Aid and Exports: Selected Country Practices 4

It is hard to say how important aid is in promoting exports. One study found that 14.6 percent of OECD exports to developing countries during 1987-1990 were aid-financed.[1] But what does this mean? On the one hand, some of these exports would have occurred without the aid financing.[2] On the other hand, exports directly financed by aid can lead to other exports not using aid financing, so over time aid could have a cumulative effect that far exceeds its export coverage in a given year.

We can, however, examine countries' practices that tend to increase or decrease the exports resulting from foreign aid. This chapter examines practices of the United States, Japan, France, Germany, and the United Kingdom[3] in four areas: the composition of aid (cash transfer, projects in particular sectors, etc.); geographic focus of aid; tying of aid, both formal and informal; and the use of loans (especially tied loans). Much of the data is available only for aid as a whole; but, where possible, environment-related aid is discussed. A fifth area of practice, the building of long-term relationships (such as through technology cooperation), was discussed in box 2-B; and a sixth area, use of a country's aid that can help national firms to win contracts under multilateral aid projects, was discussed in box 2-C.

Among the foreign countries examined, Japan's aid may pose the greatest commercial challenge to the United States, and

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[1] This figure is derived from a restricted OECD document, which gives an analysis by Professor Catrinus J. Jepma. The OECD plana to publish this analysis in a publicly available form.

[2] How much this happens is explored in Catrinus J. Jepma, "EC-Wide Untying," IDE Foundation, University of Groningen, The Netherlands, 1992, p. 10.

[3] The largest aid donors are, in order, the United States, Japan, France, Germany, Italy, and the United Kingdom. Italy is not discussed here.

receives the most attention below. Japan is, with the United States, the largest donor of aid and probably of environmental aid, and it has made a commitment to expand its environmental aid substantially. Japanese aid continues to be focused on East Asia, with its potentially large market for environmental goods and services (EGS), and where Japan has a strong commercial presence. Japan also may view the environment as a strategic industry, and has given the environment special attention in its aid programs. While the competitiveness of the U.S. environment industry is not discussed in this background paper (it will be discussed in the final report in this Assessment), it is worth noting that Japan has a long history of promoting industries that it considers strategic through coordinated use of R&D, export promotion, import restrictions, tax policy, and other policies.[4]

At the same time, Japan's ODA could benefit some U.S. environmental firms. Japan has, at least officially, been taking steps to open up more of its ODA to participation by non-Japanese firms. A recent Executive Branch report to Congress, coordinated by the State Department (referred to below as the "State Department" study), says, "we are cautiously optimistic" that U.S. and other foreign firms "will be able to increase their participation in Japan's ODA contracts over the next few years."[5] It remains to be seen whether this cautious optimism will be justified. Even if more opportunities exist in a formal sense, U.S. firms seeking to participate in Japanese ODA normally will need to make the effort to understand Japan's ODA system, and will need to be persistent.

COMPOSITION OF AID

Figures 4-1 through 4-3 show patterns in the composition of aid for 1989 and 1990.[6] Compared with other major donors, the United States spends more on debt relief and program assistance (fig. 4-l). Debt relief constitutes forgiveness, rescheduling, and refinancing of debt, including debt on an ODA loan or a non-ODA loan.[7] Debt relief is not normally associated with any particular purchases and thus does not directly promote exports.[8] Program assistance is a general category for aid not linked to specific projects. It is often given as a simple cash payment, which again does not directly promote exports.[9] A small portion of U.S. program assistance is given as a grant that can be spent only to purchase U.S. commodities. However, this restriction does not necessarily increase U.S. exports. The recipient country

4 U.S. Congress, Office of Technology Assessment, *Competing Economies: America, Europe, and the Pacific Rim*, OTA-ITE-498 (Washington, DC: U.S. Government Printing Office, October 1991), ch. 6.

5 U.S. Department of State in coordination with other Executive Branch departments and agencies in response to a request by the United States Senate, "Japan's Foreign Aid: Program Trends and U.S. Business Opportunities" (Feb. 18, 1993), mimeo., p. 6.

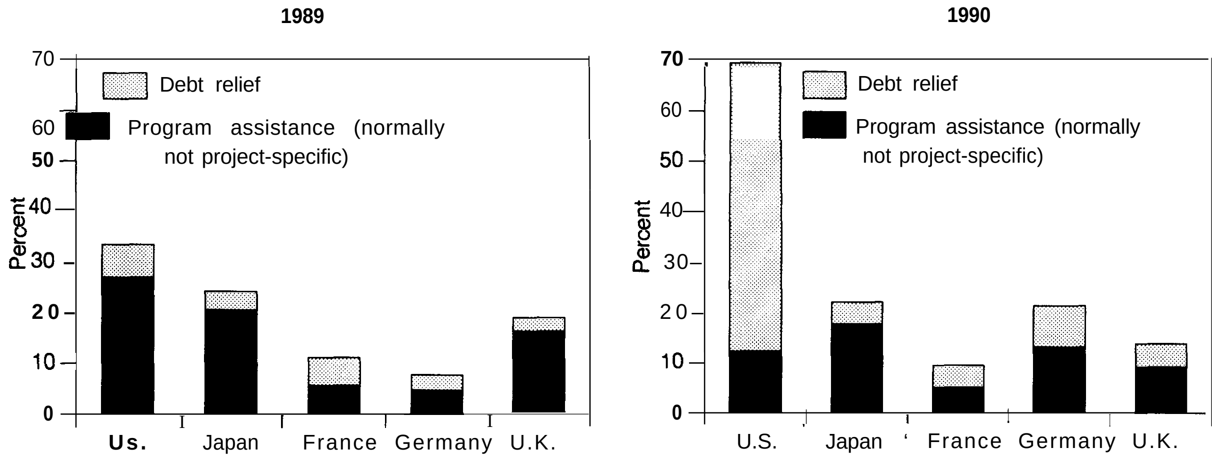
6 The terms used in these figures for different types of aid, some of which are explained below, are defined precisely in OECD, "DevelopmentAssistance Committee Statistical Reporting Directives," Note by the Secretariat, Dec. No. DAC(88)1O, drafted Feb. 22,1988. This document has unrestricted distribution.

7 Starting with 1991 figures, relief of military debt will not be counted as ODA at all, and therefore will not show up as debt relief. This changed accounting will probably reduce U.S. aid figures significantly.

8 Debt relief could indirectly promote exports in various ways. The recipient country might buy from the donor out of gratitude, or out of a perception (not necessarily encouraged by the donor) that future aid will depend on current spending patterns. The recipient country would have increased spending ability (although any extra spending that resulted would not necessarily be made in the donor country). The recipient country might buy more than it normally could afford from the donor on credit because it anticipates debt relief in the future.

9 As with debt relief, exports could be indirectly promoted because of gratitude, increased spending power, or a perception that spending in the donor country will increase future aid. This third factor may have recently become more important in the case of U.S. aid. Recently, USAID has in many cases set up special accounts to track how aid money is spent. In these cases, because it must tell USAID how it is spending the money, the recipient may feel pressure to spend it in the United States, even though USAID does not demand this. However, because the recipient can choose what particular goods and services to spend the money on, spending the special fund on U.S. goods and services would not necessarily increase its total purchases from the United States, as discussed in the text below.

Figure 4-l-Percent of ODA Commitments Devoted to Debt Relief and Program Assistance



SOURCE: OECD, *Development Cooperation 1991 Report* (Paris: OECD, 1991), pp. 202-203, table 30.

SOURCE: OECD, *Development Cooperation 1992 Report* (Pans: OECD, 1992), pp. A-40, A-41, table 30.

normally is permitted a very wide choice of what commodities on which to spend the aid. Given this flexibility, in many cases a recipient can use up its commodity grants on purchases that it would on its own have chosen to make from the United States.

In 1990 U.S. debt relief aid was abnormally large. However, even if debt relief is omitted entirely, the United States spends a higher proportion of its aid on program assistance than the other donors (fig. 4-2).

The United States spends much less of its aid on large capital projects than several other major donors. Figure 4-3 compares aid spending in several sectors (such as energy and water treatment) that could involve environmental equipment and services. Figure 4-3 presents percentages that are adjusted to omit debt relief, which in 1990 was so large for the United States that it skewed all other percentages (such as for capital projects) downward; even so, the United States falls clearly at the low end.

U.S. aid (including environmental aid) emphasizes technical assistance.[10] Much of this aid is provided as grants used to hire U.S. consultants and service providers. Provision of these services could indirectly promote export of capital goods, by familiarizing recipient countries with U.S. products.

