank's Major Program Competitiveness

Ex-Im Bank's major program structures collectively were graded "A-/B+", meaning that Ex-Im Bank was somewhere between generally and modestly competitive with the other G-7 ECAs. Although Ex-Im Bank's aircraft, project finance and foreign currency programs were competitive with the other G-7 ECAs, Ex-Im Bank's co-financing program hampered competitiveness overall.

Figure 19 shows Ex-Im Bank's competitiveness in various aspects of each major program, as well as an aggregate grade. The grades are derived from both the survey results and the Bank's analysis of how it performs in comparison to its G-7 counterparts.

Figure 19: Grading of Ex-Im Bank's Major Program Competitiveness

Key Elements	Adjusted Grade
Large Aircraft	A
Interest rate level	A
Percentage of cover	A
Risk capacity	A
Project Finance	A+
Core program features	A+
Repayment flexibilities	A+
Co-financing	B-/C+
Bilateral agreements	B-/C+
Flexibility in one-off deals	B
Foreign Currency Guarantee	A
Availability of hard cover	A
Availability of local cover	A
Pricing	A
Total Average Grade	A-/B+

Ch. 5 Economic Philosophy and Competitiveness

Section A: Trade-related Tied and Untied Aid

Introduction

The U.S. government has been pursuing OECD disciplines on aid since the 1970s. The U. S. government goal is to limit the trade distorting impacts of aid by establishing specific rules to which trade-related aid must conform. Accordingly, an OECD agreement to discipline aid that has the greatest potential to be trade distorting (also known as "tied aid" or aid tied to procurement from the donor's country) was agreed in 1992.

The OECD tied aid rules have helped reduce tied aid to an average of about \$3-4 billion annually (despite a surge in Japanese tied aid from 1998 to 2001). In 2002, Helsinki tied aid had reached its lowest level on record of approximately \$2.1 billion. In 2003, although Helsinki tied aid offers rose to about \$2.6 billion (**see Figure 20**), this figure continues to represent an over 70% reduction from the level before the implementation of the tied aid rules and is the second lowest total on record

Nevertheless, many foreign tied aid programs are likely to continue, and many projects supported by these programs contain a significant portion of capital goods that may have commercial implications. As a result, some US exporters perceive themselves as uncompetitive because Ex-Im Bank is generally unable to match tied aid offers for capital goods exports to developmentally-focused projects for which foreign tied aid is permissible.

In light of the success of the tied aid disciplines, U.S. government concern over the past few years has shifted focus to untied aid flows, which witnessed a dramatic rise in 2003 (although still significantly below the levels experienced in the mid-1990's). The concern began in the middle of the past decade when Japanese untied aid peaked at over \$10 billion per year. The U.S. has gathered anecdotal evidence and has also challenged a Japanese untied aid offer that served as a case study of the potential for untied aid abuse, when the U.S. demonstrated and convinced other OECD Members that the offer was de facto tied to Japanese procurement.

The U.S. has been seeking since 2000 to extend the principles of the tied aid disciplines to untied aid. However, these discussions have met vehement opposition from Japan and the principal untied aid donors of the EU, who claim that untied aid poses no serious threat to free trade. Opponents to the U.S. proposal to extend tied aid disciplines to untied aid argue that untied aid is developmental, and *not* trade distorting or even trade related. Moreover, as instances of de facto tying have not surfaced as a complaint since the mid-1990s, Japan and the EU argue that disciplines for untied aid would only serve to reduce much needed aid to developing countries instead of addressing a trade distortion. The U.S. has countered by noting that disciplines limiting trade distortions would only limit untied aid that had a trade motivation.

Responding to foreign opposition to discipline untied aid and in an effort to advance the technical negotiations beyond an OECD stalemate, during 2003 the United States proposed an interim agreement to enhance transparency of untied aid offers. That is, the U.S. proposed that untied aid donors agree to make their offers public to allow for competitive international bidding, and to report the nationalities of bid winners. The purpose of the transparency

proposal is to: (1) gather information that would help U.S. exporters compete for sales financed with foreign untied aid; and (2) compile evidence of possible de facto tying of “untied” aid to procurement from the donor country. If the transparency exercise is adopted, U.S. exporters will be in a better position to bid on projects financed with foreign untied aid and donors may be under pressure to avoid unfair bid awards.

U.S. Government and Ex-Im Bank Policy

The U.S. favors aid that represents *bona fide* development assistance. The U. S. thereby seeks to reduce (ideally eliminate) aid that is trade distorting because it:

- Disadvantages U.S. exporters, i.e., redirects business away from U.S. and other suppliers whose products are superior in quality and price.
- Closes markets and misallocates both international and developing country resources. Furthermore, it results in higher contract prices, a capital-intensive development bias, skewed technology choices and an increased debt burden.

Consistent with long-standing U.S. export financing policy, Ex-Im Bank does not initiate tied aid. Instead, Ex-Im Bank and the U.S. Treasury Department work together to determine whether to match a foreign tied aid offer. The decision to match is made on the basis of largely objective criteria, used to determine whether a tied aid match provides negotiating leverage for introducing new disciplines or is useful for enforcement of existing disciplines. The U.S. considers that tied aid used within the rules to gain a longer-term advantage for sales on market terms violates the spirit of the tied aid rules and should be matched. The USG would generally not require multiplier criteria to match foreign de minimis tied aid offers for commercially viable projects. This is because such tied aid can sometimes represent a competitive issue for U.S. exporters even though it was excluded from the OECD tied aid rules to reduce the administrative burden on ECAs.

Responding to U.S. exporters' demands for a U.S. Government response to foreign governments' use of concessional financing for development-related capital projects, in 2002 the TPCC introduced a USG mixed credit concept. The idea was, and still is, to combine USAID grants with Ex-Im Bank standard export credit financing for development-related projects that are identified as priorities by USAID and consistent with the OECD tied aid rules. (When combined, the two funding sources create a tied aid credit.) In 2004, USAID and Ex-Im Bank identified an inaugural project to test the mixed credit concept and are currently working out how to implement the project.

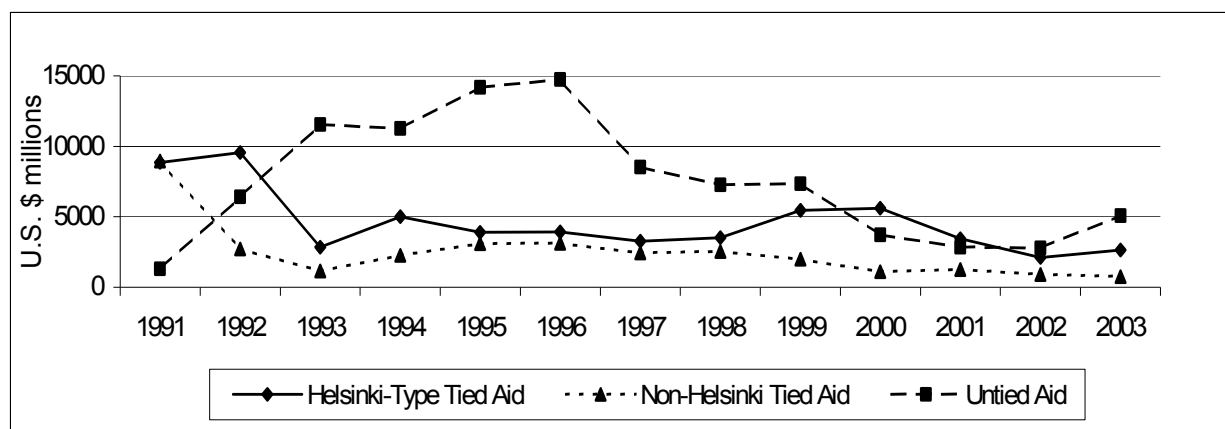
Summary Data

The 2003 aid data shows that tied aid levels have remained fairly stable since 2000. While tied aid program sizes remain stable, Spain, Finland and Portugal reported increased (and somewhat targeted) tied aid activity. However, only Spain is globally significant, with tied aid notifications in 2003 of approximately \$750 million. On the other hand France, the Netherlands

and Japan (who typically report high levels of tied aid) all seem to be containing their tied aid programs.

Small or “de minimis” tied aid offers (tied aid offers under approximately \$2.5 million) increased to their highest level since 2000. In 2003, donors reported 90 de minimis tied aid offers compared to 74 offers reported in 2002 and 60 in 2001. In terms of volume of de minimis offers, in 2003 the volume rose to \$147 million, up from approximately \$94 million in 2001. However, both figures are far below the peak of \$455 million that de minimis tied aid reached in 1995. As the de minimis tied aid offers are only subject to notification requirements, such tied aid can be offered (and was) for projects in commercially viable sectors such as power, industry and transport. The main donors of de minimis tied aid were Spain (34 cases); Austria (17 cases) and Denmark (12 cases).

Figure 20: Aid Credit Volume by Type



Note: “Helsinki-type” tied aid is subject to three principal disciplines: (1) no tied aid for commercially viable projects; (2) minimum 35% concessionality; and (3) country limitation (no country recipients with a per capita income above \$2,935, but the figure may change annually as it is based on annual World Bank lending criteria; see **Appendix G, Annex 1**). OECD Participants determine commercial viability based on the nature of the project, a feasibility study presented by the donor, and, if needed, a “consultations” meeting held to discuss the commercial viability of the project.

“Non-Helsinki-type” tied aid includes: stand-alone *de minimis* projects (valued at less than approximately \$2.6 million), grants or near-grants (at least 80% concessionality) and partial grants (at least 50% concessionality) offered to the poorest countries (the UN declared Least Developed Countries, or LDCs). Except for de minimis tied aid offers, these types of aid offers are normally not considered to have serious trade-distorting effects and, therefore, are exempt from the Helsinki rules regarding commercial viability and the consultations process (although all tied aid is subject to notification requirements, and *de minimis* tied aid must meet minimum concessionality and per capita income requirements).

During 2003, Ex-Im Bank made no new tied aid authorizations. However, the Bank approved a \$19.2 million Tied Aid Letter of Interest for a transaction in Jamaica. The Tied Aid Letter of Interest was approved to match a foreign tied aid offer that was in violation the OECD rules. The U.S. brought this violation to the attention of the OECD and obtained support to reopen the bidding process. The U.S. exporter ultimately did not win the bid but this was due to technical – not financing -- concerns. In addition, Ex-Im Bank reinstated a previously approved tied aid

transaction where the final disbursement date had expired. The borrower and exporter requested an extension in order to complete shipments and disbursements. Nonetheless, in 2003 Ex-Im Bank did not expend any of the \$260.5 million in the Tied Aid Capital Projects Fund.

Figure 21: Notifications of Helsinki Tied Aid and Consultations Group Examinations

	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	Total
Number of notifications	128	138	262	226	212	195	191	213	181	123	136	129	2,134
Number of projects examined by Consultations Group	39	25	31	14	4	2	5	2	4	2	1	2**	131
Number of non-compliant projects	16	12	21	4	3	2	5	1	4	1	0	1	70*

*Of the "non-compliant" cases (i.e., cases deemed commercially viable by the OECD Consultations Group), 19 were abandoned and 33 proceeded within Arrangement procedures or on commercial terms. The disposition of several cases is presently unknown.

Both projects were found to be financially viable but one project was found to be commercially non-viable due to lack of ECA cover in that particular market, which meant that the project was eligible for tied aid. Ex-Im Bank's matching authority is generally used to deter foreign tied aid offers that do not comply with the letter and/or spirit of the Helsinki rules, which have been reduced to practically zero at present, or to create negotiating leverage to establish new disciplines (see **Appendix G, Figures G4 and G5).

Exporter and Lender Survey Results

Only half of the survey respondents commented on tied aid, with one reporting that they had not seen such competition in several years and none reporting sales lost due to tied aid. Nevertheless, of those responding, over half expressed frustration with respect to foreign trade related aid programs, rating the Bank's tied aid program as having a "negative" impact on their competitiveness. In particular, on tied aid, exporters continue to complain that Ex-Im Bank should use its matching authority more frequently. As for untied aid, focus group participants noted an emerging trend in which untied aid offers are won (potentially displacing U.S. sales) by third-country subsidiaries of companies based in the donor country.

Conclusion

The total amount of tied aid levels rose slightly in 2003, and de minimis tied aid rose at a greater rate, but both remain dramatically below past levels. In sum, several of the G-7 OECD Members (and some other OECD Members) have aid programs that initiate tied aid and operate

within the international disciplines that were set forth in the OECD tied aid rules. The TACF today (jointly overseen by Treasury and Ex-Im Bank) is clearly focusing its use on matching only those cases that leverage ongoing negotiations, enforce current disciplines or threaten to distort commercially based competition in the future. Moreover, the competitive environment today is one in which volumes of tied aid have dropped over the past decade, while untied aid levels are rising. Most foreign aid offers comply with negotiated disciplines or have a developmental cast, and no new tied aid negotiations are ongoing or imminent. As a result, there are very few (and in some years, no) final authorizations of the TACF (although two to three cases per year do meet the current criteria and are offered support from the TACF). The success of the tied aid rules and diminished need for use of TACF to match foreign offers is consistent with overarching U.S. trade policy (although unsatisfactory from the view of some exporters).

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 additional 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.

Chapter 5: Economic Philosophy and Competitiveness

Section C: U.S. Philosophy and Ex-Im Bank Competitiveness

The U.S. government philosophy towards official export financing activity – ECAs should compete on a level playing field, should not compete with the private sector and should operate at a minimum cost to the taxpayer – provides a solid framework in which Ex-Im Bank provides export credit support to U.S. exporters. Over the years, the United States has worked diligently with other OECD governments to enshrine these principles in the Arrangement, leading to a playing field that in most cases is very level. Unfortunately, not every G-7 government subscribes to this philosophy in the provision of export credits. Tied aid, untied aid and market window programs all embody a very different governmental approach to supporting national exporters. These differing philosophical approaches have the potential to negatively impact Ex-Im Bank's competitiveness in individual cases.

Due to a combination of negotiating success (e.g., Helsinki), political events (e.g., KfW restructuring) and the financial consequences of the 2001-2003 global recession, these philosophically different programs impacted a very narrow spectrum of U.S. exporters in 2003. In fact, without specific allegations from the exporting community, it is not clear what if any impact the untied aid and market window programs of other governments have on U.S. export volumes. The export community firmly believes that – in the rare instances when U.S. exporters face competition from such programs – tied aid, untied aid and market window programs have a decidedly negative impact on U.S. exports.

