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Power Transitions and Global Trade Governance:

The Impact of a Rising China on the Export Credit Regime *

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Abstract: The existing liberal international economic order was constructed during the era of American hegemony and heavily shaped by US power. How is the rise of China affecting global economic governance? This article analyzes the case of export credit, which has long been considered a highly effective international regulatory regime and an important component of global trade governance. I show that the rise of China is profoundly altering the landscape of export credit and undermining its governance arrangements. State-backed export credit is a key tool of China's development strategy, yet I argue that an explosion in China's use of export credit is eroding the efficacy of existing international rules intended to prevent a competitive spiral of state subsidization via export credit. The case of export credit highlights a fundamental tension between liberal institutions of global governance and the development objectives of emerging powers.

Keywords: trade, global economic governance, rising powers, China, WTO, OECD

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Introduction

For over half a century, the global economy and its governing institutions have been dominated by the United States and other advanced-industrialized states. The existing liberal international economic order was constructed during the era of American hegemony and heavily shaped by US power (Gilpin 1981; Ikenberry 2009). From its hegemonic position in the international system, the US engaged in an unprecedented building of multilateral institutions and rules to govern an increasingly integrated global economy, based broadly on the principles of open markets and trade. Yet the global political economy is currently in a period of profound change: after decades of extraordinary growth, China has emerged as the world's largest exporter and second largest economy. Regardless of whether or not we are in the midst of a full-blown hegemonic transition from the US to China, the latter's rise is undoubtedly reshaping the global economy. A central question and subject of debate is how contemporary power shifts will affect global economic governance (Breslin 2013; Lesage and Van de Graaf 2015; Lipscy 2017; Scott and Wilkinson 2013).

The present article contributes to this debate by analyzing the case of export credit, an important and increasingly contentious area of economic policy and international negotiations, which, to date, has received comparatively little attention from scholars of international political economy. The governments of most major economies use export credit – loans and other forms of financing to assist foreign buyers in purchasing goods and services from national exporters – to promote their exports. If provided at below-market rates, state-backed export credit may act as a subsidy. Government-supported export financing therefore has far-reaching consequences for international trade patterns (Wright 2011).

As I will show, the global dynamics of export credit are being transformed by contemporary power shifts, with significant implications for global governance. The existing system of governance for export credit – which limits the ability of states to use export credit

to subsidize, and thus artificially boost, their exports – was created under the auspices of the Organization for Economic Cooperation and Development (OECD) in the 1970s and repeatedly strengthened since then. For decades, export credit has been viewed as a successful global governance regime (Levit 2004; Moravcsik 1989; Shaffer et al. 2015), with its system of disciplines proving highly effective in restricting the use of export credit as a form of state subsidy.

However, I demonstrate that the rise of China – who is not a member of the OECD nor bound by its rules – has profoundly altered the landscape of export credit and disrupted its governance arrangements. Over the past two decades, China has emerged as the world's largest supplier of export credit, providing volumes of financing four times greater than any other state. State-backed export credit is a key tool of China's development strategy, used to foster industrial upgrading and the international expansion of its domestic firms and industries. Yet I argue that the dramatic increase in the use of export credit by China, as well as other major emerging economies, is eroding the efficacy of existing international rules intended to prevent a competitive spiral of state subsidization via export credit. The disruption of the export credit regime highlights the conflict between the liberal principles of the existing global governance architecture and the economic development objectives of the emerging powers.[1]

Clash of Powers: Liberal Global Governance versus the Developmental State

Current power shifts have produced considerable debate about the implications for the liberal international economic order. Scholars in the realist tradition of international relations hold a pessimistic view of the prospects for multilateral cooperation amid shifting power. In the context of waning American dominance, realists foresee conflict, based on the view that

[1] This analysis draws on interviews conducted between 2015-2018 at the OECD, WTO and national capitals, with over 45 negotiators and senior government officials, as well as extensive documentary research.