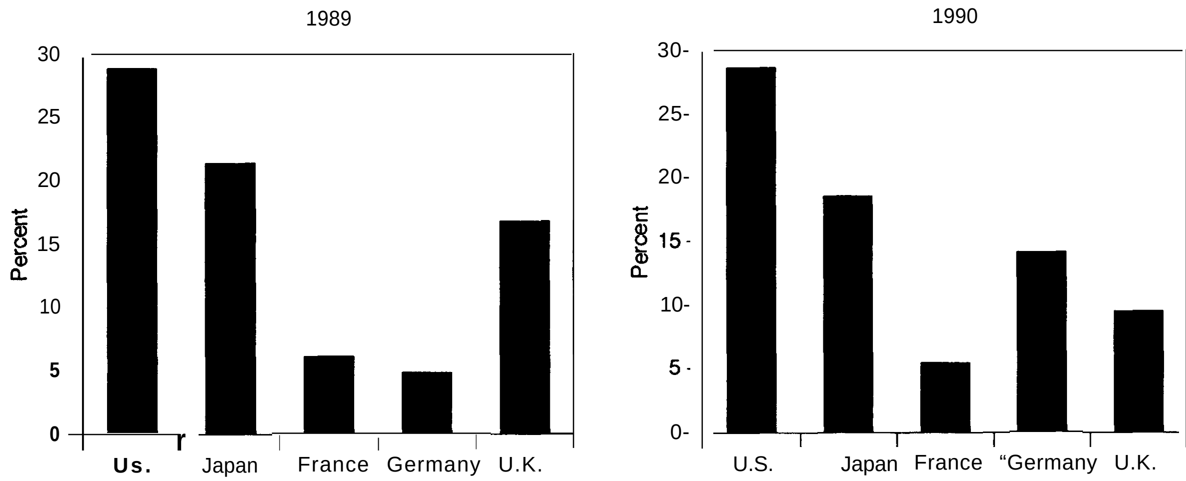
GEOGRAPHIC FOCUS

Aid tends to increase exports to a greater extent when it is focused on countries with substantial markets for the donor's exports. Japan's aid, despite geographic broadening in recent years, is still heavily focused on Asian countries. In 1990, 59.3 percent of Japan's ODA went to Asia, compared with 70.5 percent in 1980.[11] Some Asian developing countries have relatively large and fast-growing markets for capital goods, and could become important markets for environmental goods and services. Moreover, Japanese firms already have a strong commercial presence in these countries, which should help them to pursue aid-related export opportunities. More

[10] A few large capital projects have been supported through USAID, including major water and wastewater treatment and power sector support projects in Egypt.

[11] Japanese Ministry of Foreign Affairs, *Official Development Assistance 1991*, p. 63.

Figure 4-2-Percent of Non-Debt Relief ODA Commitments Devoted to Program Assistance



SOURCE: OECD, Development Cooperation 1991 Report (Paris: OECD, 1991), pp. 202-203, table 30.

SOURCE: OECD, Development Cooperation 1992 *Report* (Paris: OECD, 1992), pp. A-40, A-41, table 30.

than half of the water purifying and filtering units exported from Japan in recent years have gone to Southeast Asian countries.[12]

TYING OF AID

How do the United States, Japan, France, Germany, and the United Kingdom compare in the extent to which they tie their aid? This question has no easy answer. DAC statistics on tying have shortcomings that make comparisons difficult; also, one can look at the available data in different ways. In addition, certain circumstances can make tying either more or less likely to promote exports. Some comparisons for 1990 and 1989 are presented in figures 4-4 and 4-5,[13] but they must be understood in this light:

- The statistics are based on aid commitments made-rather than actual funds disbursed—during a given year. Some commitments never ripen into disbursements,[14] and the percentages of each that are tied could differ.
- Debt relief is counted as untied because it is not linked to any purchases;[15] thus, the abnormally high level of debt relief in the U.S. aid program for 1990 skews tying statistics downward. For this reason, the 1989 figures probably provide a more representative comparison; these show the United States roughly even with Germany and France (the United States tending to have slightly less tied aid, but more partially untied aid), and tying more than Japan but less than the United Kingdom. (Japan's tying statistics are discussed further below.)

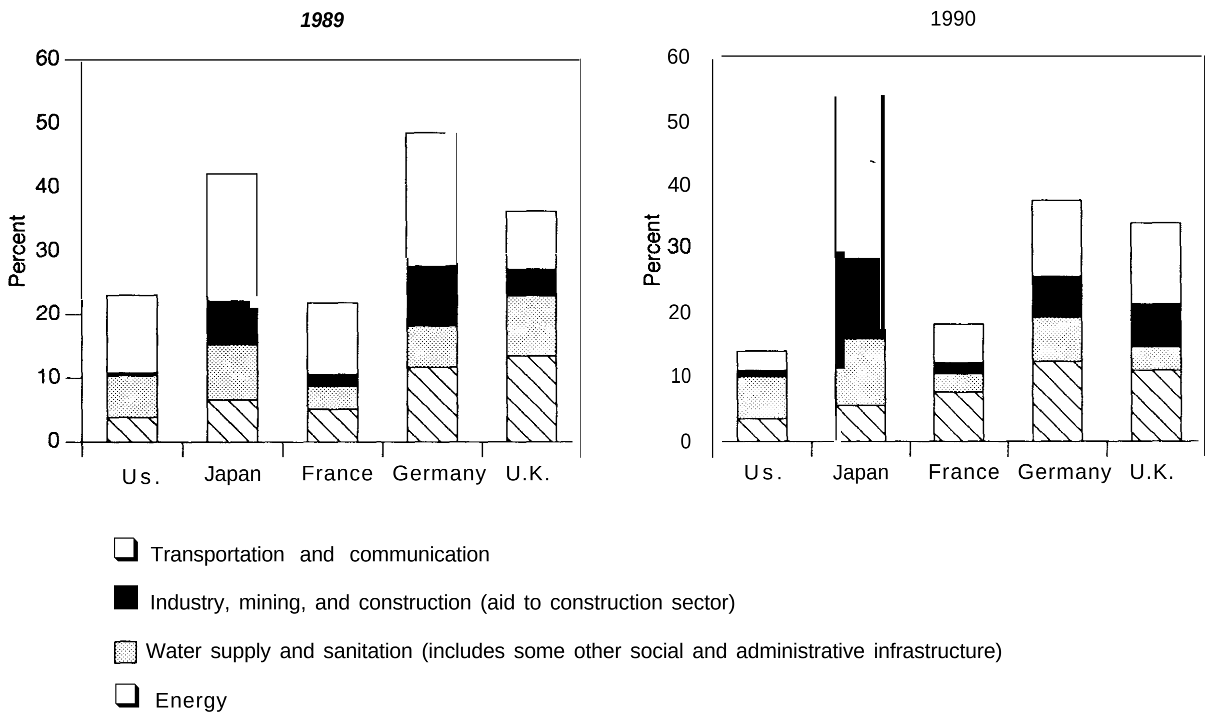
[12] As cited in Pat Murdo, "Cooperation Conflict in U.S.-Japan Environmental Relations," *JEI Report,* Japan Economic Institute, Washington DC, May 28, 1993, pp. 10-11.

[13] The reader should note that the *tying* statistics presented in figures 4-4 and 4-5 are different from *procurement* statistics. Generally, the percentage of aid spent on goods and services from the donor country will be greater than the percentage of tied aid, because some untied aid (in addition to all tied aid) will be spent on goods and services from the donor country.

[14] For example, 1988 commitments ran about 15 percent higher than disbursements. Catrinus Jepma, *The Tying of Aid* (Paris, France: OECD, 1991), p. 22.

[15] The original loan might have been conditioned on purchases from the donor country, either as tied aid or as non-aid export credits. If the original loan was aid, it would have been counted in the DAC statistics for the year it was given.

Figure 4-3-Percent of Non-Debt Relief ODA Commitments Devoted to Transportation and Communication; Industry, Mining, and Construction; Water Supply and Sanitation; and Energy



SOURCE: OECD, *Developmenf Cooperation 1991 Report* (Paris: OECD, 1991), pp. 202-203, table 30.

SOURCE: OECD, *Development Cooperation 1992 Report* (Paris: OECD, 1992), pp. A-40, A-41, table 30.