Figure 25: Grading of Ex-Im Bank's Competitiveness When Confronted with Differing Government Financing Philosophies

Program	Ex-Im Bank has program? (Y/N)	Potential Impact on Competitiveness
Tied Aid	Y	Negative (infrequently encountered)
Untied Aid	N*	Unclear to negative (rarely encountered)
Market Windows	N**	Unclear to negative (very rarely encountered)
Overall Assessment		Negative (on a very narrow spectrum of cases)

* Ex-Im Bank could use TACPF to match effectively tied "untied" aid.

** However, in its 2002 Charter reauthorization, Ex-Im Bank was granted authority to match market window transactions.

Chapter 6: Public Policies - Stakeholder Considerations

Section A: Introduction

Ex-Im Bank is the official export credit agency of the U.S. government. In this role, Congress has given the Bank a mission to provide export financing assistance to the U.S. exporting community that is competitive with, and serves to neutralize, financing offered by the major foreign government ECAs. The basis for this mission is that government intervention is in the national interest if it ensures that purchase decisions are made on the basis of market factors such as price, quality and service.

As a U.S. government institution, Ex-Im Bank is entrusted with public funds to carry out its mission. As a user of public funds, Ex-Im Bank is expected to consider broader U.S. policies in how it carries out its core mission of providing export finance to U.S. exporters. Sometimes these broader U.S. policy objectives conflict with the Bank's main objective, and thus can impact its competitiveness. Some of these other policy objectives are specified in Ex-Im Bank's Charter or other legislation (e.g., economic impact and PR 17 on U.S. shipping). Other issues, such as content requirements, reflect the intent of Congress regarding the support of U.S. jobs and attempts to balance U.S. labor and industry interests. The impact of these other policy objectives on Ex-Im Bank's competitiveness can be magnified in specific cases because, in general, other G-7 ECAs have few such broad public policy considerations, with the exception of domestic content guidelines.

The following sections of this chapter present a contextual description of selected public policies and an analysis of the competitive implications related to each issue.

Chapter 6: Public Policies - Stakeholder Considerations

Section B: Economic Impact

Introduction

Economic impact refers to the Congressional mandate for Ex-Im Bank to assess whether Ex-Im Bank support for a transaction would likely cause substantial injury to U.S. industry or would result in the production of a good that is subject to a relevant trade measure (defined below). Transactions that pose either one of these issues may be denied Ex-Im Bank support. Ex-Im Bank's economic impact procedures are designed to ensure that all of the transactions it supports meet the Bank's Congressional mandate. While all cases seeking Ex-Im Bank support are screened for economic impact, cases subject to analysis include all capital equipment transactions that enable foreign buyers to establish or expand production capacity of goods that may compete with U.S. domestic production.

Ex-Im Bank's Policy and Practice

The requirement to consider the adverse economic impact of transactions was first incorporated into Ex-Im Bank's Charter in 1968 and has been subsequently modified seven times (the most recent change to the economic impact section of the Bank's charter occurred in June 2002). Ex-Im Bank's Charter requires Ex-Im Bank to assess whether the extension of its financing support would:

- (1) Result in the production of substantially the same product that is the subject of specified trade measures (i.e., transactions resulting in the production of a good subject to an anti-dumping (AD) or countervailing duty (CVD) order, a Section 201 injury determination under the Trade Act of 1974 or a suspension agreement from an AD/CVD investigations); or
- (2) Pose the risk of substantial injury to the U.S. economy. Pursuant to Ex-Im Bank's Charter, the standard for substantial injury is met if the foreign production capacity established or expanded by the Ex-Im Bank financing equals or exceeds 1% of U.S. production. Transactions over \$10 million that meet the substantial injury standard require a detailed economic impact analysis in which Ex-Im Bank staff analyses the global supply and demand for the product in question, and assesses the broad competitive impacts on U.S. industry arising from the new foreign production (e.g., whether U.S. production could be directly or indirectly displaced as a result of the new foreign production).

If a transaction meets these legislatively specified standards, then economic impact can be the basis for denial of Ex-Im Bank support. However, the economic impact legislation provides that the economic impact prohibition will not apply in any case where the Ex-Im Bank Board of Directors determines that the benefits of the transaction outweigh the costs.

G-7 ECAs' Policies and Practices

Ex-Im Bank's economic impact policy is unique with respect to the other G-7 ECAs. Several ECAs have a broad mandate that the transactions they support should benefit their domestic economies. However, only Ex-Im Bank weighs the potential negative economic impacts of its support against the benefits and considers the relevance of trade measures to a transaction, both of which could result in the denial of support. As a consequence, a negative economic impact finding may result in processing delays and carries the real risk of denial. Moreover, Ex-Im Bank's economic impact mandate has operational consequences since Ex-Im Bank must dedicate staff and other resources to the issue.

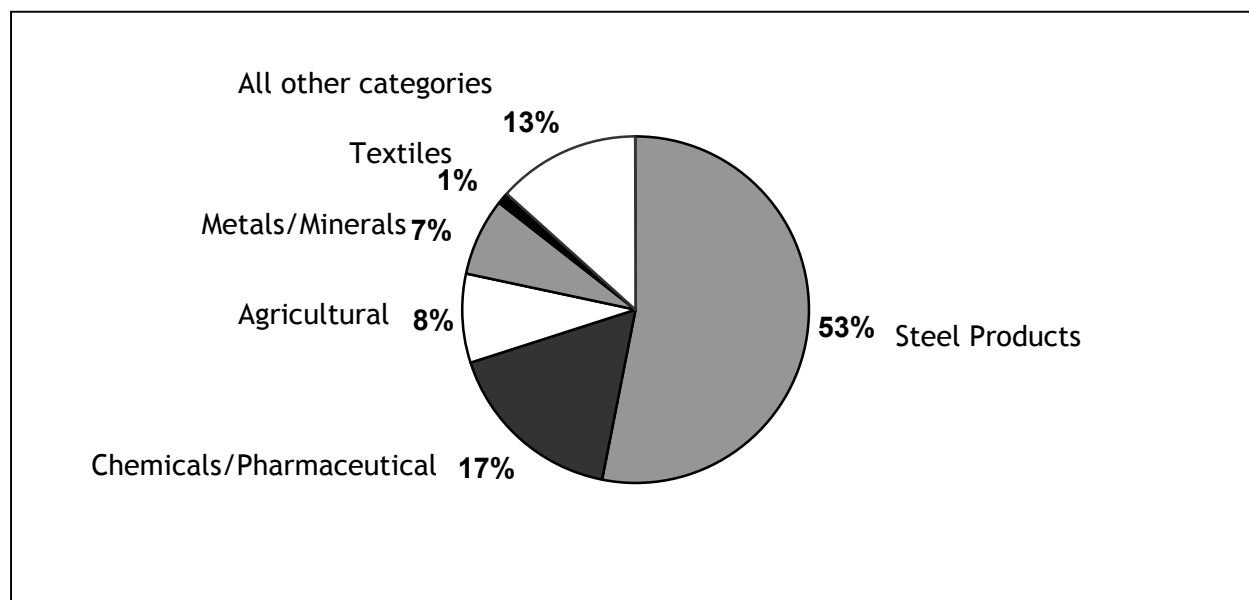
Summary Data

In FY2003, the Bank processed 558 medium-term insurance and medium- and long-term loan and guarantee transactions. Of these transactions, 227 were applications for loans and guarantees at the Preliminary Commitment (PC) and Final Commitment (AP) stages, and 331 were applications for medium-term insurance. Eighty-seven of these cases, or 16% of total transactions acted upon, were reviewed for economic impact relevance because they supported a foreign buyer's production of an exportable good. Three of these 87 transactions required a detailed economic impact analysis, all of which were found to have a net positive economic impact. The remaining 84 transactions were subject to a post-authorization review to ensure that there were no aggregations of more than \$10 million to a single buyer that would have required a detailed economic impact analysis.

No transactions were denied in fiscal year 2003 because of economic impact. Since Ex-Im Bank's economic impact policy was changed in January 1999 to account for trade measures, however, Ex-Im Bank's economic impact policy has resulted in the Board of Directors denying nine transactions because of an applicable AD/CVD order or Section 201 injury determination (six in FY1999, two in FY2000 and one in FY2002). No transactions have been affected by the notice and comment period for applicable preliminary AD/CVD injury determinations since Congress amended the Charter in June 2002. These numbers, however, do not reflect applications withdrawn or transactions for which no application was ever submitted because of the Bank's economic impact requirements.

Because of Ex-Im Bank's economic impact policy to not support any transactions that would result in the production of a good subject to a relevant trade measure, U.S. manufacturers of steelmaking equipment were broadly affected by a Section 201 material injury finding on the U.S. steel sector that lasted from March 2002 to December 2003 and prohibited Ex-Im Bank from supporting the production of steel in foreign markets. While the Section 201 trade measures on steel no longer exist, Ex-Im Bank is still prohibited from supporting many U.S. steel-making equipment manufacturers because of the large number of current AD/CVD orders that apply to steel products. **Figure 26** shows that steel products account for over half of all current AD/CVD orders. A review of G-7 ECA data shows that other G-7 members did not have such prohibitions, and supported approximately \$144 million worth of steelmaking machinery exports during the period

Figure 26: Anti-dumping and Countervailing Duty Orders by Sector



Exporter and Lender Survey Results

In general, U.S. exporters and lenders commented that Ex-Im Bank has been sufficiently transparent so as to give advance notice when a transaction may be denied because of the economic impact policy. With the exception of steelmaking equipment (discussed above), there have been few instances where a transaction was withdrawn or deterred from being submitted because of the economic impact policy. Some exporters and lenders commented that the economic impact policy could add significant time to case processing. Overall, economic impact, when present in an individual transaction, could adversely affect the Bank's competitiveness.

Conclusion

No other G-7 ECA has a similar requirement to review transactions for trade measures and potential injury to the domestic economy as does Ex-Im Bank. Still, the policy affected only 10% to 20% of medium- and long-term activity by creating the risk of denial or by increasing case processing time. As a whole, the economic impact element, when it arises, can have a negative impact on Ex-Im Bank's competitiveness, leaving Ex-Im Bank a notch below the typical G-7 ECA.

Ch. 6: Public Policies - Stakeholder Considerations

Section C: Foreign Content

Introduction

Foreign content is the portion of the export that originated both outside of the United States and the buyer's country, whereas local costs are incurred in the buyer's country. U.S. content is the portion of the export that originated in the United States.

Ex-Im Bank's Policy and Practice

In keeping with its objective of maintaining or increasing U.S. employment through the financing of U.S. exports, the Bank has adopted a content policy to ensure that its export financing targets the U.S. content associated with goods and services exported from the United States. In order to accommodate U.S. export contracts that contain goods and services that are not completely U.S.-produced, the Bank's policy allows inclusion of some foreign content within the U.S. export contract with certain restrictions and limitations. Ex-Im Bank's policy on non-U.S. content stems from its Charter but has no specific statutory requirement *per se* as it relates to non-U.S. content; rather, it reflects a concerted balance between organized labor and industry interests.

For all medium- and long-term transactions, the Bank's foreign content policy *restricts* the scope of its financial support to cover only those products that are shipped from the United States to a foreign buyer, and then it *limits* the level of its support to the **lesser of**: (1) 85% of the value of all eligible goods and services contained within a U.S. supply contract; or (2) 100% of the U.S. content of that export contract.

G-7 ECAs' Policies and Practices

In general, all export credit agencies seek to maximize the national benefit for their respective activities. However, context for that evaluation varies widely and has led to very different content policies.

All OECD Participants recognize that each country has developed its content policy to further unique domestic policy goals. Hence, the OECD Participants have not pursued common ECA rules on foreign content, and there are no Arrangement guidelines governing the scope or design of foreign content in an officially supported export credit. Thus, given the vastly different sizes of the G-7 economies and their respective views of national interest, it is not surprising that foreign content policies vary widely and substantially.

Figure 27: ECA Foreign Content Support - Comparison of Policy Parameters

	Ex-Im Bank	EDC	European ECAs	JBIC & NEXI
Application of the policy	In aggregate	In aggregate	In aggregate	In aggregate
Requirement to ship foreign content from the ECA's country?	Yes	No	No	No
Policy implications if foreign content exceeds 15%	Cover reduced	Decided on a case-by-case basis	Decided on a case-by-case basis* *Cover is not reduced for transactions that include up to 30% EU content	Decided on a case-by-case basis *Cover is not reduced for transactions that include up to 70% foreign content
Minimum amount of domestic content	No minimum threshold	If domestic content is less than 50%, coverage terms are set on a case-by-case basis	Generally, domestic content needs to be at least: (i) 85%-90% in the case of non-EU foreign content; and (ii) 60%-70% in the case of EU foreign content	If domestic content is less than 30%, coverage terms are set on a case-by-case basis

Figure _ compares the main aspects of the content policies of the G-7 ECAs in 2003. The data illustrate that Ex-Im Bank's content requirements are far more restrictive than Canada's and Japan's but are not so different overall than those of its European counterparts. The following two points regarding competitor ECA practices and policies should be noted:

- Most ECA policies are not transparent. In practice, ECAs are not always willing to provide the maximum amount of support for foreign content, particularly in the higher risk markets where ECAs generally have country exposure limits.
- Ex-Im Bank does not have a required minimum level of domestic content for an export contract to be eligible for support, while European ECAs require 60%-90% domestic or EU content. Nevertheless, **Figure 27** shows that though Ex-Im Bank's implementation procedures appear to be generally competitive with the Europeans, the requirement that the foreign content be shipped from the United States is a constraint unique to Ex-Im Bank.

Summary Data

As shown below in **Figure 28**, of those transactions that contained foreign content, the average percent of foreign content per transaction stayed generally within the 10%-12% range for the last five years. However, the export value (as a percentage) for transactions containing foreign content remains significant, which is attributable to the fact that in 2003 Ex-Im Bank support for large aircraft constituted approximately 40% of Ex-Im Bank's medium- and long-term activity. Large aircraft transactions are typically high dollar value and include, on average, 11% eligible foreign content. Conversely, smaller value transactions tend to include less foreign content, and approximately 60% of the total number of transactions supported by Ex-Im Bank contained no foreign content.

