# Appendix G: Tied Aid Report

## Introduction

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

## Implementation of the OECD Arrangement

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

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

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

## Definitions of the Various Types of Aid

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

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

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

Trade-related aid may be either "tied" or "untied" to procurement from the donor country and can be provided in two forms: grants[3] or credits. However, because grants do not involve significant repayment obligations, they are viewed as having a very small potential for trade-distortions (see below) and are not subject to OECD discipline (other than notification).

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

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

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

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

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

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

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

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

## Tied Aid Eligible Markets

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

### Figure G1: Tied Aid Notifications by Region

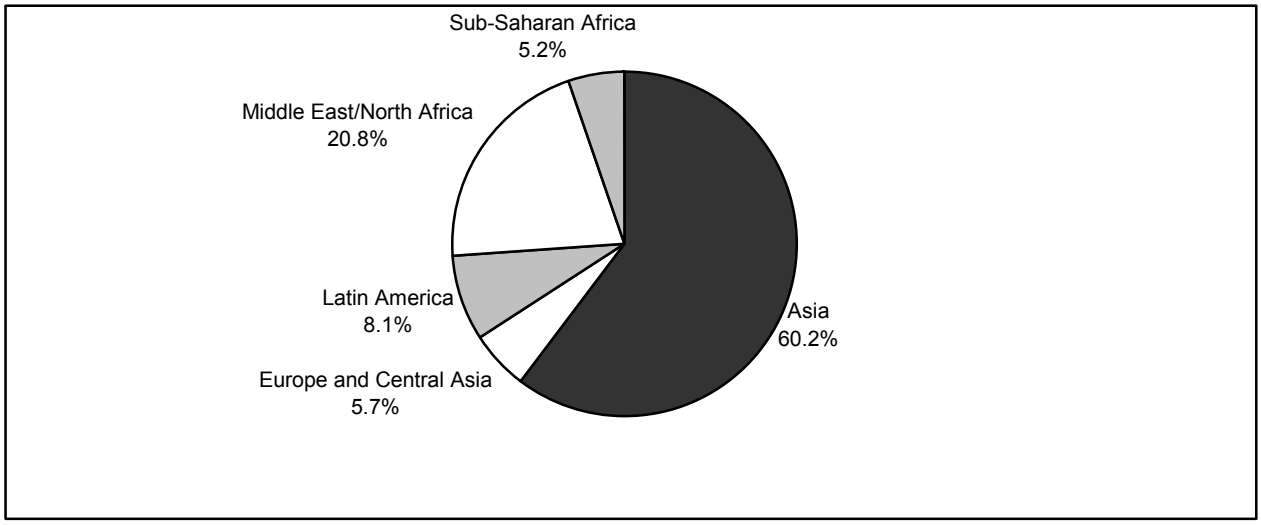
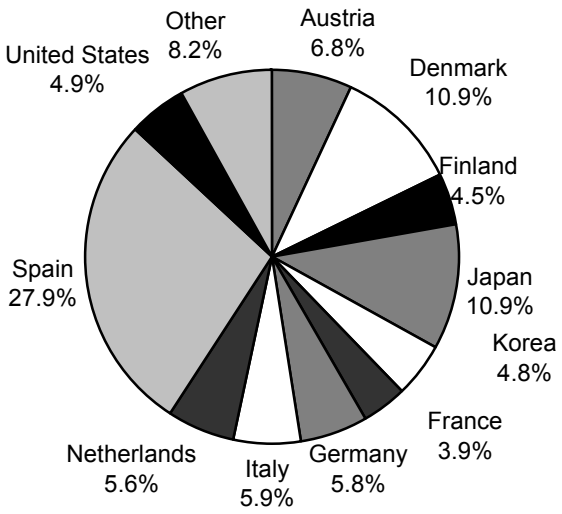



**Figure G1** shows the distribution of tied aid offers by region. Consistent with previous years, the major beneficiary region was Asia, as it includes the most significant recipient country, China, who attracted almost 20% more tied aid offers in 2003 ($758 million) than in 2002. Other significant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

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

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

**Figure G2: Tied Aid Notifications by Donor Country**




## Tied Aid Eligible Projects

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

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

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

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

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

Of the 131 projects examined by the Consultations Group from March 1992 to December 2003, 70 projects (53.4%) were found to be commercially viable or ineligible for tied aid. The remaining cases were found eligible for tied aid and no follow up was subsequently done. Of the 70 projects deemed ineligible for tied aid, 43 projects proceeded with other financing sources, including, tied[5] and untied aid, commercial financing, and standard export credits.