- Impressions about tying among countries will vary, depending on whether one examines just bilateral aid or total aid, which would include aid given through multilateral organizations. (During 1990-1991, the United States, Japan, and the United Kingdom each gave 22 percent of ODA to multilateral organizations, Germany 16 percent, and France 10 percent[16]) Normally, multilateral aid is effectively untied.[17] However, there is one important exception: the EC has a multilateral fired of aid that normally must be spent in the EC. The EC now spends about $3 billion annually on such tied aid; about 10 percent of this is environmental aid. Figure 4-4 shows tying of bilateral aid; figure 4-5, which shows tying of total aid, shows slightly less tying by the United States and Japan, which are not EC members.[18]
- The extent to which tying promotes exports depends not only on *how much* is tied, but also on *what* is tied. OECD tying statistics do not separate grants versus loans. Tied aid loans have greater export promotion potential and are restricted by OECD rules.[19] As discussed

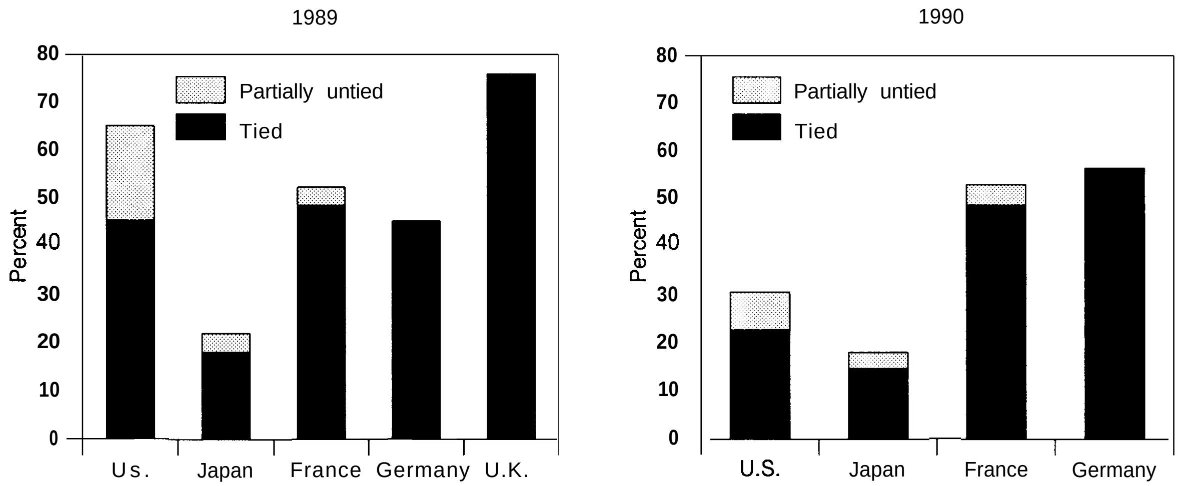
16 OECD, *Development Cooperation 1992 Report* (Paris, France: OECD, 1992), p. A-16, table 7.

17 Several MDBs restrict procurement to member countries, but membership is very wide.

18 In figure 4-5, the EC multilateral fund (which is reported separately in DAC statistics) is counted as tied, and all other multilateral aid is counted as untied.

19 At issue here are only loans that are part of ODA. Ordinary (non-aid) official export credits, which are by definition tied to purchases from the country granting the credit, are not part of the DAC statistics.

Figure 4-4-Formal Tying of Bilateral ODA Commitments



SOURCE: OECD, *Development Cooperation 1991 Repent* (Paris: OECD, 1991), p. 206, table 33.

NOTE: 1990 Figures for U.K. not available.

SOURCE: OECD, *Development Cooperation 1992 Report* (Paris: OECD, 1992), p. A-44, table 33; and unpublished OECD data (minor corrections to table 33).

below (under "Use of Loans"), the United States has given less tied aid loans than some other major donors.

- OECD tying statistics also do not separate aid by purpose (e.g., food, economic infrastructure). For example, the United States ties its food aid to the purchase of U.S. agricultural commodities. In 1990, food aid comprised 6.3 percent of U.S. ODA commitments.[20] This substantial chunk of tied aid means that the United States ties a smaller proportion of its aid in other areas than its overall average.[21] (Some other major donors might have similar tying patterns.)
- Tying practices can vary geographically, and tying of aid is most likely to promote exports when the aid is given to countries with the most promising markets. For example, as discussed below, Japan has provided substantial untied grant aid to African nations; this suggests that Japan's tying statistics for Asia, which holds the most commercial interest for Japan, might be higher than Japan's overall tying statistics reported in figures 4-4 and 4-5. Other nations also might tend to tie aid more in markets of more interest.

Tying of aid does not always increase exports; sometimes the recipient country would have bought the items from the donor even in the absence of tying. As discussed above (under "Composition of Aid"), when the recipient country has a wide choice of what goods or services to purchase with the tied aid, it often will be able to spend the tied aid on items that it would have bought from the donor anyway. This is true for U.S. commodity aid, and may be true for some aid offered by other donors.

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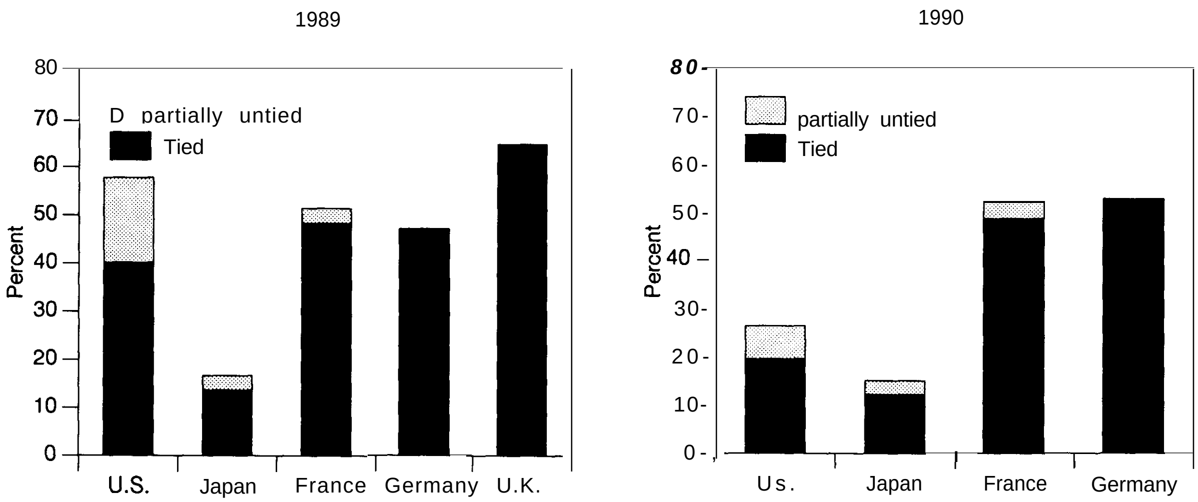
20 OECD, *Development Cooperation 1992 Report*, op. cit., p. A-41, table 30. In fiscal year 1991, U.S. food aid obligations were $1.87 billion, or 15 percent of U.S. aid commitments (excluding military aid, which is not counted as ODA by the DAC). Derived from Curt Tarnoff, Library of Congress, Congressional Research Service, "Foreign Aid: Answers to Basic Questions," Mar. 2.5, 1992, pp. 1-3,9.

21 The United States also ties almost all of its military aid, which in 1991 amounted to $4.8 billion, or 28.3 percent of total foreign aid obligations. Curt Tarnoff, Library of Congress, Congressional Research Service, op. cit., p. 3. However, military aid is not counted as ODA under DAC rules, and is therefore not reflected in the DAC data presented here.

Figure 4-5--Formal Tying of Total (Bilateral and Multilateral) ODA Commitments



SOURCE: OTA. Derived (see text) from OECD, *Development Cooperation 1991* Report (Paris: OECD, 1991), p. 206, table 33.

NOTE: 1990 Figures for U.K. not available.

SOURCE: OTA. Derived (see text) from OECD, *Development Cooperation 7992 Report* (Paris: OECD, 1992), p. A-44, table 33; and unpublished OECD data (minor corrections to table 33).

- The DAC statistics omit an unknown amount of informal tying. The DAC defines loans and grants to be tied when they are "in effect tied to procurement of goods and services from the donor country."[22] In practice, however, member countries can report figures as they wish, and the DAC does not often revise them, The quoted language is susceptible to different interpretations, and countries would normally wish to describe their aid as untied to the extent possible.[23] Also, some practices, while perhaps not rising to the level of "in effect" tying, at least make it more likely that purchases will be made in the donor country. Hence, while figures 4-4 and 4-5 show Japan with the lowest percentage of tied aid, Japan's recent reduction informal tying does not necessarily indicate an equivalent reduction in the extent to which its aid program promotes exports.

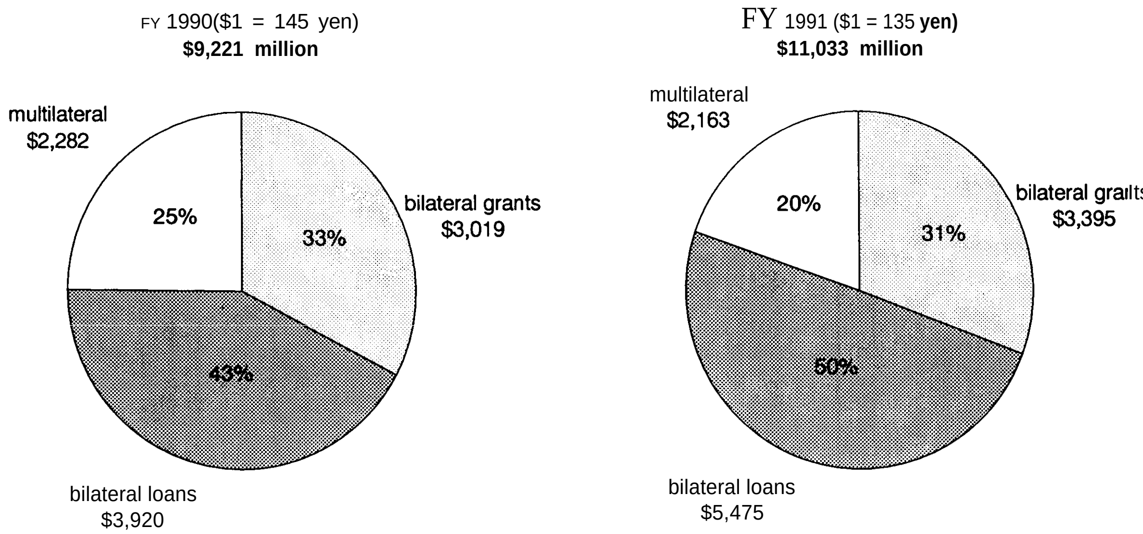
Partly because Japan's aid has been expanding rapidly, the commercial implications of its aid are receiving much attention. Figure 4-6 breaks Japan's aid into multilateral aid, bilateral grants, and bilateral loans. The multilateral aid, the smallest portion, is untied; in this regard Japan resembles the United States but differs from France, Germany, and the United Kingdom, which give roughly half of their multilateral aid to a tied EC fund. Overall statistics on tying of Japan's bilateral grant aid do not appear to be available, though there is some indication that Japan ties less of this aid than several other major donors.[24] Japan's bilateral grant aid, which is focused on the poorest developing countries, is

22 OECD, "DAC Adopts Revised Guiding Principles For Associated Financing and Tied, Partially Tied, and Untied ODA," Press Release A(87)23, Paris, 1987.