Figure 28: Recent Trends in Ex-Im Bank Foreign Content Support for Medium- and Long-Term Activity*

Authorizations		1999	2000	2001	2002	2003
Total activity	Export value (\$MM)	\$10,500	\$9,455	\$7,109	\$8,212	\$8,386
	Number of transactions	211	267	227	222	232
Transactions containing foreign content	Export value (\$MM)	\$9,001	\$7,759	\$5,757	\$7,842	\$7,823
	Percentage of total value	86%	82%	81%	95%	93%
	Number of transactions	92	100	80	96	85
	Percentage of total number	44%	37%	35%	43%	37%
Foreign content	Volume (\$MM)	\$1,076	\$805	\$631	\$836	\$814
	Average per transaction	12%	10%	11%	11%	11%

*These figures exclude medium-term insurance.

Appendix F provides a more detailed listing of foreign content contained in Ex-Im Bank's medium- and long-term transactions in 2003 at the time of authorization.

Exporter and Lender Survey Results

Several exporters maintained that although the Bank's aggregate approach to foreign content "has helped a great deal", "it still lags behind the European, Canadian, and Japanese ECAs policy", which allows them to directly finance non-domestic content. Moreover, one exporter noted that Ex-Im Bank's policy with regard to foreign content was forcing a shift in production of some products to Europe. Overall, survey respondents found that Ex-Im Bank's foreign content policy, when present in a given transaction, could negatively impact the Bank's competitiveness.

Conclusion

Ex-Im Bank's approach to foreign content appears to be more transparent and predictable than the approaches taken by our G-7 counterparts. Moreover, the Bank's approach is viewed as more competitive in 2003 than before the 2001 changes. On the other hand, the other ECAs still have more flexibility and a broader band within which they permit foreign content to be included. Consequently, Ex-Im Bank's foreign content policy can have a negative impact on competitiveness.

Chapter 6: Public Policies - Stakeholder Considerations

Section D: Local Costs

Introduction

Local costs are goods and services originated and/or manufactured in the buyer's country. In contrast to foreign content, the OECD Arrangement sets the basic parameters on official local costs support, which includes the ability of ECAs to provide support for local costs related to an officially supported export transaction. Per the OECD, this support may not exceed the amount of the down payment, typically 15%.

Ex-Im Bank's Policy and Practice

When Ex-Im Bank provides medium- or long-term guarantee, loan or insurance support for U.S. exports, it may also provide up to 15% of the value of the U.S. exports (including eligible foreign content) for project-related local costs for goods and services that are directly related to the U.S. exporter's contractual responsibilities.

G-7 ECAs' Policies and Practices

All ECAs adhere to the local costs parameters set forth in the Arrangement. In fact, most major ECAs limit local costs financing because, due to country cover limitations, support for local costs crowds out ECAs' ability to cover exports. Thus, unlike Ex-Im Bank, other ECAs require that local costs be explicitly included in the scope of the exporter's contract (except in the case of project finance).

Summary Data

In 2001, Ex-Im Bank's local costs policy was revised. Ex-Im Bank offers automatic local costs support for all environmentally beneficial and medical equipment exports as well as project finance transactions (including medium-term transactions). Furthermore, local costs support is now generally available for all long-term transactions. As **Figure 29** illustrates, since the 2001 local costs changes, there has been a significant increase in the number of transactions (but a decrease in dollar volume) that have received local costs support. The increase in the number of transactions with local costs may be attributed to the fact that the revised procedures provided more small and medium-sized U.S. exporters with greater certainty that local costs support would generally be available provided that the local costs are linked to the U.S. exporter's ability to secure the export sale. While local costs support may be more widely available, the dollar volume of local costs support has decreased. This decrease may be attributed to the fact that the requested amounts of local costs support tend to be for less than the maximum amount allowable (i.e., less than 15% of the U.S. export value).

Figure 29: Recent Trends in Ex-Im Bank Local Costs Support

	Authorizations	2000	2001	2002	2003
Total medium- and long-term activity	Export value (\$MM)	\$9,455	\$7,109	\$8,212	\$8,386
	Number of transactions	267	227	222	232
Medium- and long-term activity containing local costs	Number of transactions	11	18	31	34
	Percentage of total number of transactions	4%	8%	14%	15%
Local costs	Volume (\$MM)	\$183	\$192	\$213	\$101
	Percentage of total medium- and long-term activity	2%	3%	3%	1%

Exporter and Lender Survey Results

Overwhelmingly, survey respondents indicated that the Bank's local costs policy in 2003 was comparable to or more competitive than those of its counterparts. Exporters and lenders alike indicated that Ex-Im Bank's local costs policy for long-term transactions that "automatically offer local costs has helped us win bids." Thus, Ex-Im Bank's local costs policy was found to have a positive impact on Ex-Im Bank's competitiveness.

Conclusion

Based on both comparative information regarding our G-7 ECA counterparts and on the exporting community's actual experience with Ex-Im Bank's revised local costs policy, Ex-Im Bank is considered to be fully competitive with the best ECAs in its local costs support. Thus, the local costs policy has a positive impact on the Bank's competitiveness.

Chapter 6: Public Policies - Stakeholder Considerations

Section E: U.S. Shipping Requirements

Introduction

In accordance with policies implementing Public Resolution No. 17 (PR 17) of the 73rd Congress, certain ocean-borne cargo financed by loans or credit guarantees from a U.S. government entity, such as Ex-Im Bank, must be transported on U.S. flag vessels, unless a waiver of this requirement is obtained from the U.S. Maritime Administration (MARAD). Exports financed through Ex-Im Bank's medium- and long-term loan and long-term guarantee programs are subject to the U.S. flag vessel requirement. Exports financed under Ex-Im Bank's short- and medium- term insurance and medium-term guarantee programs are not required to be shipped on U.S. flag vessels.

The stated goal of PR-17 and other cargo preference legislation is to support the continued viability of the U.S.-flagged commercial fleet, which among other things, serves as an essential national security asset during times of war or national emergency. From the perspective of U.S. exporters, however, cargo preference requirements can make U.S. exports less competitive vis-a-vis foreign competitors, because, among other things, foreign competitors have no similar requirements and U.S.-flagged shippers generally charge higher rates than their competitors.

Policy and Practice

Exporters are responsible for ensuring that they comply with Ex-Im Bank policy implementing PR 17. Pursuant to PR 17, upon request, MARAD may waive the U.S. flag vessel requirement on a case-by-case basis. There are four types of waivers:

- **General Waivers** may be granted to a recipient country's merchant fleet to carry up to 50% of the cargo under an Ex-Im Bank supported transaction, when the recipient country agrees to provide similar treatment to U.S.-flagged vessels in its foreign trade.
- **Statutory Waivers** may be granted if MARAD determines that a U.S.-flagged vessel will not be available within a reasonable amount of time or at a reasonable rate.
- **Compensatory Waivers** may be granted in situations where goods otherwise subject to the U.S.-flagged vessel requirement are, in honest error or through extenuating circumstances, shipped on non-U.S.-flagged vessels, prior to obtaining U.S. government financing. In such circumstances, MARAD may grant a waiver where the exporter agrees to ship an equivalent or greater amount of non-U.S. government impelled cargo on U.S. flag vessels within a specific time period.
- **Conditional Waivers** may be granted for specific over-dimensional cargoes if MARAD determines that no U.S.-flagged vessel service capable of accommodating multiple shipments of over-dimensional cargoes will be available during a proposed project time period.

If a waiver is obtained, Ex-Im Bank may provide financing for goods shipped on vessels of non-U.S. registry.

G-7 ECAs' Policies and Practices

None of the other G-7 ECAs have similar cargo preference restrictions.

Summary Data

Figure 30 illustrates the number of waivers approved and denied in the last four years.

Figure 30: PR 17 Waiver Data

Waivers		2000	2001	2002	2003	Total
General Waivers	Approved	8	4	3	0	15
	Denied	0	0	0	0	0
Statutory Waivers	Approved	74	54	22	29	179
	Denied	2	6	1	5	14
Compensatory Waivers	Approved	13	7	10	11	41
	Denied	0	0	0	0	0
Conditional Waivers	Approved	0	7	0	0	7
	Denied	0	0	0	0	0

According to MARAD, all applications for statutory waivers that were denied were due to a determination by MARAD that U.S.-flagged vessels were available to carry the cargo within a reasonable amount of time and/or at a reasonable rate.

Exporter and Lender Survey Results

Ex-Im Bank customers who had experience with MARAD PR 17 requirements on specific transactions indicated that this policy had a negative impact on their business. Two exporters cited the MARAD requirement as the source of multiple lost sales, all of which occurred in the Latin American markets. The following comments, taken from the survey illustrate the strong views that some Ex-Im Bank customers have with respect to PR 17:

- "The MARAD requirement is a bear and really a turn off to our exporters I have dealt with and adds additional burden, expense and complexity to their export."
- "PR 17 shipping requirements are putting exporters at a disadvantage due to the higher cost of using U.S. flag carriers and the administrative work placed on exporters/borrowers to obtain a waiver."
- "MARAD policies continue to cost lost sales from customers."

- “MARAD requirements [are] known to be one of the main reasons sponsors, exporters, and borrowers do not want to use Ex-Im. The cost of U.S. flagged vessels and hassle of trying to get a MARAD waiver make the export uncompetitive (the deal becomes too uncertain).”

Conclusion

As a condition of Ex-Im Bank’s direct loan and long-term guarantee financing, U.S. exporters are required to comply with U.S. flag vessel requirements. The cargo preference rules do appear to present a competitive problem for U.S. exporters, because none of the other G-7 ECAs have similar requirements related to shipping. Moreover, for large capital goods that cannot use container shipping, U.S. line availability and cost are frequently cited as a competitive problem for U.S. exporters. The MARAD waiver data appear to present the waiver process as an effective means of addressing any potential hardship or limitation placed on exporters by PR 17. However, Ex-Im Bank’s customers’ perception of the costs of PR 17 to their business strongly indicates that the U.S. flag shipping requirements has a negative influence on Ex-Im Bank’s competitiveness.

Chapter 6: Public Policies - Stakeholder Considerations

Section F: Ex-Im Bank's Public Policy Competitiveness

Public policy requirements tend to be, for the most part, unique to Ex-Im Bank vis-à-vis the other G-7 ECAs. With the exception of local costs support, where Ex-Im Bank is competitive with its official counterparts, the other public policy factors can and have had an adverse effect on the overall competitiveness of transactions. Nonetheless, these issues do not arise in all cases. Thus, for the subset of cases in which they do arise, Ex-Im Bank's public policy requirements have the potential to negatively influence the Bank's competitiveness.

Figure 31: Grading of Ex-Im Bank's Public Policy Competitiveness

Policy	G-7 ECAs have similar constraint? (Y/N)	Potential impact on competitiveness
Economic Impact	N	Negative
Foreign Content	Y	Negative
Local Costs	Y	Positive
PR 17	N	Negative
Overall Assessment		Negative

Chapter 7: Conclusion

In 2003, Ex-Im Bank's competitiveness against its G-7 ECA competitors was deemed to be an "A", meaning that the Bank was "generally competitive" with the other ECAs (i.e., consistently offering terms equal to the average G-7 ECA). **Figure 32** shows that the core financing elements such as premia, interest rate, cover policy and operational efficiency Ex-Im Bank performed well against the other G-7 ECAs. Ex-Im Bank also performed well in the major program structures of aircraft, project finance and foreign currency guarantees, but it fared less well when its co-financing program was evaluated.

Figure 32: Grading of Ex-Im Bank's Overall Competitiveness

Structural Elements	Grade
Core Business Policies and Practices	A
A. Cover Policy & Risk Taking	A
B. Interest Rates	A
C. Risk Premia	A
D. Operational Efficiency	A-/B+
Major Program Structures	A-/B+
A. Large Aircraft	A
B. Project Finance	A+
C. Co-financing	B-/C+
D. Foreign Currency Guarantee	A
OVERALL COMPETITIVENESS GRADE	A

Figure 33 illustrates the "direction" of potential competitive impact on an individual transaction that might be impacted by broader U.S. economic philosophy and public policy considerations. The specific constraints imparted by any one of these considerations on Ex-Im Bank action are infrequently encountered. Moreover, each constraint would have a highly diverse magnitude of impact on an individual transaction's competitiveness. Hence, any attempt to quantifiably scale (or grade) these impacts creates more misinformation than clarification. Accordingly, although these constraints can and do have an impact on the competitiveness of individual transactions, these influences (alone or in some combination) do not affect the grades shown above (i.e., there is no addition or subtraction to the program, policy, or overall grades).

The basic free market-driven U.S. economic philosophy provides many benefits to U.S. exporters and Ex-Im Bank's competitiveness. However, as detailed in previous chapters, there are three areas of official export credit activity where the difference between U.S. economic philosophy and that of one or more of the major ECA competitors can, in infrequent cases, generate a noticeable gap between Ex-Im Bank and its competitors. These areas of activity involve tied aid, untied aid, and market windows.

Similarly, a variety of U.S. public policies intended to ensure that U.S. workers are the direct and main beneficiaries of U.S. international financing activity are increasingly differentiating Ex-Im Bank operational principles and processes from those applicable in our major ECA competitors. These principles and procedures include economic impact, foreign content, local costs and shipping.

As indicated in earlier chapters, available information and export community views both suggest that – where one or more of these infrequently arising elements is a significant factor in an individual case – the typical “tilt” imparted to the financial competitiveness of the transaction is negative (in 6 of the 7 areas).

For example, a U.S. exporter with a project finance transaction would typically expect to be in an excellent competitive position against other G-7 competitors, with respect to financing. However, if the transaction were affected by the Bank’s economic impact policy, the U.S. exporter’s competitive position could be lessened, as the other G-7 ECAs do not have a similar policy. In summary, but for Ex-Im Bank’s local cost policy, if a specific transaction encounters any of the financial aspects affected by U.S. economic philosophy and public policy, there would likely be a negative impact on the competitiveness of that transaction.