emerging powers like China hold fundamentally different interests and agendas than those of established powers and are therefore system-challengers rather than system-supporters (Gilpin 1981; Kupchan 2014). It is assumed that China and other rising powers will reject the rules, norms and principles of the liberal economic order created by the Western powers (Bremmer and Roubini 2011; Castañeda 2010; Kupchan 2014). Realists thus view power shifts as destabilizing and a threat to the global economic architecture (Patrick 2010). In contrast, liberal institutionalism is considerably more optimistic about the prospects for multilateralism and the maintenance of the liberal economic order amid a relative decline of US power (Keohane 1984). Many envision integrating new powers into the Western-made liberal world order, by socializing China and other emerging powers into existing global governance institutions (Johnson 2003) and reforming those institutions to incorporate emerging powers (Ikenberry 2009). It is assumed that having benefited from a relatively open, liberal global economy, emerging powers like China will have an interest in participating in and maintaining the system that supports it (Nye 2015). The old and new powers will therefore find ways to jointly manage the international economic architecture and cooperation will prevail.

There are thus major debates among scholars, policymakers, and foreign policy analysts about China's objectives and intentions – whether it will challenge or support the existing international economic order – as well as whether its rise is likely to generate conflict or enhanced cooperation and what its implications are for global economic governance. The case of export credit provides an important point of empirical intervention into these debates. From the perspective of economic liberalism, export credit has constituted an example of a successful global regulatory regime. Over time, the system of governance created under the OECD virtually eliminated the subsidy component of export credit, limiting state provision of export credit mainly to addressing market failure, while preventing states

from using export credit to artificially distort markets and trade flows, thereby avoiding a costly and self-defeating subsidy war.

Yet as I will show, export credit now illustrates how liberal global governance institutions are threatened by contemporary power shifts. Export credit, I contend, represents a case of what Lavenex, Serrano and Büthe in the introduction to this special issue identify as "regime-disrupting" change, in which emerging powers reject existing international regulatory models. To situate this within their introductory framework, in this issue-area, the *status quo ante* was a working export credit regime under the OECD. Originally, China was simply outside the system altogether. Now, however, China has built *capacity* – for combining expertise and resources to implement export credit policy effectively – and *capability* – to recognize its preferences and act accordingly – on a massive scale. China has emerged as the world's largest provider of export credit but refused to participate in the established governance regime or to accept international disciplines on its use of export credit.

While power transitions are causing regime disruption, this is not due to an unwillingness on the part of the established powers or the existing regime to accommodate China or other rising powers. Although based at the OECD, states are not required to be OECD members to participate in the existing system of rules governing export credit. The US and other established powers have been eager to either incorporate China into the current regime or engage it in the construction of a new one, but China has resisted both options. The issue is a fundamental incompatibility of preferences: China's preferences diverge from the established powers' preferences as enshrined in the export credit regime. China has developed preferences that are, in game-theoretic language, simply deadlock preference: there is no overlap of win-sets of China and the US/OECD coalition at the core of the export credit regime. Efforts to accommodate China within the regime have therefore failed. In this

case, China is a *regime-undermining spoiler*: given the scale of its export credit activities, China's non-participation threatens to destabilize the export credit regime.

Contrary to the expectations of liberal institutionalism, changes in the distribution of power are undermining the global regulatory regime for export credit. However, while the case of export credit accords with realist predictions regarding the disruptive nature of shifting power, it nonetheless challenges the implicit normative assumptions underlying many accounts of contemporary power shifts. As Amitav Acharya (2014) argues, the dominant narrative – whether realist or liberal – tends to take for granted the inherent goodness and desirability of the liberal order created under US hegemony. Accordingly, as Randall Schweller (2011) indicates, those who predict growing disorder due to China's rise typically assume that its goals must be illegitimate if they clash with the existing US-led liberal world order. Much analysis of China and other emerging powers has been shaped by a narrow framework for understanding their agendas and impact: if they do not support the status quo, rising powers are labelled "spoilers" or "shirkers" (Schweller 2011). The disruptive effects of emerging powers are attributed to the fact that they are "irresponsible" (Patrick 2010), "troublemakers" (Kirshner 2012), who hold inappropriate "core values" (Castañeda 2010) and lack an adequate sense of "international civic duty" (Hampson and Heinbecker 2011).