23 Catrinus Jepma, op. cit., p. 21.

24 Statistics on tying of grant aid tend to be confusing, and terms are sometimes used in different senses. In this paper, "grant aid" denotes any aid not involving a loan. This would include debt relief and simple cash transfers, which are untied because they are not linked to any purchases; technical assistance, which is often given directly as services from the donor country (e.g., training classes) rather than in c@ in which case it is tie@ and cash grants to be spent on some particular purpose, which could be tied or untied.

Figure 4-6--Japan's ODA: Multilateral, Bilateral Grants, and Bilateral Loans Net Disbursements



NOTE: Numbers do not add because of rounding.

SOURCES: Ministry of Foreign Affairs (Japan), *Wagakuni no Seifu-Kaihatsu-Enjo 1992, Jyokan [Official Development Assistance 1992],* p. 101; Ministry of Foreign Affairs (Japan), *Japan's ODA: Official Development Assistance 1991* (Annual Report), p. 62.

mostly administered through the Japan International Cooperation Agency (JICA); however, some of the untied aid is administered by non-Japanese agents. For example, Japan gave $500 million of untied grant aid for structural adjustment to African countries during its fiscal years 1987-1989, administered in large part by the British Crown Agents and the United Nations Development Programme.[25]

Bilateral loans, the largest category, are issued through Japan's Overseas Economic Cooperation Fund (OECF). Of the bilateral loan commitments, Japan's tying figures show a dramatic move toward more untied aid. For its fiscal years 1986, 1990, and 1991, Japan reported no fully tied aid. Partially untied aid declined from 51 percent in fiscal year 1986 to 15 percent in 1990 to 10 percent in 1991, with the rest untied.[26]

While Japanese statistics may show little is formally tied, there continues to be skepticism about the degree to which U.S. and other non-Japanese OECD firms will, as a practical matter, be able to participate in projects funded by OECF loans. The recent State Department study noted that "fairly consistent" impressions from published sources and from U.S. government personnel in the field indicate a pro-Japan bias in awarding OECF loans, but the evidence is "incomplete and often purely anecdotal," and "not systematically documented."[27] The report also noted that "it is not clear that other donors do not engage in similar practices."[28] Of course, to the

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25 Japanese Ministry of Foreign Affairs, *Official Development Assistance 1991*, p. 78. Japan continued with another $600 million program of untied grant aid for structural adjustment during its fiscal years 1990-1992, this time including also some Asian and Latin American countries. Ibid., p. 79.

26 *OECF Annual Report 1992*, p. 13; Japanese Ministry of Foreign Affairs, *Official Development Assistance 1991*, p. 100.

27 U.S. Department of State in coordination with other Executive Branch agencies and departments in response to a request by the United States Senate, "Japan's Foreign Aid: Program Trends and U.S. Business Opportunities," op. cit., pp. 26, 34-35 (emphasis in original).

28 Ibid., p. 35.

extent that other non-U.S. donors engage in such practices, that too poses a greater commercial challenge to the United States than the formal tying statistics would suggest.[29] To the extent that the United States engages in such practices, the United States could be reaping commercial advantages beyond what its tying statistics would suggest. However, such practices would probably be primarily for grant aid (since the United States gives very little loan aid), which has less potential to promote exports for a given amount of net aid expenditure.

As is evident from the following discussion, some Japanese ODA practices that tend to favor Japanese firms continue to be widely used, while other practices that once conferred such favor appear to be changing.

Feasibility Studies[30]

As discussed in chapter 3, when a firm from a particular country does a feasibility study, that tends to make it more likely that a firm from the same country will win the contract for the main project. This is a rationale for the United States' Trade and Development Agency (TDA), which ties grants for feasibility studies to help U.S. firms win contracts for the subsequent development projects (see app. B). Japan's practices encourage the selection of Japanese firms to do feasibility studies for proposed OECF loan projects, all of which require a feasibility study before they can go ahead. Whether intended or not, the use of Japanese firms to do feasibility studies probably tends to steer the main projects to Japanese firms.

Feasibility studies for OECF projects can be done by JICA, the recipient country, or international organizations. JICA studies are paid for by Japan and constitute grant aid. JICA'S annual budget for these studies is about $200 million—many times larger than TDA's present budget for feasibility studies (though increases in TDA's budget have been proposed).[31] JICA hires consultants to do these studies. JICA will hire only Japanese fins; some participation by non-Japanese nationals is permitted but rare.[32] For some studies not done by JICA, the use of Japanese firms is probably encouraged by subsidies given to consulting firms by the Japanese government. For example, in its 1991 fiscal year, MITI provided 420 million yen (roughly $4 million) to various associations of consulting firms, for distribution to their members for use on pre-project studies for possible aid projects.[33]

29 For example, in lg89 the Export-Import Bank of the United States reported, "Advance bidding, whereby public tendering precedes the final conclusion of an aid agreement, allows the German government to conclude an agreement only if the contract is won by a German firm." Export-Import Bank of the United *States, Report to the U.S. Congress on Tied Aid Credit Practices,* April 1989, p. 63. As well as permitting cancellation (or downsizing) of jobs not won by a German firm, this practice could encourage potential aid recipients to seek out and favor German suppliers.

30 The information about Japanese practices in this section is derived primarily from *OECF Annual Report 1992*, P. 140; JICA, "Japan's GrantAidBudgetforPY 1992"; JICA, "General Information for the Participation Of Non-Japanese Consultants," undated (given out by JICA in March 1993); U.S. Department of State in coordination with other Executive Branch departments and agencies in response to a request by the United States Senate, "Japan's Foreign Aid Program Trends and U.S. Business Opportunities," op. cit.; and other information from JICA. OTA could not obtain information from OECF's Washington office for this report, because OECF insisted on preconditions that OTA could not accept.

31 JICA's fiscal year 1992 budget fo, "development studies" was $226 million ($66 million of which came from MITI). JICA, "Japan's Grant Aid Budget for FY 1992." This budget includes not only feasibility studies for particular projects, but "master plan" studies to set development priorities for a country as a whole. The amount spent just on feasibility studies is not given.

TDA's fiscal year 1993 budget is $40 million, most of which goes to feasibility studies and related, preliminary "definitional missions."

32 The team manager must be Japanese; Japanese nationals must constitute at least half the team members and perform at least half the person-months of effort. JICA must approve any use of foreign nationals. From June 1988, when use of foreign nationals was first permitted, through August 1992, 132 foreign consultants were used for development studies. JICA, "General Information for the Participation of Non-Japanese Consultants," op. cit. For comparison, in fiscal year 1988 JICA development study teams used more than 3,000 people.

33 Ministry of Finance (Japan), *Hojokin Soran [Subsidies Digest] FY 1991,* p. 386.

Tying of a Project's Engineering Management

In the last several years, OECF often has reported projects in several East Asian countries as untied, except that "consulting services," which includes project management, are reported as partially untied, so that only Japanese and LDC firms are eligible. Since relatively few LDC firms possess the necessary experience for management of a sophisticated engineering project, partial untying can at times be tantamount to full tying. Even if some LDC firms win contracts, the rest go to Japanese firms; U.S. or other OECD country firms would not be eligible. The presence of a Japanese firm managing a project could make it easier for Japanese firms to win other parts of the project, even if the managing firm did not consciously try to favor Japanese fins. Some analysts report that Japanese consulting firms often write detailed project specifications that favor Japanese firms.[34] OECF maintains that under its guidelines project specifications "cannot" be drawn to favor particular firms, but has not cited specific language in those guidelines.[35]

Japan is reducing its use of LDC-untied project management; the practice was relatively rare in its 1992 fiscal year except for Indonesia (which accounted for 14 percent of loan commitments), for which it was still the norm.[36] According to the State Department study, the Indonesian government has successfully pressed for award of a substantial portion of engineering service contracts to domestic Indonesian firms.