Figure 33: Direction of Case-Specific Competitive Impact of U.S. Economic Philosophy or Public Policy on Certain Official Export Credit Activity, Procedures or Practices

Areas Affected by U.S. Economic Philosophy or Public Policy	Case-Specific Impact on Competitiveness
Economic Philosophy A. Tied Aid B. Untied Aid C. Market Windows	Negative Negative Negative
Public Policies A. Economic Impact B. Foreign Content C. Local Costs D. Shipping/PR 17	Negative Negative Positive Negative

Appendix A: Calculation of Ex-Im Bank Grade

In the body of this report, Ex-Im Bank graded its policies and programs. In the sections of the report pertaining to the core financing programs and practices, grades were assigned to each program and practice. In order to aggregate and average these grades for the determination of the overall competitiveness grade in Chapter 7, values were assigned to each grade that are comparable to those used in a typical U.S. university. First, **Figure A1** provides the meaning and score of select grades. Averaged sub-category grades determined a category's grade, and **Figure A2** illustrates the range of possible averaged scores that defined each grade.

Figure A1: Definition of Select Grades

Grade	Definition	Score
A+	Fully competitive compared to other ECAs. Consistently equal to the (or is the sole) ECA offering the most competitive position on this element. Levels the playing field on this element with the most competitive offer from any of the major ECAs.	4.33
A	Generally competitive compared to other ECAs. Consistently offers terms on this element equal to the average terms of the typical major ECA. Levels the playing field on this element with the typical offer from the major ECAs.	4.00
A-/B+	Level of competitiveness is in between grades A and B.	3.50
B	Modestly competitive compared to other ECAs. Consistently offers terms on this element equal to the least competitive of the major ECAs. Does not quite level the playing field on this element with most of the major ECAs.	3.00
B-/C+	Level of competitiveness is in between grades B and C.	2.50
C	Barely competitive compared to other ECAs. Consistently offers terms on this element that are a notch below those offered by any of the major ECAs. Puts exporter at financing disadvantage on this element that may, to a certain extent, be compensated for in other elements or by exporter concessions.	2.00
D	Uncompetitive compared to other ECAs. Consistently offers terms on this element that are far below those offered by other major ECAs. Puts exporter at financing disadvantage on this element so significant that it is difficult to compensate for and may be enough to lose a deal.	1.00
F	Does not provide program	0.00
NA	Does not have experience with policy/program.	

Figure A2: Range of Averaged Scores for Each Grade

Grade	Maximum Score	Minimum Score
A+	4.330	4.165
A	4.164	3.75
A-/B+	3.74	3.25
B	3.24	2.75
B-/C+	2.74	2.25
C	2.24	1.50
D	1.49	0.50
F	0.49	0

Because the public policies and economic philosophies are not expected to impact the same volume of transactions as the core financing and program elements, survey respondents were asked to indicate if the public policies and economic philosophies would positively, negatively or neutrally affect Ex-Im Bank's competitiveness. The following chart in **Figure A3** shows the scale that was used by survey respondents to assess the competitive impact of these policies and philosophies.

Figure A3: Assessing Impact of Economic Philosophies and Public Policies Ex-Im Bank's Overall Competitiveness

	Effect on Competitiveness	Description
+	Positive	Philosophy, policy or program has a positive impact on Ex-Im Bank's competitiveness (moves Ex-Im Bank's competitiveness grade up one notch).
*	Neutral	Philosophy, policy or program has a neutral impact on Ex-Im Bank's competitiveness (no impact on Ex-Im Bank's competitiveness grade).
-	Negative	Philosophy, policy or program has a negative impact on Ex-Im Bank's competitiveness (moves Ex-Im Bank's competitiveness grade down one notch).

Figure A4 shows how Ex-Im Bank's overall competitiveness grade was calculated. Grades from the Core Business Policies and Practices and Major Program Structures were given equal weight and averaged. If applicable to a transaction, also shown are the results of how U.S. economic philosophies and Ex-Im Bank's public policies would be expected to impact a U.S. exporter's competitiveness.

Figure A4: Detailed Grading of Ex-Im Bank's Overall Competitiveness (based on survey results)

Key Elements	Grade	Value	Weight	Score
Core Business Policies and Practices	A	4.0	50%	2.00
A. Cover Policy & Risk Taking	A			
B. Interest Rate	A			
C. Risk Premia	A			
D. Operational Efficiency	A-/B+			
Major Program Structures	A-/B+	3.5	50%	1.75
A. Large Aircraft	A			
B. Project Finance	A+			
C. Co-financing	B-/C+			
D. Foreign Currency Guarantee	A			
OVERALL GRADE	A		100%	3.75
Competitive Impacts of Non-financial Elements				
Economic Philosophy			Negative	
A. Tied Aid			Negative	
B. Untied Aid			Negative	
C. Market Windows			Negative	
Public Policies			Negative	
A. Economic Impact			Negative	
B. Foreign Content			Negative	
C. Local Cost			Positive	
D. Shipping/PR 17			Negative	

Appendix B: Purpose of Ex-Im Bank Transactions

Congress requires Ex-Im Bank to include in the annual Competitiveness Report a breakdown of the purposes for Ex-Im Bank support. The primary purpose of Ex-Im Bank support for transactions is to either fill the financing gap when private sector finance is not available or to meet foreign competition. **Figure B1** shows the number and amount of Ex-Im Bank transactions authorized in 2003 by purpose and program type.

Figure B1: Ex-Im Bank Transactions by Purpose

	No Private Sector Finance Available		Meet Competition		Not Identified*	
	(\$MM)	(#)	(\$MM)	(#)	(\$MM)	(#)
Working capital guarantees	\$555	285	0	0	\$12	10
Short-term insurance	\$2,221	1,797	0	0	0	0
Medium-term insurance	\$403	292	\$261	7	0	0
Guarantees	\$5,028	189	\$2,428	13	\$90	14
Loans	\$61	2	0	0	0	0
TOTAL	\$8,268	2,565	\$2,689	20	\$102	24

Appendix C: Exporter and Lender Survey Results

Introduction

Ex-Im Bank annually surveys exporters and lenders that use the Bank's medium- and long-term programs. This Congressionally mandated survey provides critical information for the Report, as it encourages respondents to compare Ex-Im Bank's policies and practices with those of its G-7 ECA counterparts. This year the Bank took a new approach by administering the survey on-line, which allowed the survey to reach a larger number of participants. In addition to the formal on-line survey, Ex-Im Bank conducted four separate focus group meetings with experienced users of Ex-Im Bank programs to get more detailed comments about the global market in which they operated in 2003 and the competitive implications for Ex-Im Bank.

Survey

Ex-Im Bank's survey consisted of five parts that focused on the following areas:

- Part 1: General information on the profile of the respondent.
- Part 2: Respondent's experience in both receiving support from and facing competition from other ECAs, in addition to reasons for using Ex-Im Bank.
- Part 3: Respondent ratings of and comments on Ex-Im Bank's competitiveness with foreign ECAs in the policies and programs in the Competitiveness Report.
- Part 4: Additional comments.
- Part 5: Outcome of specific cases of competition faced as a result of the above policies.

Participant Selection

The survey was sent to companies that used Ex-Im Bank's medium- and long-term programs during 2003. In total, 94 lenders and exporters were asked to participate in the survey.

Survey Results

Figure C1 highlights the response rate for the survey participants. For both lenders and exporters, more responses were received this year than in the previous year, which is likely attributable to the fact that more lenders and exporters were surveyed. Also, this year's survey was administered on-line, which may have reduced the burden in completing the survey, thereby possibly resulting in more survey responses. Thirteen responses were received from lenders; however, one survey was deleted because the respondent indicated that they did not have experience with Ex-Im Bank's medium- and long-term programs during 2003. The overall

response rate for lenders on the survey was 29%, which was a decrease from the 2002 response rate. Seventeen responses were received from exporters, and the response rate was 32% which was lower than 2002, although more responses were received this year. However, two of the exporter surveys were deleted because the respondents indicated that they had no experience with Ex-Im Bank during 2003, thereby reducing the response rate to 28%. The lower response rate may be due to the fact that the survey was sent to more companies, many of which had less experience with Ex-Im Bank than the pool of recipients in previous surveys.

Figure C1: Survey Response Rate

	Lenders		Exporters	
	2002	2003	2002	2003
Number surveyed	32	41	19	53
Number responded	12	12	11	15
Response rate	38%	29%	58%	28%

Lenders

Figure C2 shows the lender experience levels for both length of time in business and experience in export finance. The vast majority of survey respondents had more than ten years experience in export finance. **Figure C3** shows the volume of export credits extended during 2003. The majority of lenders that responded to the survey were smaller regional banks, and only one of the lenders had over \$1 billion in export credit extended for the year. [Note: only 7 of the 12 lenders reported volume of export credits.]

Figure C2: Lender Experience Levels

	1-3 years	4-10 years	11-20 years	20+ years
Time in business	1	1	1	9
Time in export finance	1	1	1	9

Figure C3: Volume of Lenders' Annual Export Credits

	Under \$10 million	\$10 - \$50 million	\$51 - \$100 million	\$101 - \$500 million	\$501 million - \$1 billion	Over \$1 billion
Total export credit volume	0	6	0	0	0	1

Figure C4 shows the percentage of lenders' export credits extended during 2003 that were supported by Ex-Im Bank during the year. The majority of reporting lenders noted that Ex-Im Bank support constituted less than 25% of their export credits extended during the year. Of those lenders reporting the volume and percentage of export credits, only one lender reported having over 75% of their export credit being supported by Ex-Im Bank.

Figure C4: Percentage of Lender Export Credits That Were Ex-Im Bank Supported

	Less than 10%	10%-25%	26%-50%	51%-75%	Over 75%
Percentage of export credits supported by Ex-Im Bank	2	2	1	0	1

Nearly all of the lenders surveyed noted that the lack of useful private sector financing was the reason for pursuing Ex-Im Bank financing, particularly for financing transactions in Latin America and Eastern Europe. A majority of lenders stated that Ex-Im Bank support was needed to meet competition from foreign companies that receive ECA financing, particularly in Latin America, Russia and China. The ECAs identified by the lenders as most “frequent” or “regular” partners were Hermes, and to a lesser extent SACE and EDC; as was expected, the banks that were most likely to cooperate with other ECAs were foreign owned. Hermes was cited as the ECA that lenders most often faced in competition.

Exporters

Figure C5 shows the distribution of exporters by time in business, and **Figure C6** shows the size of exporters based on sales and export sales volume. The majority of exporter respondents were more experienced and larger corporations, as nine of the seventeen exporters had over \$1 billion in annual sales. Three exporters had annual sales of less than \$10 million.

Figure C5: Exporter Experience Levels

	1-3 years	4-10 years	11-20 years	20+ years
Time in business	1	2	-	12
Time in export finance	1	3	2	9

Figure C6: Volume of Exporter Annual Sales and Exports

	Under \$10 million	\$10 - \$50 million	\$51 - \$100 million	\$101 - \$500 million	\$501 million - \$1 billion	Over \$1 billion
Total sales volume	3	2	0	1	1	7
Total export sales volume	4	2	0	2	1	5

Figure C7 shows the distribution of exporters by the percentage of export sales that were supported by Ex-Im Bank. Two of the three smaller corporations stated that they relied on Ex-Im Bank financing for more than 75% of their export sales. However, the majority of exporters responding to the survey noted that they rely on Ex-Im Bank financing for less than 10% of their export finance sales.

Figure C7: Percentage of Exporters Sales That Were Ex-Im Bank Supported

	Less than 10%	10%-25%	26%-50%	51%-75%	Over 75%
Percentage of export sales supported by Ex- Im Bank	7	3	2	0	2

Not surprisingly, very few of the exporters indicated experience working with other ECAs; however of those with experience, most used EDC of Canada and, to a lesser extent, ECGD and Hermes. However, most of the exporters did report facing competition from foreign companies that were supported by their national ECAs. The most common ECAs identified were SACE, Hermes and JBIC.

Appendix D: G-7 Export Credit Institutions

- Canada**
- **Export Development Canada (EDC)** is a “Crown Corporation” (i.e., a government entity that operates on private sector principles) that provides, among other products, short-term export credit insurance, medium- and long-term guarantees, and medium- and long-term direct loans, which may or may not be provided on a CIRR basis.
- France**
- **Compagnie Française d’Assurance pour le Commerce Extérieur (Coface)** is a private insurance company that provides, in addition to short-term insurance that goes on its own book, official medium- and long-term export credit insurance on behalf of the French government.
- Germany**
- **Euler Hermes Kreditversicherungs-AG (Hermes)** is a consortium of a private sector insurance company and a quasi-public company that provides official export credit insurance on behalf of the German government, similar to Coface of France. Hermes also provides short-term export insurance on its own account, according to standard market practices.
 - **Kreditanstalt für Wiederaufbau (KfW)** is a financial institution that is owned by the German government and the federal states (Länder). KfW exists to promote the growth of the German economy in a variety of ways. One of its missions, though not its largest, is the funding of German export credits, both at market rates and through a government-supported window to achieve CIRR. KfW also administers the provision of German tied aid funds. The decision as to where and how tied aid should be used rests with another part of the German government. At the end of 2003, KfW announced that the majority of its export credit business would be spun off into an independent, 100%-owned subsidiary called KfW IPEX-Bank (this spin-off will be finalized by 2008). KfW will continue to offer export credit support on a limited basis: in a syndicate for less risky markets and on its own only in the riskiest markets.
- Italy**
- **SACE**, or the Istituto per i Servizi Assicurativi del Commercio Estero, provides official export credit insurance. Pursuant to law enacted in 2003 and effective January 1, 2004, SACE will become a limited liability joint stock company whose shares are wholly owned by the Ministry of Economy and Finance. Under this new structure, SACE will continue providing medium- and long-term official export credit insurance and will begin to provide short-term insurance on its own account.
 - **SIMEST** provides interest rate support to commercial banks in order to achieve CIRR. SIMEST is a development financier, with public and private participation, instituted in 1990 for the promotion and construction of joint ventures abroad. The Ministry of Foreign Trade is the majority shareholder. The private shareholders consist of Italian financial institutions, banks and business associations.

Japan

- **Nippon Export and Investment Insurance (NEXI)** is an independent governmental institution responsible for official export credit insurance operating under the guidance of the Ministry of Economy, Trade and Industry (METI). Japanese exporters are required to insure all of their short-term business through NEXI, the result being that NEXI provides a tremendous volume of short-term insurance relative to other countries, where the lion's share of short-term export credit insurance is provided by the private sector.
- The **Japan Bank for International Cooperation (JBIC)** is a government bank that falls under the Ministry of Finance. In its capacity as an export credit agency, JBIC provides direct loans in combination with commercial bank financing. In addition, JBIC provides untied, investment and import credits.

