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## **Inconsistent Objectives of Agricultural Export Credit Disciplines\***

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Negotiated disciplines on export credits in agriculture are intended to (1) eliminate any subsidy element caused by preferential financing or low fees and (2) provide special and differential treatment for developing countries. Inconsistent foundations of these two objectives limit the potential for negotiations on the disciplines to succeed. The subsidy element cannot be eliminated without agreement on the benchmark. Eliminating all advantage relative to private institutions precludes any reason to continue government support. Favourable financing to developing countries would introduce a prohibited subsidy. In their capacity to provide special and differential treatment, export credits fall well short of the requirements for food aid.

Keywords: Doha Development Agenda (DDA), export credits, export subsidies, special and differential treatment (SDT), World Trade Organization (WTO)

## Introduction

Officially supported export credits, more simply and commonly called export credits, are government-supported programs that provide financing assistance to countries that import products from the country providing the support.<sup>1</sup> Export credits may take the form of direct financing or interest-rate subsidies, or they may be guarantees or insurance. Export credits that help importers access financing may provide a reduction in the total cost the importers pay for the traded goods. If present, this cost reduction would amount to an export subsidy in some sense. Support for financing of developing countries may help them to import food that otherwise would be unavailable to them.

These two possibilities are reflected in multilateral negotiations. One objective of the negotiations of the Doha Development Agenda (DDA) at the World Trade Organization with regard to agricultural policy is the elimination of export subsidies, explicitly including the subsidy element of export credits. At the same time, another objective of these negotiations is to provide special and differential treatment for developing countries, including for poor countries that use export credits to facilitate their trade in agricultural products.

These objectives are considered here with a view to highlighting their inconsistency relative to each other and to other elements of the institutions governing support for trade. This article is related to the work of other authors, whose research is summarized below, but goes further by identifying inconsistencies that, if unresolved, undermine the ability of any negotiated result to meet effectively the stated objectives of the DDA.

## Literature

Research on agricultural export credits can be divided into roughly two themes. One theme considers the effects of these programs, typically by applying net present value calculations. Dahl et al. (1995) estimate a range of subsidy in U.S. export credit programs to selected importers from about 1 percent to 12 percent, if the cost reduction is expressed as a percentage of the value of exports financed. For an overlapping subset of U.S. export credits, Dierson et al. (1997) estimate a range from 0 percent to 11 percent. Hyberg et al. (1995) provide averages for U.S. export credits over time that are less than 1 percent at the lowest but as high as 7 percent in some years. The broadest study in terms of number of exporters and importers is provided by the OECD (2000), which estimates an overall average subsidy of less than 4 percent for all exporters studied, and less than 7 percent for the United States. Dahl,

Wilson, and Gustafson (1995) use option pricing to estimate a range from 12 percent to 20 percent for the effects of export credits provided by Canada, France, Australia, and the United States to an importer. Rude and Gervais (forthcoming) provide a very different type of analysis: a highly stylized model is used to investigate the market effects of export credits in the case that the importer suffers a narrowly defined liquidity constraint, but this model does not lead to quantitative estimates. This body of research into the effects of export credits is tangentially relevant to the present study.

The second thrust of past literature on agricultural export credits focuses on the export credit negotiations at the WTO in order to assess their likelihood of success. Goodloe (2004) notes the overlap of state trading exporters and export credits. Benitah (2005) explores the logic of the WTO cotton ruling, which extended Uruguay Round export subsidy disciplines to export credits. Often, authors recommend certain positions by way of conclusions. Rude (2000) foresees little political will to discipline completely export credits, but he argues that the existing disciplines on industrial goods should nevertheless be applied to agricultural export credits provided they do not interfere with the ability of export credits to ease liquidity constraints. Abbott and Young (2003) note the inconsistency of disciplines that govern all conditions of private financing transactions with the broader objective of liberalizing markets. Thus, to prevent the loss of the possible assistance to developing-country importers only to eliminate what have been very small export credit subsidies, these authors recommend against imposing disciplines. Hoekman and Messerlin (2005) largely proceed along the lines of this last argument as well, but propose that the use of these programs at least be monitored by an international observer.

Abbott and Young, Rude, and Hoekman and Messerlin acknowledge implicitly if not explicitly the conflicting objectives of eliminating the subsidy element and providing special and differential treatment. However, there are further inconsistencies in the objectives of the WTO negotiations. These inconsistencies, which are illuminated in the text that follows, constrain the effectiveness of any agreement if measured by its ability to achieve all objectives.

