



## U.S.-China Economic and Security Review Commission Staff Research Backgrounder

### Export Assistance and the China Challenge

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By Anna Tucker

During Chinese Vice President Xi Jinping's visit to Washington in February, China agreed to participate in negotiations to reach an eventual deal to limit government financing for exports.<sup>2</sup> According to the announcement, the goal is to establish an international working group and to conclude an agreement on export credit finance guidelines by 2014. This is a potentially positive step to counter Chinese export promotion practices, many of which are market disruptive and out of step with international norms. But, there is an existing set of OECD principles guiding export credit activities; any new guidelines will need to be reviewed for their effect on the current OECD members' voluntary rules. Moreover, even if the promised negotiations with China are successful in reforming China's market distorting practices, it will likely not reverse the growing international inequities created by China's aggressive government financing of its exports.

#### **Background**

Export credit financing is one tool used by governments to aid domestic exporters.<sup>3</sup> This financing is typically extended to exporters or to overseas customers via an export credit agency (ECA), which may be a government, private or quasi-government entity. Financing can take a number of forms, including

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<sup>2</sup> "[Joint Fact Sheet on Strengthening U.S.-China Economic Relations](#)," (The White House, Office of the Press Secretary, February 14, 2012).

<sup>3</sup> Chinese export credit financing and insurance is channeled through three organizations: the China Development Bank, China's Eximbank and Sinosure. According to a 2011 ExIm Bank Report to Congress, though their functions differ somewhat, "collectively the net effect is the same: each supports the Chinese Government's 'Going Out' policy as a central means to establish long-term 'mutually beneficial relationships with other foreign governments.'" Export-Import Bank of the United States; Report to the US Congress on Export Credit Competition and the Export-Import Bank of the United States, June 2011. (p. 108)

direct loans at low interest rates and repayment guarantees for loans made by private banks. Financing varies according to the ECA. The Export-Import Bank of the United States (Ex-Im Bank) is America's official government ECA, charged with "financing and promoting exports of U.S. manufactured goods and services, with the objective of contributing to the employment of U.S. workers."<sup>4</sup>

Like other major ECAs, the Ex-Im Bank is intended to act as an export finance gap-filler. Ex-Im enables "transactions that might not otherwise occur and keep[s] the U.S. competitive in world markets" by financing exports in circumstances where limited or no private financing is available.<sup>5</sup> Much of the Ex-Im Bank's financing is extended to developing country purchasers of U.S. exports and to U.S. small-and-medium-sized enterprises (SMEs) that are unable to access commercial bank funding. In addition, the Ex-Im Bank uses export financing to level the playing field where foreign exporters might otherwise enjoy an unfair advantage, such as when a foreign government-controlled company is the competitor. Approximately 80 percent of Ex-Im Bank credit and insurance transactions go to SMEs, though by dollar value, most of the money goes to large firms.<sup>6</sup>

Ex-Im Bank is not the major source of funding for U.S. exports, however. Of the \$2 trillion in total U.S. exports in 2011, the bank's loans and guarantees covered only about \$41 billion worth of sales, or about 2 percent of all exports.<sup>7</sup> Though these numbers show that Ex-Im's financing role is small, supporters of the Bank argue that its role is nonetheless critical because it can offset particularly egregious forms of subsidized loans provided by competing governments. For example, the Ex-Im Bank has limited funds that can occasionally be used to match unorthodox terms or exceptionally subsidized rates, though such matching is rarely used.

## **The China Challenge**

The China challenge is twofold. First, the volume of Chinese government financing easily outstrips the capacity of the Ex-Im Bank. A recent report by the Information Technology and Innovation Foundation (ITIF) characterizes the government of China as conducting "the most aggressive export credit financing campaign in history," noting that between 2006 and 2010, China's government issued more than \$203 billion in new export credit financing, several times more than was invested by the United States.<sup>8</sup> The ITIF report showcases a \$30 billion credit line extended to Chinese telecommunications giant Huawei by the government-owned China Development Bank as an example of "the sheer amount of resources China has poured into export credit financing."<sup>9</sup> By contrast, Ex-Im Bank authorized just \$32.7 billion in

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<sup>4</sup> "Export-Import Bank: Background and Legislative Issues," (Congressional Research Service, February 9, 2011), p. 1.