United Kingdom

- **Export Credits Guarantee Department (ECGD)** is a separate department of the U.K. government that provides export credit guarantees and interest rate support for medium- and long-term official export credit transactions. ECGD also maintains a "top-up" reinsurance facility with a private insurance company in the event that the private sector is unwilling to provide short-term export insurance to a U.K. exporter who wishes to sell a product to a market where official export credit support is customarily available from other countries.

Appendix E: State of Play in the OECD

Introduction

One of Ex-Im Bank's primary objectives is to level the playing field for U.S. exporters facing foreign competition supported by their governments' official export finance programs. However, particularly in the late 1970's and early 1980's, the financial cost of leveling the playing field could be huge. The most successful long-term tool for both leveling the playing field across the board and minimizing the cost in those cases Ex-Im does match has been the multilateral negotiations at the OECD. Since the Arrangement came into force over twenty-five years ago, OECD ECAs have agreed to critical disciplines on repayment terms, interest rates, tied aid and exposure fees, in addition to rules on specific sectors such as large commercial aircraft. These disciplines have significantly reduced the potential volume of subsidized transactions that Ex-Im Bank would need to match, thereby saving the U.S. government hundreds of millions of dollars annually. Of critical importance, these official export finance disciplines have created room for the private export finance sector to operate.

With disciplines on most financial aspects of standard export credits and tied aid agreed, the OECD Working Party on Export Credits and Credit Guarantees in aggregate has experienced positive cash flows since the mid-1990s. This development, while obviously positive, has nonetheless removed the major impetus ECAs had to reach multilateral agreements on additional financial disciplines. For the past several years, the member countries have focused instead on a variety of issues along a much broader spectrum of non-financial concerns. Such work continued in 2003.

Typical Official Export Credit Negotiations Process:

The process of adopting multilateral rules to eliminate official export credit subsidies and level the playing field typically involves the following five stages:

1. Agreement to exchange information or establish transparency in order to provide the basis for work on a particular issue;
2. Creation of a system or framework of rules that can lead to reductions in subsidy and/or further level the playing field;
3. Establishment of a yardstick within the framework by which progress can be measured (e.g., charging market level interest rates or requiring a project to be commercially non-viable in order to allow tied aid);
4. Moving the yardstick higher (i.e., requiring ever higher interest rates until zero subsidy is achieved, or increasing the minimum concessionality in tied aid); and
5. The ongoing process of refining and adapting any rules as more knowledge becomes available and/or the world changes.

Against this framework, 2003 witnessed developments in the following areas:

- A revision of the Arrangement
- Adoption of the Common Approaches for the Environment
- Proposals on untied aid disciplines and transparency

The sections below provide a more detailed summary of these issues.

The Arrangement

The Arrangement on Officially Supported Export Credits, or the Arrangement, first came into effect in 1978 when OECD governments agreed the initial rules to constrain the provision of subsidies in support of their national exporters. By limiting subsidy competition amongst governments, the Arrangement leveled the playing field for exporters and shifted competition from the terms of financing to the quality of the goods and services being exported. The disciplines of the Arrangement have evolved and expanded over time to place significant parameters around the provision of official export credits. According to the framework above, many aspects of the Arrangement have been in stage 5 for a number of years.

Historically, there has been two means of ensuring compliance with export credit rules: the moral suasion embodied in the Arrangement and formal WTO processes. As a "Gentlemen's Agreement" rather than a formal treaty or convention, the Arrangement has traditionally been enforced by transparency (notifications and exporter competition), peer pressure (consultations) and the knowledge that violating the rules of the Arrangement would be met immediately by high-level political response and/or similar action from other governments (matching). Since 1979, the Arrangement's interest rate provisions have been codified in the WTO's Agreement on Subsidies and Countervailing Measures (ASCM) as a "safe haven" under which official export credits may be provided without being considered a prohibited export subsidy. WTO rules are enforced by formal suits brought by parties claiming injury, and remedies can include discontinuation of the program in violation of WTO rules and financial penalties.

The tension between these types of agreements – "Gentlemen's Agreement" versus international law – and the related enforcement mechanisms – notifications, consultations, moral suasion and matching versus suits and legally binding penalties – was highlighted in the long-running Canada-Brazil aircraft disputes in the WTO. In particular, the "safe haven", item k(2) of Annex I of the ASCM, refers only to the "interest rate provisions" of the Arrangement. WTO Dispute Settlement Panels found that matching non-conforming transactions is not in conformity with the ASCM; in other words, being in conformity with the Arrangement *as a whole* (e.g., following the rules for matching) does not equate to being in conformity with the ASCM. In addition, in the WTO's Doha Development Agenda discussions, Brazil and India argued that it is unfair that the Arrangement rules are negotiated by OECD countries only but apply to all countries due to its inclusion in the ASCM.

As a result of these concerns, the Participants to the Arrangement revised the Arrangement from late 2002 through 2003, and a new Arrangement came into effect as of January 1, 2004. The goals of the redrafting of the Arrangement were: (1) to improve the consistency of the text

with regard to the ASCM; (2) to provide more transparency for non-Participants; and (3) to enhance the clarity and user-friendliness of the Arrangement for non-Participants.

Transparency for non-Participants was enhanced by enabling non-Participants to have more information about how the Arrangement functions. First, non-Participants will now have access to Participants' standard export credit notifications. Second, Participants and non-Participants are expected to respond "on a reciprocal basis" to each other's case-specific inquiries in competitive situations. In addition, the Arrangement was reorganized to reduce redundancies and more clearly present the rules. Finally, all information on the calculation of exposure fees has been moved from technical ancillary documents into the body of the Arrangement.

The one area of substantive change made during the redrafting of the Arrangement was the elimination of the derogation related provisions. This was done to bring the Arrangement into conformity with the WTO rulings in the Canada-Brazil dispute mentioned above. The retention of provisions for matching derogations was considered inconsistent with the ASCM because it implied that Participants could either derogate or match derogations and, through notification, be in conformity with the ASCM (which incorporates the Arrangement through item k). As the WTO panels had found to the contrary, the Participants decided that all references to derogations needed to be removed from the Arrangement.

Environment

In December 2003, after years of work, the OECD finally concluded an agreement on ECAs' environmental review of sensitive projects, called the OECD Recommendation on Common Approaches on Environment and Officially Supported Export Credits, or "the Common Approaches." This agreement represents a significant step forward in leveling the playing field for major projects and in ensuring that export credit support for these projects does not contribute to environmental degradation.

The major achievements of the 2003 Common Approaches are provisions that require the use of international standards for environmental review and that expect disclosure of environmental information prior to approval of sensitive projects. Inadequate treatment of both these issues caused the United States to refuse an earlier draft text in 2001, leading the other OECD ECAs to unilaterally and voluntarily implement their own environmental review procedures based on that draft text. By agreeing to the 2003 text, ECAs agreed to apply the higher of host country or international standards when reviewing projects; the acceptable standards are limited to those of the major multilateral development banks, and most ECAs in most projects are likely to use World Bank standards and guidelines. In addition, ECAs agreed to require environmental impact assessments (EIA) for the most sensitive cases and are expected to make EIAs or other environmental information publicly available at least 30 days prior to final commitment. Only under rare circumstances may ECAs not adhere to these provisions, and they will report these cases to the OECD. Finally, the Common Approaches includes reporting measures that will enable ECAs to monitor each other's progress in applying the agreement.

The 2003 Common Approaches is a significant achievement for OECD ECAs. More importantly, it has leveled the playing field for U.S. exporters, who have since 1994 been subject to Ex-Im

Bank's environmental standards and transparency procedures. Thus, the OECD's environmental disciplines advanced to stage 3 in 2003.

Tied and Untied Aid

Disciplines on tied aid have been in place since 1992 and have gradually been fine-tuned over time. 2003 saw the Ex-Ante Guidance on Tied Aid updated to include energy pipelines as a sector normally ineligible for tied aid, and a precedent was set for freight transportation to normally be considered ineligible for tied aid. (The latter should be added to the Ex Ante Guidance during the next revision.) In addition, the separate tied aid bans for Eastern Europe, and select countries of the former Soviet Union, were merged, updated and incorporated into the Arrangement. Thus, the tied aid negotiations remain at the early phase of stage 4.

Continuing its efforts to achieve disciplines for untied aid, the United States advanced a proposal for increased untied aid disciplines and transparency, including disclosure of bid winners. There are currently no Arrangement rules governing untied aid, because the donor government does not legally tie procurement to its firms. However, untied aid can be "de facto tied" and used to circumvent the tied aid disciplines that require a minimum concessionality and preclude tied aid for commercially viable projects and to rich countries. While untied aid is notified and is the subject of an OECD report, notifications are not currently releasable to potential bidders, and allowing their release would facilitate wider bidding participation. The disclosure of bid winners would go a long way toward ensuring over the long-term that untied aid is effectively untied. Due to Japanese and German resistance to transparency and disciplines, untied aid discussions did not move beyond stage 1 in 2003.

Exposure Fees (Risk Premia)

ECAs charge exposure fees for taking the risk that the obligor will not repay. Rules seeking convergence on exposure fees for officially supported export credits of over two years came into force on April 1, 1999. The agreement, called the Knaepen Package, sets minimum exposure fees for sovereign transactions, and the sovereign benchmark sets the minimum rate for all other transactions within the country. Except for aircraft and ships, which are subject to separate disciplines, all transactions subject to the Arrangement must comply with the exposure fee disciplines.

The fee negotiations have remained at stage 3 since the inception of the Knaepen Package. In 2003, Participants continued an ongoing transparency exercise on buyer risk pricing and finalized one feedback system for a long-term evaluation of fees. Given the wide disparity between ECAs' private buyer pricing, pressure remains to open negotiations on developing a formal buyer risk pricing agreement. The United States will continue to advocate that buyer risk assessment be market-based, rather than based solely on buyer type, as in the structural pricing system imposed by many European ECAs (that is, these ECAs add a fixed increment based on the type of obligor, rather than assessing the ability of the obligor to repay the debt and pricing according to that risk).

Interest Rates

There was very little discussion of official export credit interest rates in 2003. Fixed interest rate provisions for ECA direct loans, or Commercial Interest Reference Rates (CIRR), have long been subject to rules that have largely neutralized competition and eliminated subsidy. Two long-standing issues with competitiveness implications remain unresolved: (1) the different ways in which ECAs interpret the rules on setting and holding CIRR rates, and (2) interest make-up (IMU) schemes, a tool largely used by European ECAs in conjunction with their commercial banks and that may involve a degree of subsidization. The ongoing lack of formal action is due to the linkage of these issues to other issues, such as market windows and exposure fees, although in 2004 Participants may discuss CIRR setting and holding. In sum, the interest rate negotiations on the current fixed rate CIRR regime as a whole have advanced to stage 5 and represent the issue for which the most progress has been achieved to date.

This issue of creating a floating rate CIRR arose in 2000 as a result of the WTO dispute between Canada and Brazil over export credit support for regional aircraft. In these cases, the WTO found that, under the ASCM, officially supported export credits are a prohibited subsidy unless they are on market terms (from the borrower's perspective, i.e., the benefit to the borrower test) or the support is in compliance with the OECD Arrangement interest rate provisions. The WTO held that the OECD interest rate provisions only yield a safe harbor for the CIRR fixed interest rate and, therefore, provide no safe harbor for individually determined floating rate lending by ECAs or for pure cover transactions (guarantees and insurance). Due to the technical and political complexity of designing a floating rate CIRR that does not compete with commercial bank activity, and the resulting U.S. and European opposition to such an instrument, work on a floating rate CIRR has not progressed beyond stage 1.

Large Commercial Aircraft

Since the 1980s, the Large Aircraft Sector Understanding (LASU) of the Arrangement has governed the provision of official export credit support for large commercial aircraft (airplanes that have more than 70 seats and are powered by a jet engine). The LASU was created to fit the unique characteristics of the large aircraft financing business, providing longer repayment terms and special interest rate structures, although it does not have exposure fee rules.

The primary LASU participants are the European ECAs that support Airbus (France, Germany and the United Kingdom) and the United States. Ex-Im Bank meets regularly with its foreign counterparts to discuss issues of common interest, but to date there has been no consensus between the European ECAs and Ex-Im Bank regarding modifications to the LASU.

The entry of Canada and Brazil into the large aircraft sector, however, could very well provide the impetus to reopen LASU discussions. In April 2003, LASU participants held exploratory discussions with Canada and Brazil about their respective aircraft finance systems. While the discussions did not progress further in 2003, Brazil has been invited to another OECD meeting in 2004, which may open the door to further talks between the main aircraft manufacturing countries. Thus, while this issue remains in stage 4, it could move to stage 5 during 2004.

Market Windows

A market window is an institution (or a part of an institution) that claims to operate on a commercial basis while benefiting either directly or indirectly from some level of government support. Market windows pose competitive challenges and transaction-specific problems to other ECAs because:

- The support provided by such entities is only available to their national economic interests; and
- The attractiveness of the financing packages (especially interest rates) provided by market windows tends to stretch the boundaries of what a private institution might be willing to provide.

The United States believes that market window activity represents a potential threat to the disciplines that the OECD Arrangement negotiations have sought to instill in all official lenders. Nonetheless, due to ongoing resistance from the Participants with major market windows (Germany with KfW, Canada with EDC) to agree even to share information about their activity, let alone agree to disciplines, little progress has been made at the OECD. Thus, the market windows issue has not even reached stage 1. To progress the issue, Ex-Im Bank is working with both EDC and KfW on a bilateral basis to increase the amount of information available to the Bank on transaction terms.