The case of export credit, however, problematizes such interpretations. From the perspective of the established powers or the regime they have created, China is indeed a spoiler, and it is easy to point to China as the problem and dismiss its stance – undermining the export credit regime by refusing to participate in it – as irresponsible. However, while contemporary power shifts are disrupting the global governance of export credit, as I will demonstrate, it is not simply because China is irresponsible or recalcitrant, but because it has legitimate objectives that conflict with the overarching goals of the regime. The disruption of

the international export credit regime is rooted in a fundamental conflict between the interests of the old and new powers: the US and other established powers have an interest in preserving the liberal regime they created, with states voluntarily cooperating to restrict their use of export credit to prevent a destructive, competitive spiral of subsidization, whereas China and other emerging powers have an interest in maintaining their ability to use export credit as part of their strategies for national development. This is, in short, a clash between liberalism and development.

Under the neoliberal model that has dominated development thinking since the 1980s, the objective of liberalizing global markets and constraining the scope for state intervention appeared highly compatible with the goal of fostering development. According to the "Washington Consensus" propagated by multilateral economic institutions like the IMF and World Bank, developing countries were told that significantly reducing the role of the state and liberalizing markets represented the best path to development (Chorev and Babb 2009). But that model has increasingly been challenged. Empirically, for many developing countries, neoliberalism resulted in deindustrialization and economic stagnation (Bayliss et al. 2011). Furthermore, the states that showed the most impressive development gains in recent decades – such as China, India and Brazil – frequently deviated from the strict dictates of the Washington Consensus and made use of distinctly illiberal, state-led development policies (Ban and Blyth 2013).

Consequently, development economists and policymakers have increasingly signaled a rejection of market fundamentalism and a renewed appreciation of the importance of an active state engaged in promoting development by fostering industrial upgrading, supporting the competitiveness of national industries and helping them to move up the value chain into higher value-added activities, and thereby boosting growth, incomes and the quality of employment (Lazonick 2008; Lin and Chang 2009; Rodrik 2008; Stiglitz et al. 2013). Even

the OECD – host of the export credit regime – has recognized this “renaissance of industrial policy” (Warwick 2013; OECD 2013). Certainly, China has emphasized the role of the state as a critical actor in development, and industrial policy is central to its strategy for continued economic development (Ban and Blyth 2013; Nölke et al. 2015).

There is growing recognition that states need to deviate from the principles of liberalism and to pursue certain illiberal policies in order to develop. In all successful developers, the state has played a vital role in supporting industrial development (Chang 2002; Lazonick 2008; OECD 2013: 105; Warwick 2013). Even the US and other advanced-industrialized states relied on a range of interventionist policies during their own processes of economic development, including using tariffs and subsidies to foster the growth of infant industries and sequence their integration into the global economy, aggressively adopting technology from more advanced countries, and controlling the inflow of foreign investment to direct it toward the goals of national development (Chang 2002; Gallagher 2008). From China’s perspective, in seeking to preserve scope for state intervention to promote industrial development, it is simply seeking to follow in the footsteps of the US and other advanced-industrialized states. Moreover, state-backed export credit, in particular, has historically been a core industrial policy instrument employed by successful late developers (World Bank 1993: 358-66).

The case of export credit thus underscores the fundamental tension between the developmental state and liberal global governance institutions. If development requires significant scope for state intervention, then can this be accommodated in, or reconciled with, governance institutions – such as the regime for export credit – predicated on the liberal principle that states should not intervene in the economy beyond providing basic public goods and correcting market failures? From the perspective of the US and other established powers, the export credit regime and its disciplines are essential to fostering an open and fair

global trading system, with competition taking place on a level playing field undistorted by state subsidies. But from the perspective of China and other emerging economies, a system that constrains their scope for development by requiring them to relinquish their use of an important industrial policy tool cannot be considered fair: what the established powers perceive as a level playing field is, in fact, one that serves to perpetuate their industrial and economic supremacy. There is thus an inherent conflict between the objectives of the established powers and those of emerging challengers. Although China's objectives are no less valid than those of the US and other established powers, they nonetheless threaten to undermine the existing liberal governance regime for export credit.