Request-Driven Aid System

Traditionally, Japan has made aid decisions based largely on specific requests from recipient governments. In the past, it would evaluate each project on its own, without considering how it fit into the country's overall development needs. (The United States has traditionally worked with developing countries to prioritize projects within an overall country plan. USAID has more people in the field than JICA and OECF, making that dialogue more feasible.)

Japan's aid appears to be changing to give more attention to a country's overall priorities. Increasingly, Japanese and developing country officials meet to discuss the country's development strategy and its relation to Japanese aid. As of March 31, 1991, Japan had sent missions to ten developing countries to establish overall development priorities, and had sent missions to nine developing countries to establish environmental priorities.[37] Also, JICA now sends study teams to evaluate proposed projects in the context of the overall development plan. Environmental aid may be serving as a testing ground for Japan's new approach. MITI has stated that its $2.5 billion Green Aid Plan (ch. 5) will rely on "policy dialogue' between Japan and the recipient country to prioritize projects, rather than evaluation of requested projects in isolation.[38]

However, Japanese aid is probably still largely request-driven; this may be true even for environmental aid. The request-driven approach lets Japanese firms encourage projects of their choosing, if they establish close ties with firms in a

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34 For example, Fujimura Manabu, a former employee of the Japan External Trade Association (JETRO), wrote, "If Japanese consultants are employed for yen-loan projects, they often draw up specifications that only Japanese contractors can meet." "The Untying of Japanese Aid: New Opportunities for Trade and Investment," Private Investment and Trade Opportunities (PITO) Economic Brief No. 9 (Honolulu: East-West Center Institute for Economic Development and Policy, May, 1992), p. 22. Mr. Fujimura noted, however, that because of "yen appreciation, Japanese consultancy does not always guarantee procurement from Japan. "

35 U.S. Department of State in coordination with other Executive Branch agencies and departments in response to a request by the United States Senate, "Japan's Foreign Aid: Program Trends and U.S. Business Opportunities," op. cit., p. 35.

36 *OECF Annual Report 1992*, pp. 87-117.

37 MITI, *Wagakuni* no *Seifu-Kaihatsu-Enjo* 1992, *Jyokan* [*Official Development Assistance 19921,* pp. 6*-69.

38 MITI, *Kankyo Gijutsu Iten ni Kakaru Sogoteki Shien (Green* Aid Plan) *No Suishin* ni *Tsuite* (*Promotion of Comprehensive Assistance Concerning Environmental Technology Transfer "GreenAidPlan"),* March 1992.

developing country that can influence that government's requests.[39] The State Department has observed that "in practice recipient countries are frequently ill-equipped to set priorities, prepare realistic proposals, and oversee implementation. Japanese trading firms often step into the vacuum to assist in project identification and design."[40] Even under the policy dialogue approach, Japanese firms may influence project selection by influencing the Japanese government's position;[41] U.S. firms similarly might be able to influence USAID'S project selection process.

Other Factors

The State Department study states that "recipient country governments often believe that while Japan's aid is formally untied, they are obliged to select Japanese suppliers, either as a gesture of gratitude or as a pragmatic means of ensuring the continued flow of Japanese ODA commitments.' '[42] The same might be said of the United States and other donors' ODA. Another factor is accessibility of information on upcoming projects: it is hard for U.S. firms to learn of opportunities without having a presence in Japan. Again, the effect is not limited to Japanese ODA; it takes effort for non-U.S. firms to learn about U.S. ODA.

Despite the difficulties and apparent barriers, some U.S. firms could benefit from Japanese ODA. There have been several recent examples of successful efforts by U.S. firms to participate in Japanese ODA, and Japanese contract procedures are becoming more competitive, according to the State Department study.[43] The U.S. government, with assistance from the Japanese government, is providing information to U.S. firms about how to compete for Japanese ODA.44

Statistics from the Japanese Government seem to suggest that in fact large quantities of Japanese aid are spent outside of Japan (and thus to suggest that the concerns raised above regarding opportunity for non-Japanese firms are misguided). For example, of its 1990 untied bilateral loans, Japan reports that only 20 percent of the procurement went to Japan, with 55 percent going to developing countries and 25 percent going to other OECD

39 In principle, firms from other countries could similarly develop ties with the developing country to influence its requests to Japan. However, in practice Japanese firms have advantages. Firms from other countries might not understand Japan's request system, and thus not appreciate the need to form such ties to influence requests. Japanese firms might also appear more credible in helping the recipient government to frame a request in a way likely to gain approval from Tokyo. Also, the system favors incumbent donors, those already with strong ties to developing countries; Japan is already the incumbent in several promising East Asian markets.

40 U.S. Department of State in coordination with other Executive Branch agencies and departments in response to a request by the United States Senate, "Japan's Foreign Aid: Program Trends and U.S. Business Opportunities," op. cit., p. 15.

41 The State Department study states:

> [P]rivate Japanese firma reportedly "lend" short-term employees to short-staffed JICA and OECF. When seconded to LDC ministries as "technical experts," these employees often advance proposals in which their firms have au interest. For example, in 1991, a JICA official indicated that private employees comprised some 30% of JICA experts in Indonesia. Meanwhile, an OECD/DAC survey found that seconded Japanese experts strongly influenced Indonesia ODA project requests, indeed originated some projects, and an OECF official echoed that fact to U.S. government visitors to Tokyo in 1991.

Ibid., pp. 34-35.

42 Ibid., p. 32.

43 Ibid., pp. 1, 6, 54-57. The State Department report identified many sales as over $5 million; almost all of those were fOr locomotives, locomotive parts, or locomotive rehabilitation by General Electric and General Motors (sometimes by their foreign subsidiaries). In some cases, General Electric and General Motors were subcontractors. The report also identified other types of contracts, including several consulting contracts.

44 @ example is a guide to Japanese ODA for U.S. firms that is part of the State Department study; another is the Japan Official Development Assistance Conference in Tokyo, Nov. 9-11, 1992, sponsored by the Department of Commerce, in which Japanese officials (among others) spoke to 72 U.S. firms about Japanese ODA.

countries.[45] Of its total fiscal year 1991 loan commitments, Japan reports that only 31 percent went to Japan, with 48 percent going to developing countries and 21 percent to other OECD countries.[46]

However, the State Department study reports that it is impossible to verify such statistics, though this problem is not unique to Japan.[47] Some skepticism has been expressed about Japan's prior statistics on procurement. An American researcher, after extensive efforts to verify statistics on procurements from non-Japanese firms during 1986-1990, was left with large gaps between Japan's reported statistics and the actual projects that could be accounted for, and concluded that the gaps could not be explained by the fact that certain types of data were Withheld.[48]

Also, Japan counts as non-Japanese any purchases from joint Japanese-LDC joint ventures with majority LDC ownership, even though much of the procurement in such cases might ultimately come from Japan. OECF'S 1992 annual report shows many such joint ventures.[49]

USE OF LOANS

As discussed in chapter 3, for a given amount of net aid expenditure, giving aid not in pure grant form, but with a loan component, increases the aid's potential to promote exports. Loan aid is typically used for large capital projects (such as power plants and waste water treatment plants), which are most often too expensive to fund by grants alone. Of the five major donors considered here, Japan uses loan aid the most, and the United States and the United Kingdom the least (fig. 4-7).[50] While loan aid may tend to increase exports, export promotion is not necessarily the prime motivation. Japan states that use of loans rather than grants benefits aid recipients by making them take more responsibility for their development, and that loans for inrastructure are central to economic development (based in part on its own rebuilding experience after the Second World War).

Aid loans have the most export potential when they are tied, in which case they are called "tied aid credits." As used in this background paper and OECD statistics, the term "tied aid credits" includes partially untied as well as tied loans. While OECD collects statistics from most member countries on tied aid credit offers, these statistics are publicly available for recent years only as a total for all countries combined, and not on an individual country basis. For the period 1984-1987, the total U.S. notifications of offers ($1.1 billion) were far less than for Japan ($8.0

45 MITI, *Keizai Kyoryoku no Genjo to Mondaiten, Heisei 4* ("Present Situation and Issues in Economic Cooperation, 1992"), p. 28. This source does not specify whether these percentages refer to commitments or disbursements.

46 *OECF Annual* Report 1992, p. 13.

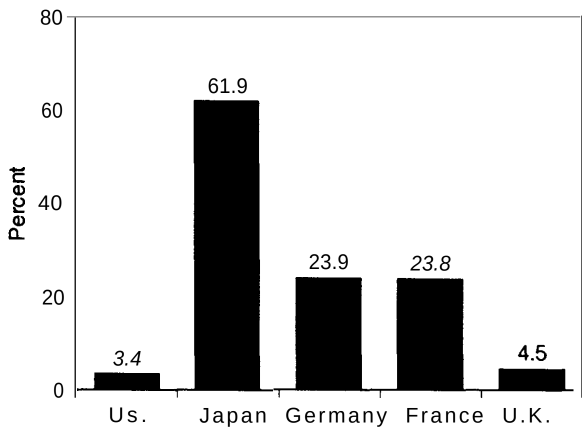
47 Japan and the aid recipients are reluctant to reveal certain &~ because they wish to protect business proprietary data; also, recipients do not always adequately record the data. These problems occur with most donors. Also, recipient countries could be reluctant to reveal information that might reflect poorly on a major aid donor. U.S. Department of State in coordination with other Executive Branch agencies and departments in response to a request by the United States Senate, "Japan's Foreign Aid: Program Trends and U.S. Business Opportunities," op. cit., pp. 1,25.