## **Negotiations**

The widespread belief when the DDA negotiations began was that export credits had not been addressed directly during the Uruguay Round (UR) Agreement, at which time signatory countries agreed to clear limits on direct export subsidies. In contrast, UR text referencing further negotiations on export credits in a different forum, implicitly under the auspices of Participants to the Arrangement on Officially

Supported Export Credits, was widely seen to exempt these programs. The Arrangement is an agreement among the countries accounting for most of global exports to discipline their export credits in other sectors through rules on the terms and conditions of credits, including a requirement of budget neutrality. Because agricultural export credits were and remain exempt from the Arrangement, many perceived there to be little or no constraint to the use of export credits. This view was not universal. A WTO panel and the Appellate Body, in ruling on the challenge Brazil brought against several aspects of U.S. agricultural policies relating to cotton, including U.S. export credit programs, judged that the UR commitments to restrain direct export subsidies apply to export credits.

The application of export subsidy disciplines to export credits notwithstanding, negotiators perceive there to be cause for negotiated disciplines on export credits. There may be cause to clarify what does and what does not constitute a subsidizing export credit and also to ensure the elimination of the subsidy element in light of the stated objectives of participating countries. For example, the cotton case demonstrates that a requirement that export credits be neutral with respect to the government budget, costing no more in support to financing than they receive in the form of repayments and fees, is ambiguous in application.<sup>2</sup> Thus, DDA negotiations seek to identify disciplines for these programs that define and prohibit practices that create a subsidy element. These considerations are reflected in the attempt on the part of the Chair of the Committee of Agriculture to set out a framework for negotiations, a draft text, in summer 2006 (WTO, 2006).

### *Subsidy Elimination*

Two mechanisms are proposed to eliminate the subsidy element of these programs. One mechanism of the disciplines on export credits in draft DDA text would limit the conditions or terms of the guarantees, direct financing, or other practices of granting agencies. The value of an export credit would be constrained in the event that there was a maximum period, a minimum interest rate in the event of direct financing, a maximum percentage guaranteed in the event of a guarantee or insurance, a fee or premium that reflects risk, and so on (see Rude for a hypothetical application of the disciplines of the Arrangement to export credits in agriculture).

Negotiations to discipline export credits propose budget neutrality or self-financing requirements as a second mechanism for disciplining these programs. Perhaps it was recognition of the difficulty of assessing the success of the range of restrictions on export credit practices, in terms of data collection and processing, that led negotiators to seek as well a second, largely separate constraint to eliminate the subsidy element. In any case, the restrictions on the budget are intended to force the

agencies that provide export credits to fund themselves out of the fees and repayments of their activities. The basis is presumably the expectation that a program that is budget neutral does not subsidize.

### *Special and Differential Treatment*

Negotiations also take into account the mandate to provide special and differential treatment for developing countries.<sup>3</sup> Two cases should be differentiated: the case where the importer has a liquidity constraint and the case without a liquidity constraint.<sup>4</sup>

Recommendations of previous authors have centred on the potential for export credits to provide special and differential treatment in the form of access to liquidity for developing countries that would not otherwise have any, or would have only limited, ability to import. Abbott and Young argue that, in light of the low level of subsidy estimated based on net present value calculations, the potential for export credits to alleviate liquidity constraints must be present to explain some part of the popularity of these programs. Rude and Gervais assess the effects of liquidity constraints on export credit use and on commodity markets based on a highly stylized model but also note that this is likely not the common case.

The absence of notification or other publicly available data about global export credit use requires using secondary sources or data that only incompletely represent export credit practices. These data indicate that liquidity constraints are not prevalent among importers who receive export credits. From 1995 to 1998, 8.9 percent of export credits were granted to net-food-importing developing countries and 0.2 percent to least-developed countries, whereas about 60 percent were given to OECD importers (OECD, 2000).<sup>5</sup> The share of U.S. export credits provided to net-food-importing developing countries was higher than average, at 17.3 percent, but the share provided to least-developed countries was approximately zero (OECD, 2000). Moreover, stating the presence of these importers should not be taken as an assertion that all these countries of either type suffer liquidity constraints in all years covered by those data. Publicly available data about U.S. export credits indicate that the vast majority of export credits provided are used to support only a portion of the corresponding bilateral trade flow of agricultural products to any given importer; U.S. export credits were applied to more than half of the bilateral trade flow (by value) in 14 percent of the instances from 1998 to 2005 in which any export credits were granted, and to more than 90 percent of the bilateral trade flow in only six cases.<sup>6</sup> If trade occurs contemporaneously without export credits, then there may be purchases without support. In conclusion, while there may be instances of liquidity constraints, circumstantial evidence indicates that they are likely to be the exceptions.