<sup>5</sup> Stephen J. Ezell, "Understanding the Importance of Export Credit Financing to U.S. Competitiveness," (Washington, DC: The Information Technology & Innovation Foundation, June 2011).

<sup>6</sup> "Reauthorization of the Export-Import Bank: Issues and Policy Options for Congress," (Congressional Research Service, January 31, 2012), p. 10

<sup>7</sup> "[Export-Import Bank is U.S. Engine That can do More: View](#)," *Bloomberg*, March 7, 2012

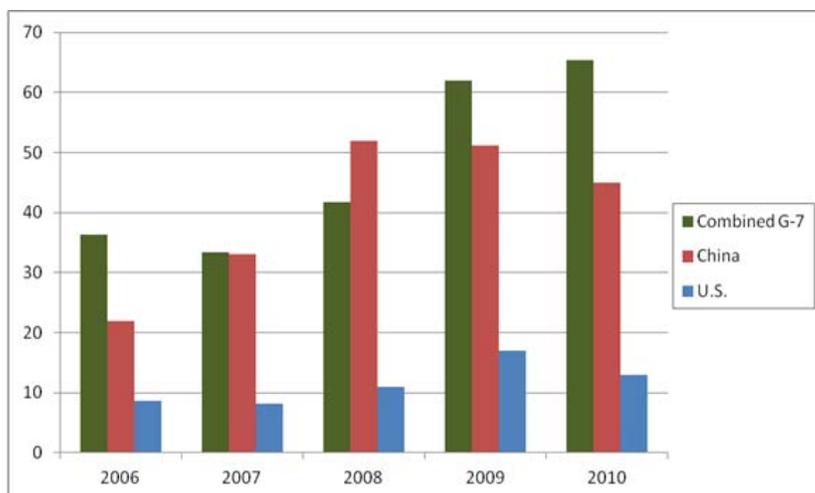
<sup>8</sup> Stephen J. Ezell, "Understanding the Importance of Export Credit Financing to U.S. Competitiveness," (Washington, DC: The Information Technology & Innovation Foundation, June 2011).

<sup>9</sup> Stephen J. Ezell, "Understanding the Importance of Export Credit Financing to U.S. Competitiveness," (Washington, DC: The Information Technology & Innovation Foundation, June 2011).

newly-issued export assistance in all of fiscal year 2011 to benefit U.S. exporters. That amount was a record high for Ex-Im.<sup>10</sup>

Indeed, estimates of annual Chinese export financing dwarf the average of roughly \$20 billion that the Ex-Im Bank extended annually over the last five years.<sup>11 12</sup> According to Ex-Im’s 2010 Report to Congress on Export Credit Competition, “China seems to have a team of financial institutions doing vast amounts of short-term and medium- and long-term export finance” which “in aggregate....could well total over \$100 billion a year.” Ex-Im concludes that “from the top down, the size, scope, and focus of [Chinese institutions providing export finance] is simply incomparable to anything within the OECD (Organization of Economic Cooperation and Development ) /G-7.”<sup>13</sup> Even were it not restrained by practical realities, Ex-Im is restrained by law from offering an amount of export credit financing on par with these estimates. The Ex-Im Bank’s total credit limit is \$100 billion, meaning its outstanding aggregate amounts of loans, guarantees, and insurance cannot exceed \$100 billion at any one time.<sup>14</sup> With roughly \$90 billion in outstanding loan guarantees, the bank’s current legal ability to extend additional loans is far too limited to compete with the government of China.<sup>15</sup>

**Combined G-7, Chinese and U.S. New, Medium-and Long-Term Official Export Credit Volumes, 2006-2010 (Billions USD)**



Data drawn from the Report to the U.S. Congress on Export Credit Competition and Export-Import Bank of the United States, June 2011. Chinese data Chinese volumes represent U.S. Ex-Im’s estimates based on best available information at the time of publication.