What is Export Credit?

Trade finance is a critical, but understudied, aspect of the global political economy. Approximately 80-90% of world trade relies on some form of financing, with over $10 trillion in trade finance provided annually (Akhtar 2015). Most trade finance comes from the private sector, but states also play a vital role in financing trade.[2] Every major economy has an export credit agency (ECA) that provides various forms of financing to facilitate and expand exports, including direct loans to foreign buyers, insurance and loan guarantees, working capital financing, and finance for large-scale infrastructure and industrial projects. Each ECA functions as a public or semipublic bank, borrowing from the national treasury or public capital markets and using the funds to finance exports (Moravcsik 1989). To quote one official, "If trade is the engine that drives the increasingly integrated global economy, export credit is the fuel that powers it" (Konno 1998: 95).

The volume of capital provided in this way is substantial: approximately 60 ECAs are now in operation worldwide, providing $300 billion in trade-related finance annually (Akhtar

[2] Private sector financing includes loans, letters of credit, guarantees, insurance and factoring, provided by exporters or financial institutions.

2015; Exim 2015). In some countries, state-backed export credit supports as much as 20% of exports, and total ECA authorizations account for more than 5% of GDP (NAM 2014). Official export credit plays a major role in financing capital goods exports – "big-ticket" exports, such as aircraft, satellites, transportation equipment, manufacturing and agricultural machinery, energy and mining equipment, power plants, and major infrastructure projects – which often involves long-term financing of complex, multi-billion dollar sales (Hufbauer et al. 2011). ECA support can make transactions more commercially attractive by mitigating risks of financing or providing another source of funding to diversify risks. In Britain, for example, UK Export Finance (UKEF) supports the aerospace sector by supplying financing to facilitate the sale of Airbus jets with Rolls-Royce engines to foreign buyers. Given the size of these transactions, the purchasing airlines rarely pay cash and instead require loans to make the purchase possible. UKEF can provide direct loans when commercial financing is unavailable, or guarantee (and thereby reduce the cost of) commercial loans. For many countries, state provision of export credit is a core part of their industrial policy and national export strategies.

The principal governance issue related to export credit arises from the fact that it may be subsidized by states as a means to promote exports. Since an ECA is a state agency with access to capital at low government rates, state-backed export credit is usually offered at interest rates below those that would be charged on the market for similar loans, if such loans are available at all (Moravcsik 1989). However, an ECA may also go further and subsidize interest rates directly, by lending at rates below its own cost of borrowing. Given that financing often represents a significant portion of a large capital goods transaction or infrastructure project, even modest government credit subsidies can be a decisive factor in awarding a bid. Like other forms of export subsidies, without global regulation, the natural tendency would be for states to offer increasingly higher subsidies in an effort to give their

exports an advantage in global markets, distorting trade flows and triggering a costly subsidy war that would drain national budgets (Coppens 2014; Levit 2004; Wright 2011).

The Global Governance of Export Credit

The use of export credit by states is governed by a set of rules established at the OECD, an institution comprised primarily of advanced-industrialized states and thus often described as a "rich man's club". Efforts to establish disciplines on government-backed export financing began in the 1970s. Many states were already providing subsidized financing at below market rates, but the oil shocks provoked the outbreak of an export credit war (Moravcsik 1989). Rising oil prices resulted in large trade deficits in most OECD countries, which prompted heightened competition over export markets. Governments increasingly turned to using subsidized export credit in a competitive race to "win" exports, leading to rising levels of subsidization across the advanced-industrialized countries. In a context of high interest rates, supporting large export contracts became increasingly expensive for states, burdening national budgets amid growing deficits (Vassard 2015).