The second case of special and differential treatment for importers, in which there is no liquidity constraint, is consequently expected to be the more common one. In those cases where export credits have been granted to countries that do not suffer a liquidity constraint, the importers have presumably benefited from the subsidy element by importing at lower cost – just as recipients of direct export subsidies benefit.

## **Unresolved Inconsistencies**

### ***1. Competing exporter benchmark versus private market benchmark***

The draft text does not make clear the benchmark against which the subsidy element is defined. The stated goal of eliminating the subsidy element of export credit programs may not be as unambiguous as casual observers would expect. The definition of the subsidy element may be largely agreed among authors of various estimates in applied economic literature, but the definition in the context of the WTO may differ. In fact, bracketed text of one draft agreement expressly precludes a key technique used in past present value calculations to estimate the subsidy element of export credits, indicating a malcontent among some negotiators with a comparison to estimated market interest rates.<sup>7</sup>

What is the benchmark of comparison? Does permitting all potentially competing exporters to access the same conditions eliminate the subsidy element of any one program? The purposes of the Arrangement are “to provide a framework for the orderly use of officially supported export credits” and, furthermore, “to foster a level playing field for official support ... in order to encourage competition among exporters based on quality and price of goods and services exported rather than on the most favorable officially supported financial terms and conditions” (OECD 2005, Art. 1). What constitutes “orderly use”? And is “the level playing field for official support” to be level among those exporters who use such programs or level among all exporters including those who are not party to the Arrangement and do not use export credits?

The draft text does not specify the notification data. Even if notification data were specified, they might only suffice to police behavior of export credit agencies relative to one another and to any disciplines. These data alone would not suffice to test for success of the disciplines relative to a private market benchmark that will not be found in export credit agency data. The omission of notification requirements may reflect the underlying inconsistency: one view may be that notification data for cross-program comparisons suffice whereas the opposing view may be that these data are incomplete for measurement relative to private market practices.

The definition of the budget of an export credit program represents a critical omission that may reflect this inconsistency as well. One element of the proposals to eliminate the subsidy element takes the form of requirements for budget neutrality or self-financing, but the method of budget calculation is ambiguous. Nevertheless, the draft DDA agreement of mid-2006 goes no further than observing that such a definition is needed. If the benchmark is the private sector rather than competing programs, then the budget of an agency for administrative purposes may not be relevant; if the benchmark of comparison is the private market, then the requisite budget neutrality of the activities of the export credit agency may not eliminate its potential to offer better conditions than private financial institutions. The export credit agency could provide export credits that pay for its financing activity alone, but no more, in the event that staff and office rental costs were omitted from its budget and costs incurred for regulatory compliance or insurance by a private institution were not paid by the public agency. Private financial institutions would charge higher rates to cover all their operating expenses in addition to the expected costs of the credits themselves. Thus, if the benchmark is to be the private sector, budget neutrality must be defined very broadly to be inclusive of all operating costs and, even so, must be supplemented by any costs incurred by private institutions that are not also paid by public agencies.<sup>8</sup>

## *2. Subsidy element elimination versus credit elimination*

If the subsidy element relative to private trade is to be eliminated, then what role remains for export credits? If the benchmark against which export credits are judged is the private market, rather than simply their ability to out-compete other potentially subsidizing export credit programs, then successful disciplines in whatever form would render government export credits equivalent to those offered by private institutions.<sup>9</sup> If this is the intention of the negotiations, then what purpose would export credits serve if this objective were accomplished?