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

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

## Trends in the Use of the TACPF

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

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

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

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

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

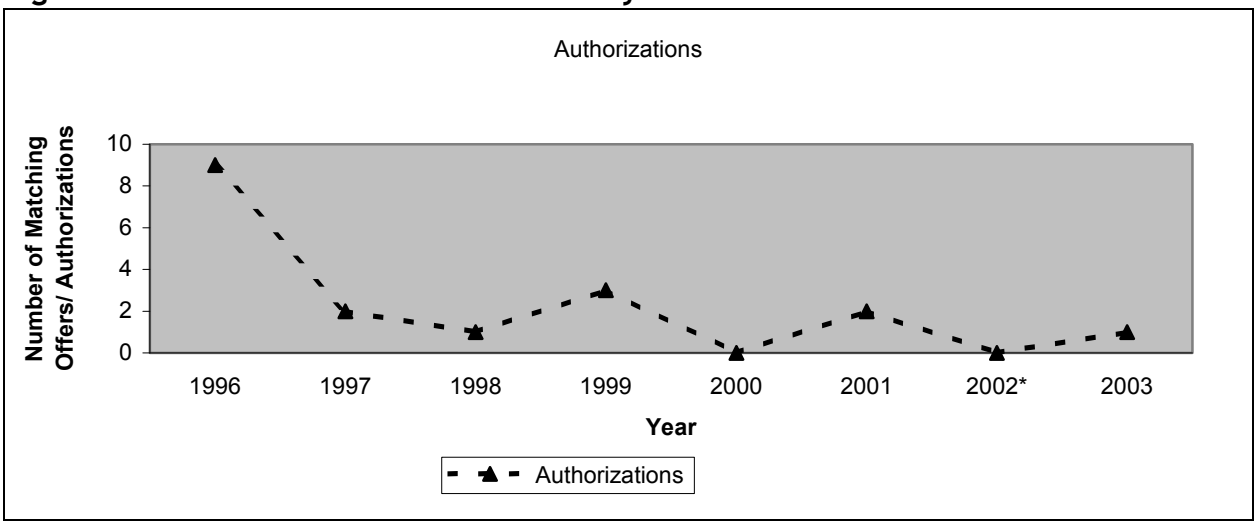
**Figure G3: Cumulative Ex-Im Bank Matching of Previously Notified Foreign Tied Aid Offers**

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

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

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

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




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

## Ex-Im Bank Initiated No Aid Common Lines

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

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

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

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

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

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

# Appendix G Annex 1

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

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

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

# Appendix G Annex 2

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

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

# Appendix G Annex 3

| Projects Generally Considered Commercially Viable (Helsinki-Type Tied Aid Prohibited) | |
|---|---|
| **Power** | ▪ Oil-fired power plants<br>▪ Gas-fired power plants<br>▪ Large stand-alone hydropower plants<br>▪ Retrofit pollution-control devices for power plants<br>▪ Substations in urban or high-density areas<br>▪ Transmission lines in urban or high-density areas |
| **Energy Pipelines** | ▪ Gas transportation and distribution pipelines<br>▪ Gas & oil transportation pipelines |
| **Telecommunications** | ▪ Equipment serving intra and interurban or long-distance communications<br>▪ Telephone lines serving intra and interurban or long-distance communications<br>▪ Switching equipment serving urban or high-density areas<br>▪ Radio-communications equipment serving urban or high-density areas |
| **Transportation** | ▪ Air traffic control<br>▪ Freight railroad operations (locomotives, cars, signaling) |
| **Manufacturing** | ▪ Manufacturing operations intended to be profit-making<br>▪ Privately-owned manufacturing operations<br>▪ Manufacturing operations with export markets<br>▪ Manufacturing operations with large, country wide markets |

# Appendix G Annex 4

| Projects Generally Considered Commercially Non-Viable (Helsinki-Type Tied Aid Permitted) | |
|---|---|
| **Power** | ▪ Transmission lines to low-density, rural areas<br>▪ Geothermal power plants<br>▪ Small wind turbine farms<br>▪ District heating systems<br>▪ Small hydropower plants connected with irrigation |
| **Telecommunications** | ▪ Telephone switching equipment serving low-density, rural areas<br>▪ Switching equipment serving low-density, rural areas<br>▪ Radio-communications equipment serving low density, rural areas |
| **Transportation** | ▪ Road and bridge construction<br>▪ Airport terminal and runway construction<br>▪ Passenger railroad operations (locomotives, cars, signaling)<br>▪ Urban rail and metro systems |
| **Manufacturing** | ▪ Highly-localized, small scale cooperatives<br>▪ Highly-localized, small scale food processing<br>▪ Highly-localized, small scale construction supply |
| **Social Services** | ▪ Sewage and sanitation<br>▪ Water treatment facilities<br>▪ Firefighting vehicles<br>▪ Equipment used for public safety<br>▪ Housing supply<br>▪ School supply<br>▪ Hospital and clinic supply |