Appendix F: Ex-Im Bank Foreign Content Support for Medium- and Long-Term Transactions* in 2003

Country	Product/Project	Export Value	Foreign Content Percentage**	Estimated Budget Increase***
ALGERIA	Power Plant	\$195,500,000	10%	\$3,024,858
AUSTRALIA	Large Aircraft	\$262,892,071	15%	\$162,264
AZERBAIJAN, GEORGIA, & TURKEY	Oil Pipeline Project	\$152,941,176	3%	\$1,092,149
BAHRAIN	Large Aircraft	\$128,837,923	5%	\$885
BRAZIL	Used Locomotives	\$310,937	32%	***
BRAZIL	Construction Equipment	\$539,315	5%	\$647
BRAZIL	Hospital Equipment	\$2,846,800	10%	\$77,828
BRAZIL	Printing Machinery And Equipment	\$5,231,274	19%	\$16,908
BRAZIL	Power Plant	\$44,874,220	7%	***
BRAZIL	Locomotives & Off Road Trucks	\$62,103,746	9%	***
BULGARIA	Concrete Block Manufacturing Machinery	\$1,163,600	10%	\$2,882
CAMEROON	Telecommunications Equipment	\$1,707,857	26%	\$23,275
CAMEROON	Construction Equipment	\$2,745,612	8%	\$21,551
CANADA	Large Aircraft	\$415,500,000	16%	***
CHINA (MAINLAND)	Railway Track Maintenance	\$84,443,547	5%	***
CHINA (TAIWAN)	Large Aircraft	\$441,200,000	5%	\$21,136
DOMINICAN REPUBLIC	Agricultural Equipment	\$20,000,000	8%	\$580,061
DOMINICAN REPUBLIC	Hospital Expansion Project	\$34,617,596	11%	\$1,193,174
DOMINICAN REPUBLIC	Mining & Reclamation	\$43,877,051	8%	\$2,017,692
DOMINICAN REPUBLIC	Water Supply Project	\$44,095,000	1%	\$1,255,844
DOMINICAN REPUBLIC	Engineering Services	\$45,786,276	3%	\$127,709
ETHIOPIA	Large Aircraft	\$262,432,681	13%	\$1,425,634
HONDURAS	Waste Recycling Equipment	\$410,000	10%	\$11,741
HONG KONG	Telecommunications Project	\$34,278,123	15%	***

Country	Product/Project	Export Value	Foreign Content Percentage**	Estimated Budget Increase***
HONG KONG	Large Aircraft	\$348,000,000	13%	***
INDIA	Small Aircraft	\$4,605,000	12%	\$12,215
INDIA	Large Aircraft	\$44,000,000	15%	\$94,956
INDIA	Refrigeration Equipment	\$83,645,526	5%	***
INDONESIA	Small Aircraft	\$12,954,595	10%	\$145,314
INDONESIA	Helicopters	\$15,829,328	2%	\$30,922
IRELAND	Large Aircraft	\$155,000,000	15%	***
ISRAEL	Power Plant	\$48,601,320	14%	***
ITALY	Large Aircraft	\$764,459,387	15%	***
JAMAICA	Telecommunications Network	\$77,749,000	19%	\$1,204,420
KAZAKHSTAN	Telecommunications Services	\$9,704,290	22%	***
KAZAKHSTAN	Railroad Transportation	\$39,857,480	2%	***
KOREA, REPUBLIC	Large Aircraft	\$461,400,000	8%	\$517,531
MEXICO	Industrial Machinery	\$149,950	11%	***
MEXICO	Laser Cutting Machine	\$642,390	17%	***
MEXICO	Shrimp Farm	\$705,200	10%	***
MEXICO	Sodium Hypochlorite Production	\$3,040,000	13%	***
MEXICO	Locomotives	\$23,574,554	10%	***
MEXICO	Packing Equipment	\$53,332,129	4%	***
MEXICO	Power Plant	\$132,848,505	8%	***
MEXICO	Satellite System	\$166,165,000	8%	\$1,949,209
MEXICO	Oil & Gas Field Development	\$447,247,620	1%	***
MOLDOVA	Solid Waste Recycling Plant	\$5,680,000	.2%	\$228,830
MOROCCO	Large Aircraft	\$39,079,623	15%	\$47,216
MOROCCO	Large Aircraft	\$79,600,000	15%	***
NETHERLANDS	Large Aircraft	\$262,707,025	5%	\$31,809
NETHERLANDS	Large Aircraft	\$503,300,000	12%	\$663,458
NIGERIA	Used Aircraft	\$6,000,000	10%	\$33,740
NIGERIA	Wireless Telephone Service	\$16,482,806	12%	\$269,595
OMAN	Large Aircraft	\$40,750,000	15%	\$79,381
PAKISTAN	Large Aircraft & Spares	\$385,830,685	15%	\$8,951,633
PANAMA	Large Aircraft	\$213,500,000	16%	\$900,386
PERU	Construction Equipment	\$573,407	9%	\$9,888
PHILIPPINES	Sporting And Recreational Goods Equipment	\$509,818	15%	***
PHILIPPINES	Building Materials And Equipment	\$1,158,029	14%	***

Country	Product/Project	Export Value	Foreign Content Percentage**	Estimated Budget Increase***
PHILIPPINES	Radio And Television Broadcasting Equipment	\$1,226,957	21%	***
PHILIPPINES	Construction Equipment	\$2,846,354	15%	***
ROMANIA	Earth Station Upgrades	\$13,163,376	12%	\$592,607
ROMANIA	Large Aircraft	\$88,323,551	17%	\$135,272
RUSSIA	Combines And Related Equipment	\$1,098,930	8%	\$8,922
RUSSIA	Combine Harvesters	\$4,462,934	12%	***
RUSSIA	Sugar Beet Harvesting	\$4,649,000	4%	\$4,097
RUSSIA	Railway Maintenance	\$11,712,030	1%	***
RUSSIA	Coal Mine Project	\$23,050,000	9%	\$143,736
SAUDI ARABIA	Flight Controls	\$77,982,825	9%	\$724,262
SINGAPORE	Cargo Aircraft W/Engines	\$305,000,000	5%	\$27,881
TURKEY	Surgical System	\$884,000	10%	\$9,134
TURKEY	Computer Products	\$891,474	10%	\$9,229
TURKEY	Organic Dairy Farm Equipment	\$1,593,000	16%	\$23,687
TURKEY	Medical Equipment	\$6,394,937	5%	\$29,969
TURKEY	Power Plant	\$7,943,000	17%	\$57,728
TURKEY	Power Plant	\$8,527,332	12%	\$80,414
TURKEY	Power Plant	\$33,547,734	13%	\$498,646
TURKEY	Housing Project	\$33,908,486	15%	\$891,481
UKRAINE	Network Systems	\$2,290,000	15%	\$36,247
UZBEKISTAN	Mining Project	\$21,300,000	8%	\$174,686
UZBEKISTAN	Crop Harvesting Machinery	\$21,469,400	9%	\$204,230
UZBEKISTAN	Gold Processing Project	\$78,014,500	15%	\$2,610,850
UZBEKISTAN	Large Aircraft	\$85,214,000	9%	\$644,830
VIETNAM	Large Aircraft	\$125,000,000	15%	\$385,594
VIETNAM	Large Aircraft	\$125,000,000	15%	\$385,594
TOTAL		\$7,822,511,292	11%	\$33,438,355

* Preliminary data, excludes Credit Guarantee Facilities

** When eligible foreign content exceeds 15%, the buyer is required to make a minimum cash payment equal to the amount of foreign content

*** Increase in the estimated budget amount for the U.S. portion of the contract due to inclusion of foreign content in the financing package

**** No budget increase (negative budget cost)

Appendix G: Tied Aid Report

Introduction

This appendix sets forth the annual report on tied aid credits, required by Sections 10(G) and 2(b)(1)(A) of the Export-Import Bank Act of 1945, as amended. This appendix first addresses the implementation of the OECD Arrangement rules on tied aid (also known as the Helsinki Package) during 2003, followed by a discussion of trends in the use of the TACPF through 2003. Finally, it addresses other actions and plans to combat predatory financing practices.

Implementation of the OECD Arrangement

This section describes the implementation of the Arrangement, including foreign governments' compliance with the Helsinki Package, the operation of notification and consultation procedures and, finally, the outcome of Consultations Group activity.

Tied aid is concessional financial support provided by donor governments in the form of a grant or a "soft" loan for which capital goods procurement by developing countries is contractually linked to procurement from firms located in (or in some way benefiting the economy of) the donor country (see below for "**Definitions of the Various Types of Aid**").

In December 1991, the Participants to the Arrangement agreed to OECD rules governing the use of tied aid (Helsinki Package) aimed at limiting the use of concessional financing for projects that should generate sufficient cash flows that would support the use of commercial – rather than concessional -- financing. The rules went into effect on February 15, 1992 and the data trends reported in Chapter 5 evidence the notable decreased use of tied aid since that time. The Helsinki Package established: 1) country and project eligibility requirements for the provision of tied aid; 2) rules requiring notification of tied aid offers; and 3) mechanisms for consulting on (and in some cases challenging whether) tied aid offers conform to established guidelines. The Helsinki rules on country and project eligibility basically resulted in two disciplines to restrict the use of tied aid: 1) no tied aid in "rich" countries; and 2) no tied aid for commercially viable projects. In addition, since the mid-1980s, the Arrangement has required that tied aid contain a minimum concessionality level of 35% as measured with a market-based interest rate¹.

Definitions of the Various Types of Aid

Official Development Assistance (ODA), or aid, is concessional financial support of which at least 25% is intended to carry no repayment obligations (i.e., contains 25% concessionality or grant

¹ The term "concessionality" refers to the total value of the subsidy being provided by the donor to the recipient country for any one project or purchase. For example, if a country receives a grant of \$100 million for a \$100 million project, the concessionality of this aid would be 100%, whereas a grant of \$35 million combined with a traditional export credit for the remaining \$65 million would have a concessionality of 35%.

element),² and the vast majority of it is 100% pure grant. Aid from a donor government to a recipient developing country government normally supports either “general” uses (e.g., balance of payments support) or the purchase of specific goods and/or services (local, donor country and/or third country) necessary for the completion of an action or specific project. The latter (with the exception of some local purchases) is trade-related aid.

Trade-related aid may be either “tied” or “untied” to procurement from the donor country and can be provided in two forms: grants³ or credits. However, because grants do not involve significant repayment obligations, they are viewed as having a very small potential for trade-distortions (see below) and are not subject to OECD discipline (other than notification).

Tied aid credits refer to financing that is *developmental* (i.e., for commercially non-viable projects or exports for commercially non-viable projects) and contractually conditioned upon the purchase of some or all of the goods and/or services from suppliers in the donor country or a limited number of countries. This type of aid falls within the OECD Arrangement rules. Using the Arrangement’s financial measurement methodology, tied aid to developing countries must be at least 35% concessional, and tied aid to least developed countries must be at least 50% concessional.

Untied aid credits refer to financing that is **not** contractually conditioned upon the purchase of goods and/or services from any particular country. This aid currently falls under the OECD Development Assistance Committee (DAC) rules, which differ from the OECD Arrangement rules in that the DAC provides virtually no restrictions on untied aid use. Therefore, there is a wide gap in multilateral requirements between these two differing forms of aid credits. The resulting ambiguity has often been used to advantage by foreign untied aid donors.⁴

Trade-distorting aid refers to aid credits for which the motivation is largely (or significantly) connected to promoting the sale of goods from the donor government’s country. Because tied aid credits by their nature can be trade distorting, strict OECD rules discipline their use. For example, it would be considered trade distorting to provide tied aid credits for projects that can service *commercial* term financing, including standard export credit financing (i.e., “commercially viable” projects). As a result, the Arrangement prohibits tied aid credits for such projects. The Arrangement also prohibits tied aid to countries with a per capita income level above \$2,975, because they are considered to have ready access to market financing and official export credits for all types of projects.

By definition, untied aid should not be trade-distorting because it should be equally accessible to exporters from all countries. However, through influence exerted indirectly (e.g., through special procedures, required designs and specifications, promises of additional aid, political pressures, gratitude shown by the recipient, etc.), untied aid can become effectively tied while it escapes the Arrangement rules for tied aid. All such aid that is effectively tied must be

² The technique for measuring concessionality (grant element) of ODA is antiquated and results in one half of annual ODA levels having a concessionality below 25%.

³ Credits with a concessionality level of 80% or more are viewed as grants and are not considered trade distorting.

⁴ DAC rules were developed decades ago. Currently, the DAC is discussing whether to accept a U.S. proposal to modify the DAC methodology for calculating grant element levels. The nominal level of grant element that qualifies as Official Development Assistance (ODA) must be 25%. However, current DAC methodology allows the real level of concessionality to be much lower than 25% (e.g., untied aid credits have been notified with as low as 6% real concessionality and theoretically could provide only 4% real concessionality).

considered trade distorting. No OECD Arrangement rules currently discipline the use of untied aid except those requiring confidential notification, although the U.S. has proposed a comprehensive set of rules. The general lack of Arrangement rules governing the use of untied aid also provides the donor the ability to use very low rates of concessionality with its untied aid and to use the aid for commercially viable projects, thereby *encouraging* the use of untied aid for inexpensive trade promotion and trade distortion.

Tied Aid Eligible Markets

In addition to establishing limits to tied aid for commercially viable projects, the OECD rules and subsequent negotiations designated a number of key markets as no longer eligible for tied aid financing. Specifically, the Helsinki rules ban tied aid into high or upper middle-income markets, as defined by the World Bank. Another OECD agreement bans tied aid into Eastern Europe and select countries of the Former Soviet Union, unless the transaction involves outright grants, food aid or humanitarian aid. See **Annex 1** for a list of key markets for which tied aid is prohibited and **Annex 2** for a list of key markets eligible for Ex-Im Bank tied aid support.