This line of argument raises broader questions about the purpose of export credits that have been addressed in the broader literature about export credits for industrial products. For example, Baron (1983) notes the scope for export credits to address capital market imperfections or failures and capital market deficiencies, which are subjectively defined, as well as other objectives of public policy. In terms of imperfections, there may be the possibility that the export credits could cover political or systemic risk in agricultural export credits that the private market would not address, if any exists. Eaton (1983) cautions against citing the absence of any activity by private financial institutions as evidence of market imperfections: “Although absence of active private competition is evidence of a subsidy element, it is not

evidence that private markets would be unwilling to provide the services ...” (p 116). Eaton also discusses the possibility that the exporting country government could coax repayment from an importer who does not fear ostracism in credit markets as one potential justification for export credits. Even if one of these arguments proves true and is accepted as good cause for the program, the special ability of the export credit agency to overcome market failures or to withstand such risks would represent an advantage over private competitors and, consequently, would not withstand comparison to a private market benchmark.

### ***3. Subsidy elimination versus special and differential treatment***

If the subsidy element is eliminated relative to private financing, then how can special and differential treatment be provided? Or, conversely, if the special and differential treatment offered poor countries is worth having, then how can the subsidy element be maintained? It is not clear how best to meet conflicting goals of eliminating the subsidy element and subsidizing the purchases of some selected importers, as noted by Abbott and Young, Rude, and Hoekman and Messerlin.

The draft text proposes exemptions for developing countries. But the conditions under which exemptions apply – and who declares that these conditions are met – are not points of agreement.<sup>10</sup> In any case, an exemption amounts to perpetuating the subsidy element, which, even if the cause is widely applauded, undermines the objective of eliminating that element. The underlying tension arises from conflicting goals to (1) eliminate a means of subsidizing exports for commercial gain and (2) establish a mechanism for aid to developing countries, without any clear agreement about how to separate these two objectives in the context of export credits.

### ***4. Export credits versus food aid***

If special and differential treatment is provided by means of export credits, then why not apply the Food Aid Convention requirements for food aid to export credits? The argument that export credits represent a form of aid for developing countries is received by several authors with skepticism. Baron (1983) considers “back-door aid in the form of concessionary export financing ... inappropriate” (p 80). Eaton (1988) and the OECD (2000) question the wisdom of providing to poor countries with bad finances support in the form of more lending.

Even if the justification for export credits based on their potential to provide special and differential treatment for developing countries is accepted, what limited evidence is available indicates potential is not realized. Liquidity constraints may be present in a minority of cases historically: most export credits do not go to the



countries that seem most likely to face liquidity constraints and, in the case of the United States, usually less than half of bilateral trade to any export credit recipient is facilitated with export credits. In the majority of cases, then, the subsidy element is a relevant estimate of the benefit to importers, and these estimates are very low. Subsidy elements average 3.6 percent according to one estimate (OECD, 2000) and, according to others, range no higher than 11 percent (Dierson et al., 1997), 12 percent (Dahl et al., 1995), or 20 percent (Dahl, Wilson, and Gustafson, 1995). In light of the low rates of subsidy and the few instances of liquidity constraints among recipients in historical use of these policies, it may be difficult to see what special and differential treatment export credits provide that outright export subsidies do not.

In contrast, the Food Aid Convention mandates an average concessionality of 80 percent, and signatory parties are to strive towards 100 percent.<sup>11</sup> Moreover, food aid is subject to disciplines that seek to prevent commercial trade displacement. In the event that export credits are intended to facilitate developing-country imports, then the underlying logic of food aid rules is presumably applicable. Yet there seems to be no consequence for current negotiations: draft agreements do not make clear how disciplines on export credits would gravitate towards food aid disciplines in the event that the justification for permitting these programs is a claim that they facilitate poor countries' imports.

## **Conclusion**

Negotiations relating to export credits in agriculture exhibit no fundamental agreement on what constitutes an ideal outcome of any consequent disciplines. Instead, the following inconsistencies between conflicting objectives are left unaddressed.

- Is the benchmark of comparison when judging what constitutes subsidy elimination (1) harmony of practices among competing export credit programs or (2) financing available from private institutions?
- If a private market benchmark is accepted and all subsidy relative to that benchmark is to be eliminated, then what scope remains for useful government involvement in export credits?
- If a private market benchmark is used, then how can meaningful special and differential treatment be provided without undermining the objective of eliminating the subsidy element? Conversely, how can the subsidy element relative to a private market benchmark be eliminated if poor importing countries are to benefit from these programs?

- If special and differential treatment is an objective of export credits, then why are not the mechanisms and goals established in the context of food aid the basis of export credit disciplines?