4S Margee Ensign, Doing Good *or Doing Well: Japan's Foreign Aid Program* (New York, NY: Columbia University Press, 1992), ch. 3.

49 *OECF Annual Report 1992*, pp. 136-139. OECF does not list all of its contractors. However, of 54 parties listed as doing construction work, 6 were such joint ventures (including 4 joint ventures involving firms from Japan, a developing country, and another OECD country); and of 51 parties listed as doing consulting work, 15 were such joint ventures. (For this tally, the same party working on two contracts is counted as two parties.)

50 The percentage of ODA given in pure grant form is computed by taking the 1991 "Share of Grants in total ODA," *Development Cooperation 1992 Report,* p. A-43, Table 32 (the figure for France, missing from that table, was supplied separately by DAC), and subtracting the portion of that grant share that (based on O'IA's interpretation of unpublished DAC data) was combined together with other financing (e.g., a commercial loan) in an "associated financing" package (also called "mixed credits"). Figure 4-7 gives the reverse percentage, i.e., the percentage of ODA *not* given in pure grant form.

Figure 4-7-Percent of Total ODA Commitments Not in Pure Grant Form 1991



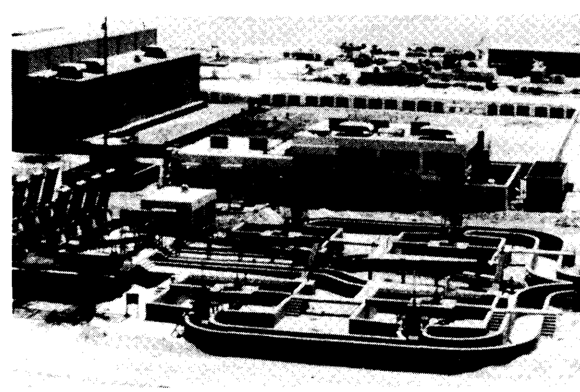
NOTE: Excludes debt relief and reorganization.

SOURCE: OTA, derived from DAC data (see text).

billion), France ($6.4 billion), Germany ($5.8 billion), and the United Kingdom ($5.9 billion).[51] (Notifications do not precisely correspond to credits actually disbursed, as noted in the next section in this chapter.) It is widely believed that the United States in recent years has used tied aid credits much less than Japan, Germany, and France.[52] Some donors give tied aid credits in a form called ‘mixed credits,” which typically are a combination of grant and loan funds. Some foreign examples are discussed in chapter 5; a U.S. response (the use of “War Chest” grant money with Eximbank loans) is discussed in the next section of this chapter.

TIED AID CREDITS AND THE HELSINKI PACKAGE

The U.S. government has long sought to reduce use of tied aid credits to gain commercial advantage, arguing at OECD that tied aid credits decrease economic efficiency when they distort normal trade patterns. OECD'S “Arrangements on Guidelines for Officially Supported Export Credits” (or “Arrangement”) has restricted the use of tied aid credits (whether or not they count as ODA as defined by the DAC), largely by making them more expensive, though it has not yet reduced the overall volume of tied aid credit offers. The latest amendments-the Helsinki Package agreed to at the end of 1991—further restricted use of tied aid credits for projects deemed “commercially viable, ” and strengthened the mechanisms for reporting credit offers and for resolving disputes. While these amendments appear to have given the rules more teeth, the rules are still not all-inclusive; in particular, the “commercial viability” test may be interpreted so as to permit tied aid credits for



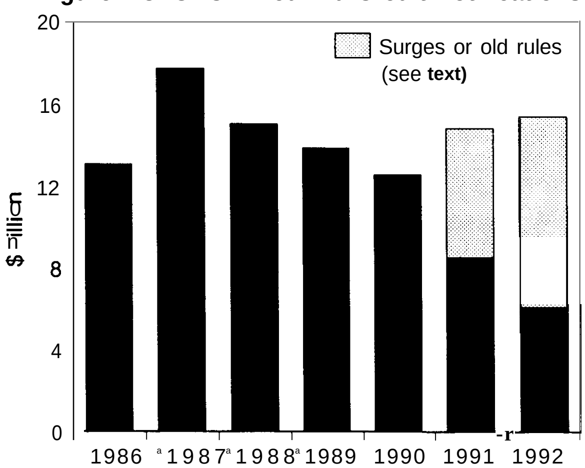
CAMP DRESSER & MCKEE INTERNATIONAL INC

Abu Rawash Wastewater Treatment Plant, Egypt. Donor country firms often provide equipment and engineering services for water and wastewater treatment projects, even though much of the material and labor may be locally provided.

51 Export-Import Bank of the United States, *Report to the u.S. Congress on Tied Aid Credit Practices,* April 1989, p. 7.

52 Some partial 1992 figures for particular countries have been published in an April 1993 Eximbankreport. Of $3.8 billion total notifications potentially subject to challenge and consultation under the Helsinki Package (see the next section), $1.1 billion, or percent, each came from France and Spain. Other significant providers, in order, were Finland, Japan, Austria, Australia, and Italy. Of $1.7 billion in notifications not subject to challenge and consultations because they were too small, of too high concessionality, or made to least developed countries, the largest amounts were made by Italy ($667 million or 39 percent) and Finland ($559 million or 3percent). Export-Import Bank of the United States, “Report to the Congress under Section 15(g) of the Export-Import Bank Act of 1945, as Amended,” Apr. 26, 1993, p. 9.

Figure 4-8--OECD Tied Aid Credit Notifications



a Twelve months starting July of the year indicated.

SOURCES: Eximbank's Apr. 26, 1993, report to Congress on tied aid credits, pp. 8-10; Eximbank's June 18, 1882, report to Congress on tied aid credits, Attachment 1.

many environmental projects or components of projects.[53]

Despite the attention focused on tied aid credits, it is difficult to quantify their use and still more difficult to determine their effect on U.S. trade. The main source of information on volumes of tied aid credits comes from the operation of the OECD Arrangement. Almost all OECD members participate in the Arrangement: the EC on behalf of its members, and Australia, Austria, Canada, Finland, Japan, New Zealand Norway, Sweden, Switzerland, and the United States. Each Arrangement participant is required to notify other participants when it makes an offer of tied aid credits, to allow other participants the opportunity to match the offer. Figure 4-8 gives total notifications since 1986.[54] (As mentioned earlier, recent country-by-country figures are not publicly available.) However, these statistics should be interpreted with caution. The notification data differs in many ways from the actual tied aid credits disbursed.[55]

Also, it would be a mistake to extrapolate future trends from this data, because of the tightening of the rules on tied aid credits in the Helsinki Package. The 1991 and 1992 figures include surges of notifications in advance of the need for funds, as donors hurried up their notifications to take advantage of the old rules. U.S. Eximbank estimated that this surge accounted for $6.3 billion of the $14.9 billion in total 1991 notifications.[56] Some $9.3 billion of the $15.4 billion in 1992 notifications were made under the old or transitional rules, with only the remaining $6.1 billion made under the new rules.[57] The future trend under the new rules is difficult to predict; it probably lies in between the slight increase shown by the total bars in figure 4-8 (which include all notifications) and the dramatic decrease shown by the solid portions (which do not include the 1991 estimated surges and the 1992 notifications under old or transitional rules).

53 The Arrangement, as amended by the Helsinki Package, is printed as OECD Document OCDE/GD/(92)(5) (1992). The Arrangement was first promulgated in 1978. The Arrangement gives guidelines for non-aid government-supported export credit terms and conditions, to ensure that they are close to those of commercial loans; it also gives guidelines for tied aid credits. Generally, any government-supported export credits should conform to one or the other of these sets of guidelines. The Helsinki Package strengthened both sets of guidelines.

54 As this paper went t. press, a question arose concerning whether (and if so, to what extent) these Statistics include offers that are grants or close to grants (concessionality level of at least 80 percent). Such offers are of relatively little commercial concern and are largely exempt from the Arrangement's restrictions.

55 Upward biases exist. The figures include some planned projects that are never carried out, and some duplicate notifications by two Or more countries for the same project, Downward biases also exist. The figures omit financing of ships, military equipment, a agricultural products; members reportedly do not always notify as they should; and members do not have to notify transactions in which the ODA is only for technical cooperation amounting to less than both 3 percent of the transaction's total value and $1 million. Also, countries are permitted to report transaction amounts as falling in ranges, rather than the precise figure; th OECD statistics use the midpoint of the range.

56 Export-Import Bank of the United States, "Report to the Congress under Section 15(g) of the Export-Import Bank Act of 1945, As Amended (Section 19 of the Export-Import Bank Act of 1986, Public Law 99472)", June 18, 1992, Attachment 1.