Figure G1: Tied Aid Notifications by Region

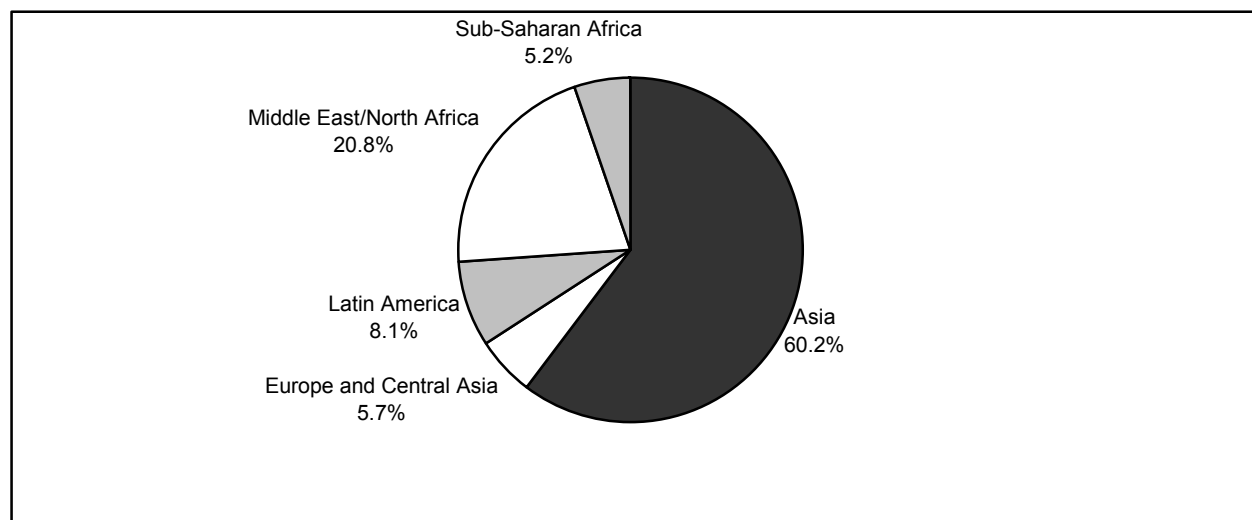
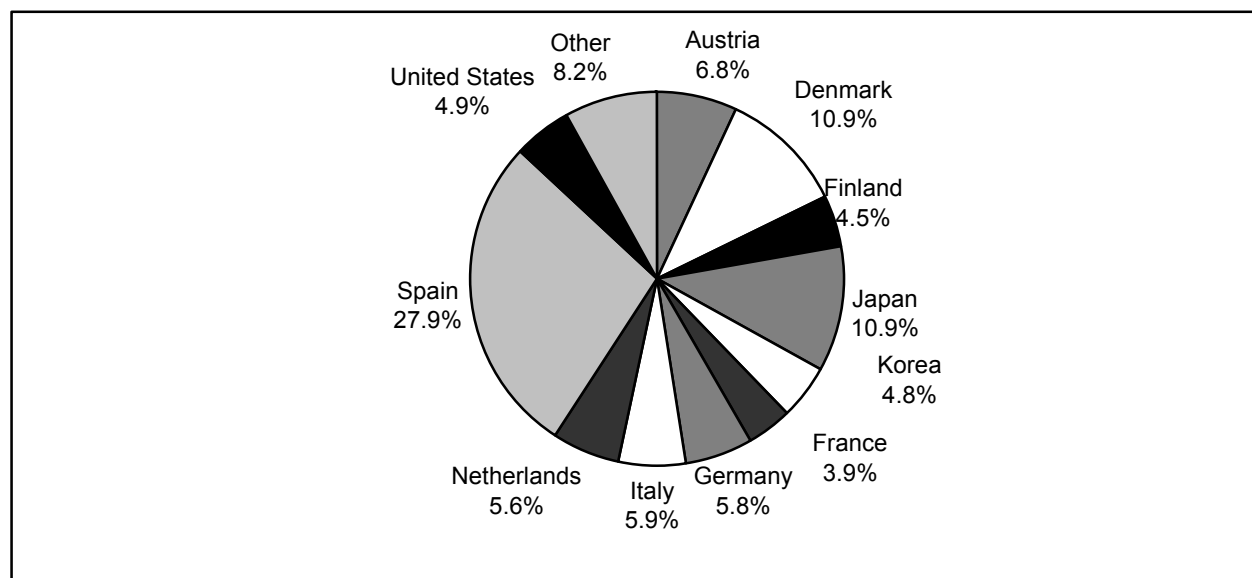


Figure G1 shows the distribution of tied aid offers by region. Consistent with previous years, the major beneficiary region was Asia, as it includes the most significant recipient country, China, who attracted almost 20% more tied aid offers in 2003 (\$758 million) than in 2002. Other significant Asian markets that attracted tied aid include Indonesia (\$322 million), the Philippines (\$209 million) and Vietnam (\$295 million). In the sub-Saharan Africa region, Ghana registered an increase in tied aid (\$42 million) to transportation sectors, followed by Namibia (\$30 million). The remaining regions registered a less significant and more disparate distribution of tied aid.

Figure G2 shows the variety of donor countries that offered tied aid in 2003. Spain, most notably, continued to surpass Japan as the largest tied aid donor by a wide margin. Spain

notified almost \$1 billion in tied aid offers in 2003, which was well above the amount notified by Japan, which was below \$400 million. France, a traditional tied aid donor, reduced its tied aid offers but dramatically increased its untied aid offers.

Figure G2: Tied Aid Notifications by Donor Country



Tied Aid Eligible Projects

The Helsinki Package established the principle that tied aid should not be used for “commercially viable” projects, defined as revenue-generating projects for which ECA cover (financing) is available:

- Generate operating cash flows sufficient to repay debt obligations on standard OECD Arrangement export credit terms; and
- Could potentially attract standard export credit financing (several OECD export credit agencies would be prepared to provide export credit).

A Tied Aid Consultations Group was formed to address those Helsinki-type tied aid issues relating to projects that, following required notification, may be challenged by other governments as being potentially commercially viable. Sovereign guarantees from the buyer do not factor into the determination of “commercial viability”.

In December 1996, the OECD countries agreed to and publicly published *Ex Ante Guidance for Tied Aid*, a set of guidelines which assists export credit agencies, aid agencies, project planners and aid recipients in judging at the outset whether potential projects will be eligible for tied aid. These guidelines, designed to avoid the use of official aid for exports that could proceed without aid, encapsulate the body of experience of the Consultations Group and have been a useful tool. From 1992 to 1995, a total of 109 cases were challenged with about half being found commercially viable. From 1996 through 2003, a total of 22 cases have been challenged, with 17 of these deemed commercially viable. See **Annex 3** for a list of projects generally

considered commercially viable, for which tied aid is prohibited. See **Annex 4** for a list of projects generally considered commercially non-viable, for which tied aid is permitted.

Of the 131 projects examined by the Consultations Group from March 1992 to December 2003, 70 projects (53.4%) were found to be commercially viable or ineligible for tied aid. The remaining cases were found eligible for tied aid and no follow up was subsequently done. Of the 70 projects deemed ineligible for tied aid, 43 projects proceeded with other financing sources, including, tied⁵ and untied aid, commercial financing, and standard export credits.

In 2003, two projects were examined by the Consultations Group (in the rail transport and oil and gas sectors). One project was deemed commercially viable and thus ineligible for tied aid. The assumption is that the project would then be open to financing offers on market or standard ECA terms. The other project was deemed commercially non-viable on the basis that export credit financing was not generally available in the market of the borrower. Therefore, the donor country was allowed to proceed with its tied aid financing offer and win the business for its exporter.

As far as sector concentration, during 2003, tied aid notifications for energy projects continued to decrease sharply while tied aid notifications for transportation projects (which had shown a decreasing trend up until 2002) witnessed an increase of 14% over 2002 levels. These projects were primarily in road and rail transportation. Regarding recipient countries, during 2003, China continued to account for the largest number of notifications and witnessed an increase in tied aid notification of almost 20% from 2002 levels.

Trends in the Use of the TACPF

Ex-Im Bank in consultation with Treasury has established guidelines for the use of the TACPF. These guidelines have two core components:

1. A series of multilateral and/or domestic steps (e.g., no-aid agreements, preliminary offer of matching, actual offer of matching) that attempt to get competitors to drop consideration of tied aid use and/or let tied aid offers expire for project of interest to U.S. exporters.
2. A set of "multiplier" criteria (e.g., prospect of future sale without using tied aid) that attempt to limit tied aid support to those transactions with a benefit that would extend beyond the individual tied aid offer and generate the most benefit to the U.S. economy.

Although in the past Ex-Im Bank matching policy achieved some limited success in deterring foreign tied aid offers as part of the overall U.S. tied aid strategy, in recent years Ex-Im Bank has been faced with fewer opportunities to match due to record low levels of tied aid. From 1994 through 2003, of the 26 cases in which Ex-Im Bank tried to discourage tied aid use by issuing a "willingness-to-match" indication, seven saw the competing tied aid offer withdrawn;

⁵ Although 18 projects found to be commercially viable proceeded with tied aid financing, the majority of these offers (15 offers) were made during 1992 and 1995 when the Helsinki disciplines were relatively new and 3 tied aid offers made despite Consultations Group findings between 1996 and 2003.

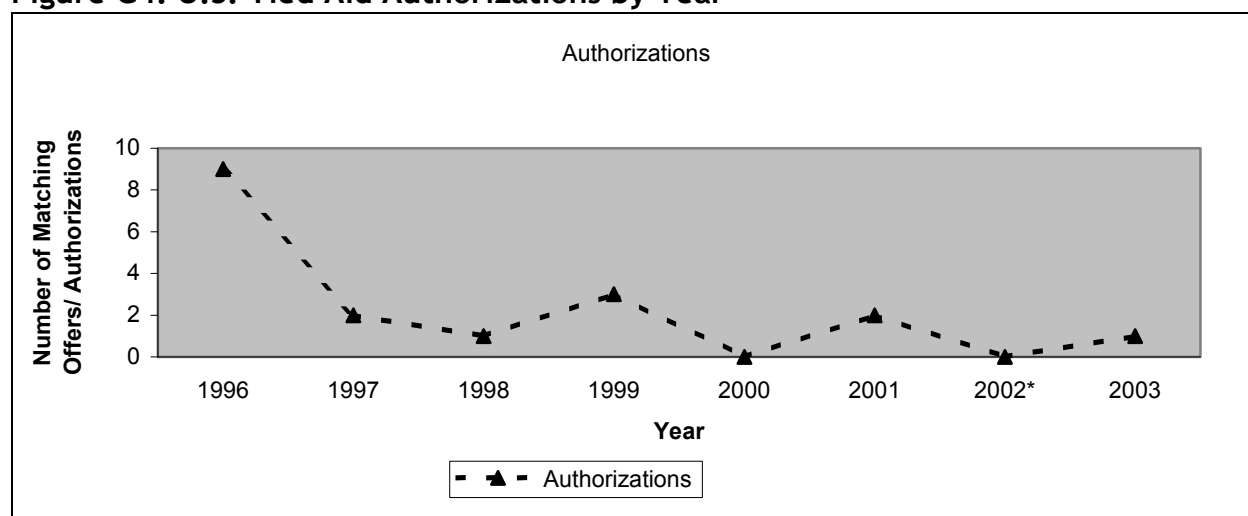
U.S. exporters won five out of seven cases on standard Arrangement terms. Nine cases have been lost to foreign tied aid financing, while ten remain outstanding or have been indefinitely delayed. Notably, however, most matching success occurred in the years immediately following the Helsinki Package when the lines between commercial and aid financing were being drawn. By the end of 1996, 30 matching offers had been made, and seven had been withdrawn. As shown in **Figure G3**, of the 44 cases where Ex-Im Bank matched, the United States has won 19 while losing 24. One case has been indefinitely delayed while another remains outstanding.

Figure G3: Cumulative Ex-Im Bank Matching of Previously Notified Foreign Tied Aid Offers

	1997	1998	1999	2000	2001	2002	2003
New matching offers during year	4	2	4	1	2	0	1
U.S. win	12	13	16	17	19	19	19
U.S. loss	10	10	21	23	23	23	24
Outstanding, no decision	12	13	3	1	1	1	1
Cumulative total	34	36	40	41	43	43	44

However, in 2003, an OECD Participants meeting held at the request of the United States concluded with a finding that one of its Members had made a tied aid offer that did not conform to the OECD rules with respect to notification requirements. The result was that the bidding period was extended and the U.S. exporter was able to submit its bid along with a tied aid matching offer from Ex-Im Bank for the buyer to consider. The U.S. firm lost the bid based on technical issues rather than financing. Additionally, a request from the United States for a Consultations Group review of a project for which a U.S. exporter was competing resulted in the withdrawal of the foreign tied aid offer.

As shown in **Figure G4**, the pace of Ex-Im Bank tied aid matching activity has slowed dramatically in recent years with the number of tied aid authorizations showing a similar downward trend with one new action in 2003. This tracks with a sharp increase in compliance with the tied aid rules as evidenced by a reduction in the annual average number of tied aid consultations, from 23 per year over 1992-1996 to fewer than 3 per year over 1997-2003.

Figure G4: U.S. Tied Aid Authorizations by Year

*For 2003, the one action taken was the approval of a Tied Aid Letter of Interest supporting the sale of patrol boats to the Government of Jamaica. Additionally, Ex-Im Bank reinstated a previously approved tied aid transaction where the final disbursement date had expired. The borrower and exporter requested an extension in order to complete shipments and disbursements.

Ex-Im Bank Initiated No Aid Common Lines

Since April 1994, there have been 26 cases where the OECD Secretariat, acting upon Ex-Im Bank's request, has obtained OECD-wide approval of "no aid" agreements for particular projects of interest to U.S. exporters that could otherwise receive tied aid under the OECD rules. With such agreements in place, U.S. exporters can compete without fear of tied aid competition and without the need for Ex-Im Bank to provide a matching tied aid offer. When Ex-Im Bank receives an application for financing in a tied aid eligible country for a project that is commercially non-viable, and the U.S. exporter has reason to be concerned about the possibility of tied aid financing competition, Ex-Im Bank may propose a no aid common line in hopes of eliminating this possibility. If the common line request is accepted, other OECD member countries are prohibited from offering tied aid financing for the particular project for a period of two years (with the possibility of extensions). If the no aid common line request is rejected, other OECD member countries may make a tied aid financing offer for the project. **Figure G5** shows the results of the no aid common line requests initiated by Ex-Im Bank from 1996 through 2003.

Figure G5: U.S. Proposed No Aid Common Lines

	1997	1998	1999	2000	2001	2002	2003
Proposed	24	5	13	8	1	0	3
Rejected	17	5	12	5	0	0	1
Accepted	7	0	1	3	1	0	2*

* Although the OECD technically accepted the no-aid common line for a patrol boats transaction in Jamaica, one Member later notified the OECD that it had accepted the common line in error. Subsequent face-to-face consultations at the OECD concluded that that Member violated the Arrangement's notification requirements and was forced to freeze its tied offer until a level playing field had been achieved for the U.S. exporter involved. The U.S. exporter subsequently lost the bid for technical, not financing, reasons.