The US led the creation of the current international regime governing export credit. As Andrew Moravcsik (1989: 199) details, the hegemonic power of the US played a crucial role in the creation of the regime and lent decisive support to liberalization efforts. The US's interest in eliminating subsidies provided "the catalyst that sparked serious negotiations" and the US assumed leadership of the negotiations, with its initiatives driving the formation, and subsequent extension, of the export credit regime. There was a relatively large degree of consensus among states on the desirability of an international regime, but where necessary at several crucial junctures, the US used the exercise of coercive power to overcome resistance from recalcitrant countries, such as France and Japan, with more interventionist economic models and greater support for subsidies.

The Arrangement on Officially Supported Export Credits ("the Arrangement") was created in 1978.[3] Its disciplines place strict limits on the financing packages that ECAs may offer to borrowers. Its highly specific and technical provisions define the most favorable terms under which credit may be granted (including minimum interest rates and premiums, term-to-maturity, down payment, and repayment schedules). These conditions are designed to automatically adjust based on changes in capital markets and commercial interest rates. The Arrangement includes disciplines on tied aid, as well as additional sector-specific understandings governing the terms and conditions of export financing for commercial aircraft, ships, nuclear power plants, renewable energy, coal-fired power plants, and railway infrastructure. Since its creation, the Arrangement has been continuously revised and updated to tighten its disciplines, close loopholes and adapt to changing circumstances (Moravcsik 1989; Vassard 2015). In addition to being the key driver behind the Arrangement's creation, the US was also the primary force behind this continual strengthening of its disciplines, designed to bring the global provision of export credit closer to market principles (Hall 2011; Coppens 2014).

Transparency is a critical aspect of the governance regime for export credit. The Arrangement sets out detailed procedures for mandatory notification and exchange of information on credit practices. The system provides what participants describe as "real time transparency" – a procedure and forum for reporting on impending transactions, exchanging confidential transaction data, and resolving disagreements before a transaction is completed. A participant is allowed to deviate from the terms of the Arrangement if they follow its notification process, providing other participants with the opportunity to match the terms of that bid by offering the same level of support; this threat of matching acts as a powerful

[3] The most recent version of the Arrangement is OECD 2018a. Participants are the US, EU, Japan, Korea, Canada, Australia, New Zealand, Norway, and Switzerland. Israel and Turkey are observers.

enforcement mechanism for the Arrangement's provisions (Coppens 2014). As described by a senior OECD official, "everyone knows what the best terms available are, so no one worries about what terms competing governments might offer. … There are no secret financing terms and, thus, no competitive advantages to be gained from deviating from the rules" (Drysdale 2015). The transparency and monitoring mechanisms built into the regime encourage participants to conform to its disciplines and provide confidence that others are doing the same.

The Arrangement is not a formal treaty and has no formal enforcement mechanisms; instead, it is an informal, consensus-based "Gentleman's Agreement". Yet despite its status as mere "soft law", the Arrangement has proven to be a highly effective regulatory regime. As Janet Koven Levit (2004: 68) demonstrates, the Arrangement has succeeded in achieving "thorough, deep, sustained compliance" among its participants. OECD and ECA officials themselves report that non-compliance is extremely rare. Many argue that its soft law status has, in fact, been an advantage – ensuring that the Arrangement is flexible and adaptable and can more easily be reviewed, modified, amended, and strengthened (Bonucci 2011; Levit 2004). The Arrangement has built trust among its participants and a shared understanding of appropriate practices that has significantly shaped state behavior (Shaffer et al. 2015).

As a result, the existing regulatory regime for export credit is widely identified as a successful institution of global economic governance (Levit 2004; Moravcsik 1989; Shaffer et al. 2015). In the words of one ECA official, "over years and years of tightening its disciplines, the Arrangement has evolved to largely eliminate the subsidy component of export credit."[4] Its rules have enabled ECAs to fill gaps in the availability of commercial financing and facilitate the expansion of trade without distorting global markets, ensuring that exports compete on the basis of price and quality rather than subsidized financing (Wright

[4] Interview, July 2016.