<sup>10</sup> Export-Import Bank of the United States; [2011 Annual Report](#).

<sup>11</sup> Stephen J. Ezell, “Understanding the Importance of Export Credit Financing to U.S. Competitiveness,” (Washington, DC: The Information Technology & Innovation Foundation, June 2011).

<sup>12</sup> Export-Import Bank of the United States; Report to the US Congress on Export Credit Competition and the Export-Import Bank of the United States, June 2011. (p. 112)

<sup>13</sup> Export-Import Bank of the United States; Report to the US Congress on Export Credit Competition and the Export-Import Bank of the United States, June 2011. (p. 112)

<sup>14</sup> “Reauthorization of the Export-Import Bank: Issues and Policy Options for Congress,” (Congressional Research Service, January 31, 2012), p. 11

<sup>15</sup> Josh Mitchell, “U.S. Trade Bank Stuck in Crossfire of Lobbying War Over Loan Limits,” *The Wall Street Journal*, December 20, 2011.

The second challenge from Chinese export credit financing is that the terms of Chinese financing are often more advantageous than those allowed within the OECD Arrangement on Officially Supported Export Credits, to which the U.S.—but not China—is a party.<sup>16</sup> The OECD first articulated export credit financing guidelines in 1978 and periodically updates this non-binding “gentleman’s agreement,” commonly referred to as the OECD Arrangement.<sup>17 18 19</sup> Adherents to the OECD Arrangement include the United States, the 27 EU nations, Australia, Canada, Japan, South Korea, New Zealand, Norway and Switzerland. The Arrangement is meant to level the playing field among participant nations and to prevent subsidy competitions that could result in countries extending export credit financing on increasingly more generous terms and to ever more risky recipients.

China’s official government system of export financing is supplemented by lending from commercial banks controlled or owned outright by the government as well as quasi-government agencies. China’s “policy banks,” such as the China Development Bank, are directed to extend loans for specific purposes delineated in China’s official economic plans, including the goal of producing “national champions” able to compete on a global scale. The China Export and Credit Insurance Corporation (SINOSURE), was created and funded by the government in 2001 specifically to “fulfill the Chinese government’s diplomatic, international trade, industrial, fiscal and financial policies.”<sup>20</sup> The amounts and terms of such lending are often unclear but are likely to be guided more by policy considerations than by prudent and market-driven criteria.

As a non-member of the OECD, China is not obligated to adhere to the OECD Arrangement’s guidelines and has generally ignored them, putting OECD Arrangement participants, including the United States, at a competitive disadvantage. U.S. exporters therefore complain that China’s government-backed financing can make it difficult for them to conclude sales.<sup>21</sup> Whereas most of the ECAs of OECD

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<sup>16</sup> “Export-Import Bank: Background and Legislative Issues,” (Congressional Research Service, February 9, 2011), p. 16.

<sup>17</sup> Organization for Economic Cooperation and Development: Agreement on Officially Supported Export Credits, September 1, 2011, TAD/PG(2011)13

<sup>18</sup> The OECD Arrangement on Officially Supported Export Credits (“OECD Arrangement”) was established in 1978. It is non-binding, but with 30 participating advanced industrialized economies, it has long been the preeminent international guidance for ECA activity. The OECD Arrangement lays out limitations on terms and conditions for official export credit activity. “It includes financial terms and conditions, such as down payments, repayment terms, interest rates, and country risk classifications; provision on tied aid; notification procedures; and sector-specific terms and conditions, covering the export credits for ships, nuclear power plants, civil aircraft, renewable energies, and water projects. Military equipment, agricultural goods, and untied development aid are not covered by the agreement. The OECD lacks the authority to enforce compliance with its agreements, though members generally monitor compliance and raise concerns when members’ policies and actions are viewed as violating the OECD Arrangement.” “Reauthorization of the Export-Import Bank: Issues and Policy Options for Congress,” (Congressional Research Service, January 31, 2012), p. 6

<sup>19</sup> China Export and Credit Insurance Corporation, Company Profile, <http://www.sinosure.com.cn/sinosure/english/Company%20Profile.html>