The "no aid common lines" have had limited utility for U.S. exporters in the past few years because the U.S. has generally initiated these lines and foreign governments reject them out of hand, considering this additional restriction within the bounds of Helsinki to limit their flexibility/competence to provide aid within the Helsinki disciplines.

Responding to U.S. exporters' demands for a U.S. Government response to foreign governments' use of concessional financing for development-related capital projects, in 2002 the TPCC introduced a USG mixed credit concept. The idea was, and still is, to combine USAID grants with Ex-Im Bank standard export credit financing for development-related projects that are identified as priorities by USAID and consistent with the OECD tied aid rules. (When combined, the two funding sources create a tied aid credit.) In 2004, USAID and Ex-Im Bank identified an inaugural project to test the mixed credit concept and are currently working out how to implement the project.

Appendix G Annex 1

Key Markets Where Tied Aid is Prohibited	
Americas*	Argentina, Brazil, Mexico, Venezuela; Trinidad and Tobago
Asia*	Hong Kong, Korea, Malaysia, Singapore, Taiwan
Middle East*	Bahrain, Israel, Kuwait, Lebanon, Oman, Qatar, Saudi Arabia, United Arab Emirates
Africa*	Botswana, Gabon,
Eastern Europe	Czech Republic, Hungary, Poland, Romania, Slovak Republic; Belarus**, Bulgaria**, Latvia**, Lithuania**, Russian Federation**, and Ukraine**.

*These markets are not eligible for tied aid as a result of the fact that their Gross National Income (GNI) per capita was sufficient to make them ineligible for 17-year loans from the World Bank for at least two consecutive years (using 2002 data, those countries with a GNI per capita above U.S.\$2,935).

**These markets are covered by a Participants' agreement to try avoid tied aid credits other than outright grants, food aid and humanitarian aid, known as the "soft ban". The decommissioning of nuclear power plants for emergency or safety reasons, or due to serious cross-border pollution caused by a major industrial accident, can be regarded as humanitarian aid. Such projects would be eligible for tied aid in these markets despite the soft ban.

Appendix G Annex 2

Key Tied Aid Eligible Markets	
Asia	China, India, Philippines, Thailand, Vietnam
Americas	Belize; Colombia, Ecuador; El Salvador; Guatemala; Paraguay; Peru
Africa	South Africa; Egypt, Namibia
Middle East	Jordan; Turkey

Note: In addition to OECD tied aid eligibility, additional criteria are applied to transactions to determine whether tied aid can be made available (e.g., follow on sales criteria and “dynamic market” evaluation).

Appendix G Annex 3

Projects Generally Considered Commercially Viable (Helsinki-Type Tied Aid Prohibited)	
Power	<ul style="list-style-type: none"> ▪ Oil-fired power plants ▪ Gas-fired power plants ▪ Large stand-alone hydropower plants ▪ Retrofit pollution-control devices for power plants ▪ Substations in urban or high-density areas ▪ Transmission lines in urban or high-density areas
Energy Pipelines	<ul style="list-style-type: none"> ▪ Gas transportation and distribution pipelines ▪ Gas & oil transportation pipelines
Telecommunications	<ul style="list-style-type: none"> ▪ Equipment serving intra and interurban or long-distance communications ▪ Telephone lines serving intra and interurban or long-distance communications ▪ Switching equipment serving urban or high-density areas ▪ Radio-communications equipment serving urban or high-density areas
Transportation	<ul style="list-style-type: none"> ▪ Air traffic control ▪ Freight railroad operations (locomotives, cars, signaling)
Manufacturing	<ul style="list-style-type: none"> ▪ Manufacturing operations intended to be profit-making ▪ Privately-owned manufacturing operations ▪ Manufacturing operations with export markets ▪ Manufacturing operations with large, country wide markets

Appendix G Annex 4

Projects Generally Considered Commercially Non-Viable (Helsinki-Type Tied Aid Permitted)	
Power	<ul style="list-style-type: none"> ▪ Transmission lines to low-density, rural areas ▪ Geothermal power plants ▪ Small wind turbine farms ▪ District heating systems ▪ Small hydropower plants connected with irrigation
Telecommunications	<ul style="list-style-type: none"> ▪ Telephone switching equipment serving low-density, rural areas ▪ Switching equipment serving low-density, rural areas ▪ Radio-communications equipment serving low density, rural areas
Transportation	<ul style="list-style-type: none"> ▪ Road and bridge construction ▪ Airport terminal and runway construction ▪ Passenger railroad operations (locomotives, cars, signaling) ▪ Urban rail and metro systems
Manufacturing	<ul style="list-style-type: none"> ▪ Highly-localized, small scale cooperatives ▪ Highly-localized, small scale food processing ▪ Highly-localized, small scale construction supply
Social Services	<ul style="list-style-type: none"> ▪ Sewage and sanitation ▪ Water treatment facilities ▪ Firefighting vehicles ▪ Equipment used for public safety ▪ Housing supply ▪ School supply ▪ Hospital and clinic supply

Appendix H: Human Rights and Other Foreign Policy Considerations

Pursuant to the 1978 amendments to the Export-Import Bank Act of 1945, Ex-Im Bank may deny financing based on international human rights or other foreign policy considerations only upon a determination by the President that such denial furthers U.S. policy goals (this legislation, P.L. 95-630, 92 Stat. 3724, is also referred to as the "Chafee Amendment"). The Chafee Amendment, as amended in 2002 by P.L. 107-189, states that the Board of Directors of Ex-Im Bank may not deny applications for non-financial or non-commercial reasons unless the President determines that such denial will clearly and importantly advance U.S. policy in such areas as international terrorism, nuclear proliferation, the enforcement of the Foreign Corrupt Practices Act of 1977, the Arms Export Control Act, the International Emergency Economic Powers Act, the Export Administration Act of 1979, environmental protection and human rights (including child labor).

It should also be noted that, pursuant to Executive Order 12166, the President has delegated his authority to make Chafee determinations to the Secretary of State, who must consult with the Secretary of Commerce and the heads of other interested Executive agencies.

Ex-Im Bank has developed procedures with the State Department, including the Bureau for Democracy, Human Rights, and Labor, for regular consultation regarding human rights concerns. According to these procedures, Ex-Im Bank periodically receives a list of countries where the State Department has found no "consistent pattern of gross violations of internationally recognized human rights." Where a proposed transaction over \$10 million dollars involves goods or services to be exported to a country that has not received "pre-clearance" on such list, Ex-Im Bank refers the transaction to the State Department for human rights review. In addition, Ex-Im Bank country economists may work in concert with the State Department to, where appropriate, examine human rights and other foreign policy considerations in their assessment of the risks associated with transactions in specific countries.

Appendix I: Equal Access for U.S. Insurance

Pursuant to the Export Enhancement Act of 1992, Ex-Im Bank is required to report in the annual *Competitiveness Report* those long-term transactions approved by Ex-Im Bank for which an opportunity to compete was not available to U.S. insurance companies.

At the time the legislative requirement was imposed on Ex-Im Bank, Ex-Im Bank had neither encountered nor been informed about any long-term transaction for which equal access for U.S. insurance companies was not afforded. Consequently, Ex-Im Bank, the Department of Commerce and the Office of the United States Trade Representative agreed that the establishment of a formal reporting mechanism was not necessary. It was also agreed that should Ex-Im Bank identify any long-term transaction in which U.S. insurance companies are not allowed equal access, a more formalized procedure would be created. As of December 2003, Ex-Im Bank has not identified any long-term transaction in which U.S. insurance companies were not allowed equal access.

Appendix J: Trade Promotion Coordinating Committee (TPCC)

Introduction

The Trade Promotion Coordinating Committee (TPCC) is an interagency committee that is comprised of 19 U.S. government agencies.¹⁰ Each TPCC agency plays a key role in advancing the Administration's goal of maximizing U.S. export potential. The Export Enhancement Act of 1992 established the TPCC to coordinate U.S. government export promotion initiatives under the leadership of the Secretary of Commerce. The President and Chairman of the Export-Import Bank serves as the Vice-Chair of the TPCC.

Among the responsibilities of the TPCC is to prepare and submit to Congress an annual report entitled the National Export Strategy (NES) that outlines the Administration's trade promotion agenda. In April 2004, the TPCC issued the most recent NES report to Congress that provides a status report on progress made toward implementing the recommendations presented in the 2002 and 2003 NES reports. TPCC accomplishments during 2003 that pertain to Ex-Im Bank are summarized below.

Highlights of TPCC Accomplishments During 2003

Highlights of the TPCC's major accomplishments during 2003 that directly impact Ex-Im Bank and its competitive position vis-à-vis foreign export credit agencies include:

- Ex-Im Bank and Small Business Administration (SBA) finalized terms for a Co-Guarantee Agreement that will build on previous efforts to harmonize the export working capital loan programs of both agencies. This approach will provide the exporter with more easily accessible trade finance and the lender with combined SBA and Ex-Im Bank coverage without having to deal with two separate agencies.
- Broadening the scope of the joint marketing task force, which includes representation from Ex-Im Bank, SBA, the U.S. Commerce Department's Census Bureau and International Trade Administration, and the U.S. Department of Agriculture. This task force produces literature on U.S. government trade promotion programs that it disseminates at major domestic trade shows, trade financing seminars and direct mail campaigns. This marketing effort provides the U.S. export community with information and knowledge on how to effectively use U.S. government programs to boost U.S. export potential.

¹⁰ Members of the TPCC are the following U.S. government agencies: U.S. Departments of Commerce (Chair), State, Treasury, Agriculture, Defense, Energy, Transportation, Interior, Labor, the Overseas Private Investment Corporation, Ex-Im Bank, U.S. Agency for International Development, Small Business Administration, U.S. Trade and Development Agency, U.S. Trade Representative, Environmental Protection Agency, the Council of Economic Advisors, National Economic Council and the Office of Management and Budget.

- Creating increased opportunities for U.S. exporters by marketing the availability of Ex-Im Bank financing to foreign buyers during the developmental phase of projects. Specific aims are to: (1) identify nascent U.S. export opportunities and, where appropriate, encourage foreign buyers to source goods and services from U.S. suppliers; and (2) demonstrate USG financing support for these U.S. export opportunities at the initial developmental stage of the project; and (3) assist the company to enhance its proposal.
- Responding to U.S. exporters' demands for a U.S. Government response to foreign governments' use of concessional financing for development-related capital projects, in 2002 the TPCC introduced a USG mixed credit concept. The idea was, and still is, to combine USAID grants with Ex-Im Bank standard export credit financing for development-related projects that are identified as priorities by USAID and consistent with the OECD tied aid rules. (When combined, the two funding sources create a tied aid credit.) In 2004, USAID and Ex-Im Bank identified an inaugural project to test the mixed credit concept and are currently working out how to implement the project.
- Continuing the cross-training program in which TPCC agencies train their staffs on a host of U.S. government trade promotion programs. The objective is to prepare the next generation of international trade officers to accurately gauge their customer's real needs and export objectives and to package and seamlessly deliver an effective, customized solution integrating a multitude of different services from the TPCC Agencies. In 2003, the training was given to 92 participants from a total of ten federal agencies.

Appendix K: Efforts to Promote Renewable Energy Exports

In Ex-Im Bank's 2002 reauthorization process, Congress added to Ex-Im Bank's Charter the requirement to report on efforts to promote renewable energy exports.

During 2003, Ex-Im Bank staff participated in a number of outreach and marketing events intended to promote renewable energy exports. Participation in these events involved organizing panels, making presentations, meeting with individual exporters and meeting potential buyers. These events included:

1. A workshop entitled "Financing Environmental Exports" at Ex-Im Bank's April 2003 Annual Conference, which included guest speakers from GE Wind and the Solar Energy Industries Association.
2. The American Wind Energy Association Annual Conference in Austin, TX in May 2003.
3. A panel on "Financing International Sales" for the Solar Energy Industries Association Annual Conference in Austin, TX in June 2003.
4. A panel on "Financing Solar Energy Projects" for the American Solar Energy Society in October 2003 in Phoenix, AZ.
5. Two "reverse trade missions" for the National Hydropower Association, meeting with potential buyers from India and Mexico.

In addition, Bank staff engaged in efforts to explore policy and technical issues related to supporting renewable energy exports. These meetings included:

1. Convening a meeting of the Bank's Renewable Energy Exports Advisory Committee in October 2003.
2. Participating in an October 2003 meeting in London sponsored by the United Nations Environment Program that explored ECA financing of renewable energy exports and projects. The meeting included officials from other ECAs and renewable energy project sponsors.
3. Participating in the Fourth International Workshop on Large-scale Integration of Wind Power in Denmark during October 2003. This technical workshop analyzed the current state and future direction of large wind generation farms and impacts on the existing electric power infrastructure.

APPENDIX L



Operational Efficiency

Please complete the survey and e-mail your response to bu-sec@berneunion.org.uk by:
Friday 19 March 2004.

Member Name

1. Have you been encouraged by your customers to provide better customer service?

Yes

No (go to 3.)

2. In which areas has improved customer service been requested?

- Information requirements for applications
- Documentation for application processing e.g. volume & depth of info required
- Speed of application processing
- Speed of decision making
- Speed of claims processing
- Possibility of online applications
- Availability of staff to answer questions
- Case sensitive information
- Availability of website information & assistance
- Availability of a call center
- Availability of regional offices
- Other; specify

3. Describe any operational efficiency measures/metrics that you have recently introduced: (if none, go to 6.)

For example: Do you have case processing turnaround deadlines?

4. Describe the steps that you have undertaken in order to meet these measures/metrics:

For example: Have processes been modified for improvement?

Have you adopted IT systems?

Have you reorganised?

5. Describe any measurement of your performance that you have based on the adopted measures/metrics?

What were the results and how were they obtained?

If no, why not?

6. If you have not introduced any measures/metrics, describe what you may be considering in the near future:

7. Do you survey your customers on your levels of customer service?

If so, how often?

How have the results compared with your internal measurement of performance?

8. Do you receive complaints about your response time?

Yes

No

Rarely

Occasionally

Frequently

Very frequently

Can you estimate the amount of "lost exports" due to slow response times?

9. What is your approach towards balancing the need for quality (eg sound underwriting, adherence to policy etc.) with the need for faster responses on applications?

Thank you for your time.