The purpose of negotiations is to find grounds for compromise, not to reconcile differing policy goals, but some elements of negotiation are points along a scale, such as the decision of the pace for eliminating all direct export subsidies, the minimum level of concessionality of food aid, or the magnitude of reductions in bound rates of domestic support or import barriers. As the text above indicates, however, negotiations on export credits may not be reduced to arguing over a point on a scale or, at least, not until the scale is identified. A compromise can be envisioned in the contest to eliminate the subsidy element without identifying either a private market or competing exporter benchmark. A compromise is less apparent when considering whether or not such programs should exist if set to a private market benchmark and even less so without knowing whether the fundamental purpose of export credits is or is not to facilitate meaningfully, or perhaps even exclusively, poor countries' imports. These differences are manifested by bracketed paragraphs in, and important omissions from, draft agreements that negotiators may be hard-pressed to bridge when participating parties seem not yet to agree on the chasm to be bridged.

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## Endnotes

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- \* The author is an Assistant Professor, Department of Agricultural Economics, University of Missouri, Columbia. Appreciation is due to two anonymous reviewers and the editor. All views expressed here are the author's own.
1. Export credits are also provided by private financial institutions without government support. Where private arrangements are discussed in this article, the word "private" will be used.
  2. The Appellate Body agreed with the panel to abdicate the responsibility to set out a single, precise budget test: "In these circumstances, we agree with the Panel that, in this particular case, it was not necessary to choose a particular method nor determine the precise amount by which long-term operating costs and losses exceeded premiums" (paragraph 672).
  3. Proposals for the DDA calling for special and differential treatment for exporting developing countries are not addressed here.
  4. The definition of a liquidity constraint is the inability to access credit at all, at any rate. Alternative definitions of a liquidity constraint exist: the importer faces borrowing costs that are too expensive or the importer pays too much interest. Definitions of liquidity constraint that are based on a subjective assessment of high – or unfair – borrowing costs are not appropriate in this context, although high financing charges doubtlessly do discourage imports on credit. Likewise, the need to forego other important purchases in order to afford food imports or the need to export more to pay for imports, while potentially troubling for reasons of equity, do not by themselves provide evidence of a liquidity constraint.
  5. The confidential data from which these shares are drawn include a certain number of export credits, accounting for 0.6 percent to 9.4 percent of the total value, the recipients of which are not identified (OECD, 2000, p. 23).
  6. The values of export credits allocated by importers are from the website of the Foreign Agricultural Service of the U.S. Department of Agriculture (<http://www.fas.usda.gov/excredits/ecgp.asp>). Total agricultural export data are from Foreign Agricultural Trade of the United States (<http://www.ers.usda.gov/Data/FATUS/>). The comparison is over fiscal year data. The portion of bilateral trade flows not subject to export credits may be supported by an alternative export competition policy, such as U.S. food aid.

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7. The draft DDA agreement circulated in mid-2006 included a bracketed paragraph that would prohibit calculation methods based on estimated discount rates by requiring that any comparison with market conditions be based on a commercial loan that is identical in every detail to the export credit (WTO 2006, Annex I paragraph 4.i).
  8. There are other hurdles, such as debt written off and the time value of money, which must be overcome regardless of the benchmark.
  9. This is not to say that there would be no possible effects. Sumner (1995) expects a negative effect on national income. Rude (2000), for example, emphasizes the potential for export credits to be used as part of a policy of price discrimination in export markets. However, these effects are not to be broached as justifications during multilateral DDA negotiations to liberalize trade. Additionality, if defined as a net effect that is positive owing to the ability of export credits to enable more purchases by importers who would not otherwise be able to purchase, might be relevant, although the same historical evidence that argues against frequent liquidity constraints among recipients also argues against additionality. Moreover, the definition of additionality is ambiguous. Regardless of the potential for additionality, by whatever definition, the argument of the text remains valid: if export credits are not permitted to provide any different terms than private financial arrangements, then they cannot cause additionality relative to whatever private agents can achieve.
  10. As noted above, bracketed text relating to special and differential treatment for exporting developing countries is not addressed here.
  11. Concessionality is calculated on a net present value basis, but from the perspective of the exporting country, so it is not equivalent to the subsidy element estimates noted earlier. In either case, however, exports with a 100 percent concessionality or a 100 percent subsidy element are free for the importer.

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