<sup>20</sup> “Reauthorization of the Export-Import Bank: Issues and Policy Options for Congress,” (Congressional Research Service, January 31, 2012), p. 7

<sup>21</sup> Report to the US Congress on Export Credit Competition and the Export-Import Bank of the United States, June 2011 (Export-Import Bank of the United States), pp 12-13.

members, especially the U.S. Ex-Im Bank, operate primarily or wholly as lenders of last resort in a free market context, China's financing programs incorporate broader government policy priorities and "go beyond the free trade or traditional approach," applying "aggressive 'quasi-commercial' financing programs or concerted or targeted approaches."<sup>22</sup>

Amid the challenges posed by China's nontraditional financing practices, OECD Arrangement participants are increasingly tempted to depart from the non-binding guidelines themselves in order to help their exporters compete.<sup>23</sup> In other words, China's practices may be creating incentives for countries to engage in rate cutting and to offer exceptional terms that the Arrangement seeks to limit. The growth in export credit in a number of OECD nations has significantly outstripped export credit growth in the United States in the past decade, and though this cannot be attributed solely to the pressures that Chinese export finance practices are creating, China's practices certainly are not discouraging the ramp up.<sup>24</sup>

### **Uncertain Prospects for the Recently Announced Talks**

The February agreement between the United States and China to initiate talks reiterates a previous bilateral agreement to discuss export credit financing, made during the May 2011 meeting of the Strategic and Economic Dialogue (S&ED) but also adds a deadline for negotiations. The parties plan to set up an "international working group of major providers of export financing" in order to "make concrete progress towards a set of international guidelines on the provision of official export financing that, taking into account varying national interests and situations, are consistent with international best practices, with the goal of concluding an agreement by 2014."<sup>25</sup>

While persuading China to adhere to some yet-to-be-determined export credit financing guidelines could be a beneficial achievement, any agreement with China that is less than comprehensive could undermine the existing non-binding OECD guidelines. For example, it remains unclear how much international participation the U.S.-China-led talks will garner. On the positive side, it is possible that the dialogue could lead to China endorsing and complying with some existing OECD guidelines as a non-OECD member, a practice that has already been undertaken by Brazil in the commercial aviation sector. On the other hand, China may see the dialogue as a means of reaching a separate agreement with the U.S. outside the scope of the OECD Arrangement, or as a means of watering down existing OECD guidelines.

A separate agreement between the U.S. and China would be a "big step backwards," according to Peterson Institute for International Economics Senior Fellow Gary Hufbauer, because it would erode OECD members' trust in the U.S.<sup>26</sup> Frank Vargo, Vice President for International Economic Affairs at the

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<sup>22</sup> "U.S., China Agree to Seek International Pact on Export Finance by 2014," *Inside U.S.-China Trade*, February 15, 2012.

<sup>23</sup> Stephen J. Ezell, "Understanding the Importance of Export Credit Financing to U.S. Competitiveness," (Washington, DC: The Information Technology & Innovation Foundation, June 2011).

<sup>24</sup> "[Joint Fact Sheet on Strengthening U.S.-China Economic Relations](#)," (The White House, Office of the Press Secretary, February 14, 2012).

<sup>25</sup> "U.S., China Agree to Seek International Pact on Export Finance by 2014," *Inside U.S.-China Trade*, February 15, 2012.

<sup>26</sup> Doug Palmer, "[U.S., China Agree to Negotiate Export Credit Deal](#)," *Reuters*, February 14, 2012.