2011).[5] To quote a negotiator, the OECD Arrangement has been "very effective in terms of creating a level playing field and creating a situation where governments are complementing rather than competing with or crowding out the private sector."[6] In short, as one OECD official summed it up, "the export credit world has been really peaceful because of the Arrangement."[7]

WTO rules on export subsidies prohibit subsidized export credit; however, as detailed below, in practice, export credit is extremely difficult to police via the WTO. The smaller forum of the OECD became the institutional home of the export credit regime because it offered a more nimble and effective means of governing export credit (Moravcsik 1989). The Arrangement is not a universal agreement, but a form of club governance. It operates as a system of mutual self-restraint in the provision of state-backed export credit: while its participants are in direct competition with one another for export markets, they nonetheless abide by a common set of rules governing the terms of that competition. OECD membership is not required to join the Arrangement: any significant export credit provider is eligible to participate.

Export credit is what Robert Keohane (1982: 351) calls a "control-oriented regime", in which, through a set of institutionalized arrangements, "members maintain some degree of control over each other's behavior, thus decreasing harmful externalities arising from independent action as well as reducing uncertainty stemming from uncoordinated activity." Control-oriented regimes, like that for export credit, seek to regulate the behavior of their members. The condition for a mutual-control regime to be effective, however, is that *all* significant actors within the issue-area being regulated must be members of the regime

[5] As with any mechanism that restricts export subsidies, the Arrangement could be seen as harming importers, since credit subsidies reduce their costs. However, Arrangement participants are also importers of goods and services backed by foreign ECAs.
[6] Interview, July 2015.
[7] Interview, June 2016.

(Keohane 1982: 353). When the Arrangement was created, and for several decades afterwards, it covered all of the world's major export credit providers – which were then exclusively rich countries. Since developing countries were not significant providers of export credit, there was no reason for them to be subject to such disciplines and their non-participation did not undermine the regime's functioning.[8] Now, however, the club model of governance for export credit centered on the advanced-industrialized states of the OECD is coming under strain, as major providers of export credit – such as China – emerge outside the club and show little interest in joining.

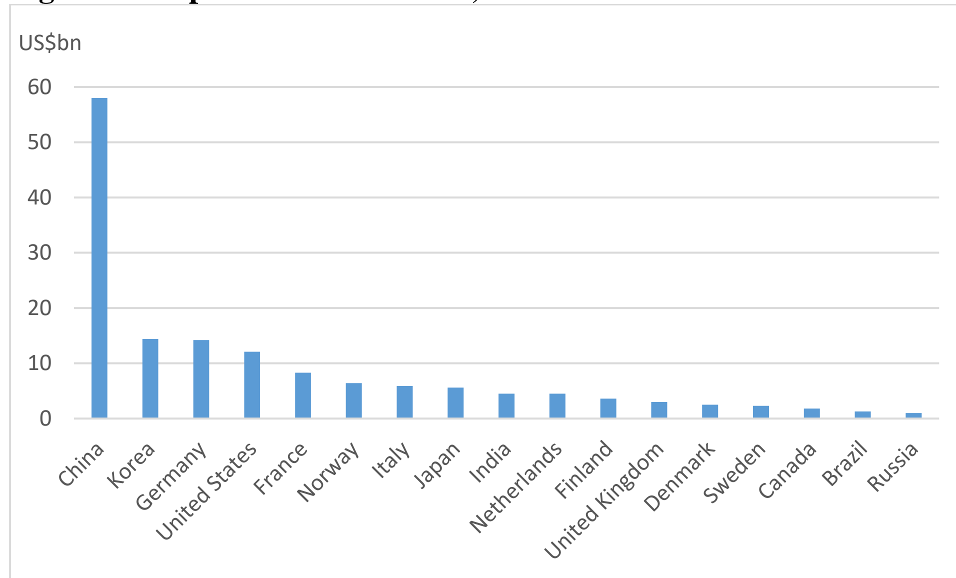
Changing Global Dynamics of Export Credit