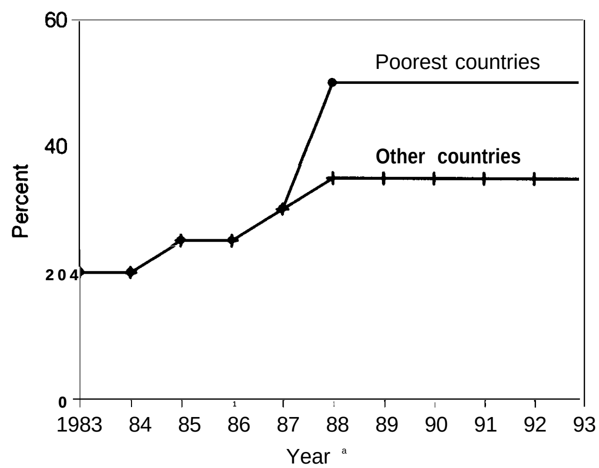
57 Export-Import Bank of the United States, "Report to the Congress under Section 15(g) of the Export-Import Bank Act of 1945, as Amended," Apr. 26,1993, pp. 9-10. Because of peculiarities in the statistics, some items maybe double-counted, in the $6.3 and $9.3 billion.

Tied aid credits on balance probably have lessened U.S. exports, though it is difficult to say by how much. In the mid- 1980s the United States probably lost billions of dollars in exports because of foreign tied aid credits, though the figure is quite uncertain.[58] The losses will likely be less under the latest OECD rules: even if the volume of total tied aid credit offers does not decline, the latest OECD rules will likely shift tied aid credits to projects with less overall commercial effect (as discussed below).

Since 1983, the Arrangement has imposed certain minimum "concessionality levels" on tied aid credits.[59] The idea was to make these credits more expensive for donors, thus decreasing their use and limiting their power to leverage aid dollars into exports.[60] Also, packages with higher concessionality levels were thought less likely to distort trade.[61] The minimum levels have been raised three times since (fig. 4-9). However, the tied aid credits notifications stayed in the $10 to $15 billion dollar range into the 1990s.

In 1988, the DAC (whose membership does not correspond precisely to the participants in the Arrangement) adopted Guiding Principles urging donors to limit use of tied aid credits to "priority projects and programmes which are carefully appraised against developmental standards.' '[62] In addition to serving development goals, such limits could, if followed, prevent the use of trade-distorting tied aid credits in cases where the project did not meet the developmental standards. However, these Guiding Principles were non-binding and had no provision for enforcement,

Figure 4-9-Minimum Concessionality Levels for Tied Aid Credits



[a] Minimum levels shown are those in effect as of July of the given year.

SOURCE: OTA, derived from Eximbank reports and information from the Treasury Department.

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58 A 1989 report by the Export-Import Bank of the United States (Eximbank) estimates that U.S. firms lost $400-$800 million in exports annually during 1985-1988 because of foreign tied aid credits. Export-Import Bank of the United States, *Report to the U.S. Congress on Tied Aid Credit Practices*, April 1989, p. 142. This estimate considers only sales lost directly to offers supported by tied aid credits; it does not consider any losses in follow-on work. Also, one expert argues that the data presented in tbat report instead support a much higher estimate of directly lost sales, $2.4-4.8 billion. Ernest Preeg, *The Tied Aid Credit Issue: U.S. Export Competitiveness in Developing Countries* (Center for Strategic and International Studies Washington, DC, 1989). Whichever figures are used, this export loss was much greater than the export gain from U.S. use of tied aid credits, which averaged, according to the Eximbank report, at most $250 million annually during this period ($250 million is the average annual value of *all* exports made using tied aid credits, whether or not the exports would have been made without them).

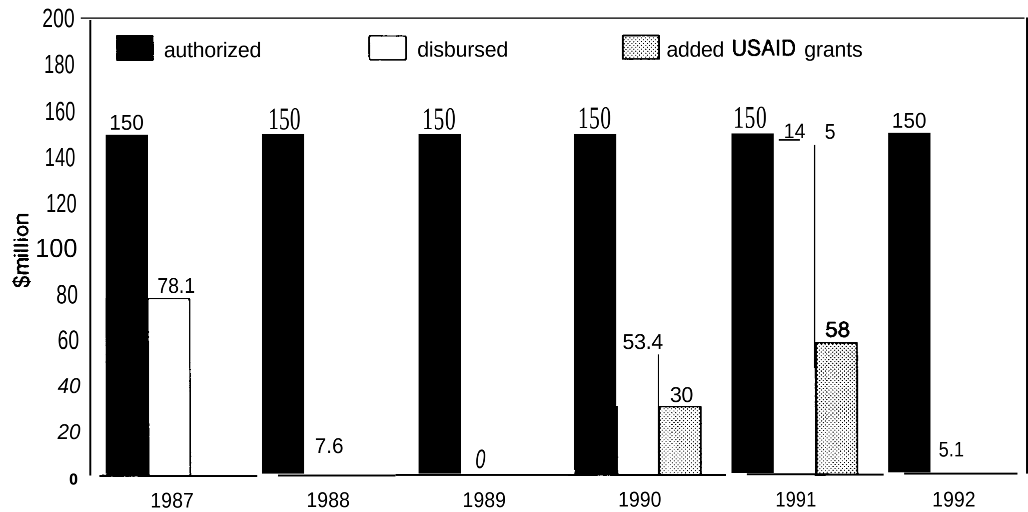
59 Conceptually, the concessionality level represents the extent to which the aid is a grant as opposed to a loan. A pure grant would have a concessionality level of 1(K) percent, and a loan on terms deemed commercial a concessionality level of O percent. Technically, the concessionality level of a soft loan equals the face value of the loan, minus the present value of the future repayment stream (using a reference discount rate to represent commercial rates), all divided by the face value of the loan.

60 For example, with a concessionality floor of 25 percent, each dollar of aid can be leveraged at most into 4 dollars of exports; with a concessionality floor of 50 percent, each dollar of aid ean be leveraged into at most 2 dollars of exports.

61 The higher a package's concessionality level (i.e., the closer it is to a pure grant), the more likely it is that the package will fund purchases that otherwise would not have been made, rather than divert purchases from one supplier to snother. John Ray, "Commercial Viability In the Helsinki Package'' (mimeo., undated), pp. 4-5.

62 ''DAC Guiding Principles for Associated Financing and Tied and Partially Untied Official Development Assistance," adopted Apr. 24, 1987, attached to press release, "DAC Adopts Revised Guiding Principles for Associated Financing And Tied and Partially Untied Official Development Assistance," PRESS/A(87)23, Apr. 28, 1987.

Figure 4-10--U.S. Eximbank War Chest Grant Funds



SOURCE: Eximbank's June 18,1992, report to Congress on tied aid credits, Attachment 3; U.S. Congress, General Accounting Office, Export *Finance: The Role of the U.S. Export-Import Bank,* GGD-93-39 (Washington, DC: U.S. Government Printing office, Dee. 23, 1992), pp. 48-49.

and in fact development priorities have not always been observed.

To provide leverage for U.S. negotiations to restrict the use of tied aid credits, Congress in 1986 established a "War Chest" of grant money to be combined with Eximbank loans. The War Chest was intended to let the United States respond in kind to foreign tied aid credits.[63] However, the War Chest's effectiveness has been limited by its size and manner of use. In its initial five years, the War Chest was authorized at only $150 million per year (fig. 4-10), much less than the corresponding sums used by several foreign countries, so that only a small fraction of foreign offers could be matched.@ In three of the six years, the War Chest was used relatively aggressively to gain leverage in negotiations concluded in 1987 and 1991. In the other years, the War Chest was used sparingly if at all, and then only when a foreign country violated or derogated from the recently concluded agreement. Recent legislation has increased the War Chest authorization to $500 million annually for FY 1993-1995,[65] though again the amounts authorized will not necessarily be spent. Eximbank's stated intention is to use the War Chest "selectively,' with the "focus" on enforcing the new rules.[66] Eximbank points out that War Chest use can disproportionately reduce the funds available for ordinary export credits. The reason is that the subsidy component of each Eximbank loan is counted against Eximbank's overall appropriations; loans using War Chest funds are subsidized much

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63 12 U.S.C. 635i-3.

64 War Chest funds are not separately appropriated; War Chest funds are charged against Eximbank's overall appropriation levels. In some years, as shown in figure 4-10, some USAID grant funds were added to the War Chest to support additional tied aid credits.

When combined with Eximbank loans, $150 million in War Chest grant funds would typically yield about $430 million in tied aid credits. This assumes a 35 percent concessionality level.

65 Export Enhancement Act of 1992, Public Law 102-429, Sec. 103.

66 Export-Import Bank Of the United States, "Report to the Congress under Section 15(g) of the Export-Import Bank Act of 1945, as Amended,'' Apr. 26,1993, pp. 13-14.

Figure 4-11 Helsinki Rules

Recipient country's economic level	Type of project	Tied aid eligible?	Minimum concessionality level
Wealthiest (1991 per capita GNP over $2,555)	All projects	No	—
Middle group	Commercially viable projects	No	—
	Projects not commercially viable	Yes	35%
Least developed	All projects	Yes	50%

NOTE: Conditions apply to funding of at least 2M SDR with under 80 percent concessionality.