National Association of Manufacturers, has called the dialogue “a welcome development, because China is not now under any export financing disciplines at all,” and is “undercutting everyone.” But he has also expressed concern about the implications of the announcement’s language regarding “varying national interests.” This could be a “‘huge loophole’ that would render any agreement with China meaningless,” according to Vargo, because China could cite its national interests as grounds for weakening or altogether doing away with the most meaningful disciplines.<sup>27</sup>

### **Additional Efforts that Might be Undertaken**

Regardless of what the U.S.-China-led talks may achieve among other nations, the Obama administration argues that if U.S. exporters are to compete effectively with Chinese exporters, additional export financing tools must be deployed. During a speech at Boeing’s Seattle facilities on February 17, the President outlined several new efforts designed to enhance assistance for U.S. exporters and ensure that his National Export Initiative goal of doubling American exports in five years is achieved. Among the initiatives, the President announced that he has directed Ex-Im Bank to actively employ its full authority to provide matching financing support for U.S. firms seeking to secure domestic or third-country sales when they are up against “non-competitive official financing that fails to observe international disciplines.”<sup>28</sup> The White House calls this a necessary tool because “China and other global competitors often provide unfair advantages to help their companies win business overseas.”<sup>29</sup>

At the President’s direction late last year, Ex-Im used this authority, offering financing outside accepted international guidelines in order to help General Electric Co. successfully secure a contract to sell locomotive engines to Pakistan despite Chinese offers of loans at below-commercial rates to subsidize Pakistani purchases of Chinese locomotives. Ex-Im also has the ability to discourage the use by other countries of tied-aid—or foreign aid that is conditioned on the purchase of goods and services from the donor country. Ex-Im has a “tied aid war chest” available to help level the playing field for U.S. exporters competing with anticompetitive financing terms such as those often offered by China. The President’s full use of this authority could help counter some unfair Chinese subsidies. Ex-Im noted in its last report to Congress that although “historically, the Bank and U.S. exporters passed on matching such transactions...as China has become a player in nearly every market and sector, the U.S. government has looked for ways in which to keep U.S. exporters from losing market share to such financing packages that fall outside of the OECD rules, with the intention of effectively neutralizing Chinese offers.”<sup>30</sup>

Another potential means of aiding U.S. exporters competing with China would be to increase the volume and scope of trade assistance offered through Ex-Im. Raising the Bank’s lending limit is primary among the business community’s recommendations for the Congressional reauthorization of Ex-Im. The Bank’s

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<sup>27</sup> [“President Obama Takes Actions to Promote American Manufacturing and Increase U.S. Exports at Boeing,”](#) The White House, Office of the Press Secretary, February 17, 2012.

<sup>28</sup> [“President Obama Takes Actions to Promote American Manufacturing and Increase U.S. Exports at Boeing,”](#) The White House, Office of the Press Secretary, February 17, 2012.

<sup>29</sup> Export-Import Bank of the United States; Report to the US Congress on Export Credit Competition and the Export-Import Bank of the United States, June 2011. (p. 110)

<sup>30</sup> “U.S. Trade Bank Stuck in Crossfire of Lobbying War Over Loan Limits,” Josh Mitchell, December 20, 2011, The Wall Street Journal.

charter is set to expire on May 31 of this year, and concern that it may reach its \$100 billion lending cap before May is adding to the urgency for Congressional reauthorization. “In a letter sent [in December 2011] to congressional leaders, more than 60 chief executives, including Boeing’s James McNerney Jr. and G.E.’s Jeffrey Immelt, warned that leaving the current lending limit in place could result ‘in the loss of thousands of U.S. jobs.’”<sup>31</sup> Proponents of a higher lending limit are pushing for it to be raised to \$140 billion. However, some opponents object and consider official export financing a form of corporate welfare that should be diminished, not expanded. House Majority Leader Eric Cantor (R-VA) is advocating for alternative legislation that would limit the reauthorization to one year, increase the lending cap to \$113 billion, and require the Administration to negotiate with other nations to end all official export credit financing.

### **Conclusion**

It is unrealistic to expect that the U.S.-China-led effort to identify international standards will eliminate China’s massive export credit financing subsidies and unorthodox lending practices, but inducing China to introduce greater transparency into its export credit financing would be a substantial improvement over the current situation. At present, China not only has no obligation to restrict its tied aid, but also has no requirement or incentive to reveal its financing terms in many other circumstances.