SOURCES: Summary of OECD rules provided by Eximbank; OECD, *Arrangements on Guidelines for Officially Supported Export Credits* (OECD: Pans, 1992), paragraph 8(a).

more heavily than Eximbank's ordinary export credits.

While retaining the previous minimum concessionality levels,[67] the 1991 Helsinki Package further limits use of tied aid credits (fig. 4-11). The additional provisions, given in paragraph 8(a) of the Arrangement, apply only to tied aid credits with a concessionality level under 80 percent (which is fairly close to a pure grant), and only to financial packages worth at least SDR 2 million (roughly $2.8 million).[68] Paragraph 8(a) distinguishes three classes of LDCS: the wealthiest, defined in 1993 as those countries that had 1991 per capita GNP above $2555;[69] the "least developed countries" as defined by the United Nations (sometimes referred to as "LLDCS"); and a residual middle group. The division between the middle group and the least developed group is not strictly on the basis of per capita income. The United Nations' definition of "least developed' considers not only per capita income but also other factors that can affect development, such as literacy rate and frequency of natural disasters;[70] also, countries are not automatically reclassified as their conditions change. The wealthiest group includes, for example, Brazil, Mexico, and Venezuela; the middle group, China, Indonesia, Thailand, and the Philippines; and the least developed group, Chad, Haiti, and Yemen.

For the wealthiest LDCS, tied aid credits within the scope of paragraph 8(a) are prohibited. The rationale is that those countries should be able to attract investment for commercially viable projects, and should be able to finance non-

67 However, the Package did change the way in which concessionality is calculated, in order to better represent the actual market terms used for comparison. In addition, the requirements for non-aid export credits were tightened somewhat, requiring them at times to be closer to commercial terms.

68 A Special Drawing Right (SDR) is an international money unit based on a weighted average of 16 national currencies. In April 1993 an SDR was worth about $1.40.

69 The wealthiest LDCs are technicall, defined as "countries whose per capita GNP would make them ineligible for 17-or 20-year loans from the World Bank." Because of lags in collecting da@ the World Bank bases eligibility in a given calendar year on a country's per capita GNP two years earlier. In 1992, when the Helsinki Package first took effect, the wealthiest LDCs consisted of those with 1990 per capita GNP over $2,465.

70 United Nations, Committee for Development Planning, *Report on the Twenty-Seventh Session (New York, 22-26 April 1991)*, Doc. E/1991/32, Economic and Social Council, Official Records, 1991, Supplement No. 11 (New York, NY: United Nations, 1991).

commercially viable projects on their own. For the least developed group, tied aid credits within the scope of paragraph 8(a) are (as before) permitted with a minimum concessionality level of 50 percent. Thus, tied aid credits would be a particularly expensive way to promote exports to these poorest countries; and these countries' poverty limits the opportunity for follow-on business.

The rules are more complex for the middle group. For these countries, tied aid credits within the scope of paragraph 8(a), when permitted, must (as before) have at least 35 percent concessionality. But such tied aid credits are permitted only if the project is not "commercially viable." To be commercially viable, a project must be able to get financing from the commercial market, and must be able to generate income sufficient to pay back the loan. The rationale for this restriction is that tied aid for commercially viable projects is unnecessary (since commercially viable projects could presumably go forward without any aid), and is more likely to distort trade.[71] This provision is considered a key feature of the agreement. The middle group of countries to which it applies includes some East Asian countries with promising environmental markets, such as Thailand and Indonesia. The effect of this requirement is difficult to predict. The precise meaning of "commercially viable' is only gradually becoming clear, as countries consult about specific cases (see below).

The strengthened notification and consultation process set up under the Helsinki Package[72] is also a key feature of the agreement. As before, countries participating in the Arrangement must notify other participants about contemplated tied aid credit offers.[73] However, there are some new features. On request of any other participant, the notification must be supplemented with detailed information about the project's development function, the project's technical preparation and appraisal, and the procurement procedures. Also, notifications are now required more often for aid credits that the donor considers untied. Other Arrangement participants can then request information to verify the untied status.

The consultation process has also been strengthened. Consultations among members must always be held for notifications exceeding SDR 50 million (about $70 million) with concessionality level less than 80 percent. Consultations are also required if any country objects to an offer on the ground that it does not meet the requirements of paragraph 8(a) concerning commercial viability. The consultations are face to face; and if a particular proposed aid offer is challenged, the potential donor must justify its position. In the consultation, the participants consider "first, whether an aid offer meets the requirement of the rules in [paragraph 8(a)]," and "if necessary, whether an aid offer is justified even if the requirements of the rules in [paragraph 8(a)] are not met." Unless its position receives "substantial support," the potential donor is advised to withdraw the offer; if it wishes to proceed, it must submit a written justification citing the "overriding non-trade-related national interest that forces this action.' '[74]

In 1992, there were 824 notifications of tied aid credit offers, totaling $15.4 billion.[75] Of these, 137 totaling $3.8 billion were potentially subject

71 Tied aid credits might add a project that would not otherwise go forward, or might divert a project from One supplier to another; the latter distorts trade more. For commercially viable projects, which can go forward on their own without aid, the latter alternative seems more probable for noncommercially viable projects, which cannot go forward without aid, the former alternative seems more probable.

72 Arrangement, par. 14 and Annex VII.

73 Arrangement, par. 15.

74 Arrangement, par. 14.

75 The information in this paragraph is from Export-Import Bank of the United States, "Report to the Congress under Section 15(g) of the Export-Import Bank Act of 1945, as Amended,'' Apr. 26, 1993, pp. 5-8.

to the consultation process.[76] For many of these, additional information was requested by the United States or other participants. In four cases, the country in question withdrew its offer rather than have to provide the information and face a possible formal challenge. Formal consultations were requested on 41 offers. The United States initiated or otherwise endorsed all of these consultations; even when no U.S. firm was bidding on the project, these cases were important to the United States because they would become precedents as to how "commercially viable" is defined. Of these 41 cases, 36 were completed as of April 1, 1993. In 13 of these cases, the projects were deemed not commercially viable. An additional seven projects received "substantial support" primarily because they were each part of an ongoing project. In the remaining 16 cases, the project was deemed commercially viable and the offering country failed to get substantial support. Of these, in seven cases the country went ahead with the offer, obligating it to explain in writing its "overriding non-trade-related national interest" in making the offer. The U.S. Administration expected such derogations to be concentrated "in the early stages of the implementation of the new rules,' and is not alarmed by the number; nevertheless, it 'is signaling its intention that the current pace of derogations should not continue beyond the early implementation phase." In the only derogation in which a U.S. firm bid on the project, Eximbank authorized use of the War Chest to provide matching financing.

Based on the limited sample of completed cases, it seems that projects in the manufacturing, power, and telecommunications sectors are deemed commercially viable except in special circumstances (such as a local facility serving a remote area, where operating the facility at a loss is cheaper than providing a good or service by long distance). No completed cases have focused on environmental projects or components of projects, and it is not always clear when such projects or components would be deemed commercially viable. It is possible that some environmental projects will be deemed not commercially viable and thus eligible for tied aid credits. Some types of projects, such as water and wastewater treatment facilities serving very poor communities, often might not generate enough revenue to pay for themselves. New projects with environmental components (such as a factory with a stack gas scrubber) will be judged on the commercial viability of the project as a whole; so the project could be deemed commercially viable unless the environmental requirements made the whole project unprofitable. In the case of a retrofit, such as a stack gas scrubber put onto an existing factory, the United States expects that the commercial viability standard will be the same (e.g., whether the factory with the scrubber is commercially viable), though there is not yet a precedent addressing this sort of case; it is possible that commercial viability would instead be judged for the retrofit in isolation, in which case a finding of non-commercial viability would be common (scrubbers do not normally bring in revenue).[77]

If, as the precedents from OECD consultations evolve, some types of environmental projects or components tend to be regarded as not commer-

76 Every other offer was exempt for at least one Of these reasons: it was made before Feb. 15, when the new rules took effect; it was covered by transitional rules; it was an offer to match a previous offer by another country, and thus not independently subject to consultation; it was made to a least developed country, and thus permitted as long as the concessionality level was at least 50 percent; it had at least 80 percent concessionality; it was for under 2 million SDR; it was for ships (credits for ships are excluded from coverage under the Arrangement and are covered by a special agreement).

77 Even in isolation, such environmental modifications might more often be considered commercially viable if environmental costs and benefits were internalized. Thus, a scrubber in isolation could generate revenues if a mechanism existed such as tradable emissions permits. Similarly, the modifications to make a plant more energy efficient would more often pay for themselves if the cost of the energy reflected the environmental costs of its use. Tradable permits, input pricing, and other economic measures to provide incentives to pollute less will be discussed further in the final report of this Assessment.

cially viable, donors could shift aid into those types of projects, in order to retain the freedom to usw tied aid credits. In this case, aid could play a greater role than it does now in international competition in environmental goods and *services.*