Greater Chinese transparency could facilitate Ex-Im Bank’s efforts to level the playing field for U.S. exporters by identifying and matching Chinese financing on a case-by-case basis, to the extent that such matching proves advisable. As the Pakistan deal shows, when Ex-Im utilizes its “tied aid war chest” it can help U.S. exporters to respond with effective counter offers that would otherwise be beyond their reach. But successful matching will require not just improved transparency but a high level of transparency. According to Ex-Im, “In [the Pakistan] transaction the Bank had precise information on the terms of the Chinese offer, confirmation that financing was a/the critical factor in bid award, and had determined that exact matching of the [Chinese] terms would still provide a transaction-specific financial surplus.”<sup>32</sup>

Even if a higher degree of Chinese transparency is achieved, U.S. budget constraints would remain. Ex-Im’s \$180 million budget for matching non-competitive financing is pocket change compared to estimated Chinese subsidies.<sup>33</sup> If Ex-Im Bank’s cap were raised to \$200 billion and its tied aid war chest doubled, the United States still could not hope to out-subsidize Beijing, and it would present serious potential pitfalls even if the U.S. could do it. Some in Congress argue that the United States should not engage in a competition that would have U.S. taxpayers subsidizing foreign consumers in this manner.

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<sup>31</sup> Gary Clyde Hufbauer, Meera Fickling and Woan Foong Wong, “Revitalizing the Export-Import Bank,” *Policy Brief* (Washington, DC: Peterson Institute for International Economics, May 2011).

<sup>32</sup> Jonathan Weisman, “[Business Bets on the GOP may be Backfiring](#),” *The New York Times*, March 28, 2012.

<sup>33</sup> Jonathan Weisman, “[Business Bets on the GOP may be Backfiring](#),” *The New York Times*, March 28, 2012.

Ex-Im has an excellent track record of not losing money even if some loans go sour. The bank is self-financed and has produced \$3.4 billion in profits for the federal government in the last five years.<sup>34</sup> But some critics also worry that doubling the Bank's credit exposure limit would put taxpayers at greater risk of absorbing the cost of bad loans. The Washington-based Club for Growth views Ex-Im as "the next Fannie Mae or Freddie Mac, crowding out private lending and offering dangerous loans that ultimately could be left in the laps of the taxpayer."<sup>35</sup> The Economic Policy Institute counters that unilaterally shutting down the Ex-Im would mean that export sales and jobs would simply go to other countries.<sup>36</sup>

Those who warn against trying to compete with China's export financing practices also cite the pitfalls of state capitalism as reasons not to match China's subsidies. Some warn that China is misallocating resources, a practice they believe will ultimately harm China's economy. When the heavy hand of the state causes "decisions on how assets should be valued and resources allocated [to be] made by political officials (not market forces) with political goals in mind," the results are generally less efficient, notes political scientist Ian Bremmer, president of the Eurasia Group, a consulting firm.<sup>37</sup>

China's state-directed business practices present long-term challenges for U.S. businesses. As experience demonstrates, China's willingness to come to the negotiating table does not equate with willingness to compromise what it views as significant strategic advantages. Persuading China to participate in a revised set of international export credit financing disciplines will involve international discussion and domestic consideration of a host of details such as taxpayer impacts, environmental impacts, and domestic content requirements. Just as we should not expect China to easily compromise its strategic advantages, the United States should guard against compromising important and accepted fairness principles and standards.

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<sup>34</sup> Owen Herrstadt and Robert E. Scott, "Institutions that support U.S. jobs should be strengthened, not gutted," Economic Policy Institute, March 28, 2012, <http://www.epi.org/publication/export-import-bank-jobs-goods-services/>

<sup>35</sup> Ian Bremmer and Devin T. Stewart, "[China's State Capitalism Poses Ethical Challenges](#)," (New York, NY: Carnegie Council, August 12, 2010)

<sup>36</sup> "[The 'Rise' of China's State Capitalism is not a Point of Pride, but a Reason to Worry](#)," *South China Morning Post*, March 1, 2012.

<sup>37</sup> "[The 'Rise' of China's State Capitalism is not a Point of Pride, but a Reason to Worry](#)," *South China Morning Post*, March 1, 2012.