In recent years, the global landscape of export credit has changed dramatically due to an explosion in export credit provision by China and other emerging powers. Between 2000 and 2014, the BRICs (Brazil, Russia, India and China) increased their official export financing from less than 3% to 40% of the world total (Exim 2015). The vast majority of this increase has come from China, who constitutes 90% of the medium and long-term trade-related official support activity of the BRIC countries and is now the world's largest export credit provider. In 2014, China supplied $58 billion in export credit support – far more than the $12 billion provided by the US and, indeed, more than *all* the G7 rich countries *combined* – plus an additional $43 billion in overseas investment financing to promote its exports (Figure 1). As one US export credit official stated regarding China's provision of export credit: "They just dwarf everyone else."[9]

[8] No developing country has joined the Arrangement, with the exception of Brazil, which is a participant in the Aircraft Sector Understanding but has shown no interest in joining the larger Arrangement. South Korea joined the Arrangement in 1997, once it was already a developed country. Some emerging economies, including Turkey, Poland, Mexico and Chile, are members of the OECD but not participants in the Arrangement. They are not major providers of export credit and their use of export credit has never been large enough to be seen as a threat to the Arrangement or to concern its participants. Poland, for instance, provides only 0.39% of total OECD export credit, Turkey 0.16%, and Mexico 0%, while Chile does not have an ECA (OECD 2018b).

[9] Interview, July 2015.

Figure 1: Export Credit Volumes, 2014



Source: Exim 2015.

The expansion in China's use of export credit is closely tied to its evolving development strategy. After 40 years of rapid economic growth, China is reaching the limits of a growth model centered on low-wage, labor-intensive production of basic consumer goods, as the country faces slowing growth and rising labor costs. According to Chinese policymakers, "China has entered a critical stage of economic restructuring" in which it faces "the challenge of optimizing and upgrading its industrial structure" in order to "escape the middle-income trap and develop into a high-income country" (DRC 2014). China's officials see industrial upgrading as "the only way out" of underdevelopment, but "a long uphill battle" in which the state must play an active role (DRC 2014).

The Chinese government identifies advanced manufacturing as the answer "for China as it seeks a new economic driver and a new global competitive edge" (Jing and Man-ki 2015). China is seeking to transform its economy and move into more technology-intensive and higher-value-added industries. With its "Made in China 2025" industrial strategy, China has targeted ten priority sectors: information technology, robotics, aerospace, vehicles, rail equipment, advanced materials, power equipment, ocean-engineering equipment and ships,

biopharmaceuticals and medical equipment, and agricultural machinery. China's stated goal is to enable its manufacturing sector to "catch-up" with advanced-industrialized countries by 2025 and ultimately to be a world-leading manufacturing power by 2049.

Export credit is a key part of China's developmental state toolkit. It is one of the prime means by which China is deploying its newfound financial power to give its firms a competitive advantage in global markets, while fostering industrial upgrading and the development of strategic sectors. The country has three ECAs – China Eximbank, China Development Bank, and Sinosure – and, as one US trade official put it, "Now China is sitting on huge reserves, and they probably more than anyone can afford to subsidize."[10] Promoting China's exports through state-backed export credit is a strategy that comes from the State Council and is implemented by these state-owned policy banks (CDB, Eximbank) and insurer (Sinosure) in close coordination with Chinese firms (Downs 2011). China's policy banks are funded through bond issues (80% of which are bought by China's state-owned commercial banks), and also receive periodic cash infusions from state coffers and China's massive foreign exchange reserves; in 2015, for example, China Eximbank and CDB received capital injections totaling $93 billion (Kong and Gallagher 2017). Since the late-1990s, China has undertaken substantial administrative reforms to improve the performance of its policy banks, building highly effective institutions for delivering export credit: its ECAs are well-resourced and professionalized, with considerable expertise (Downs 2011; Sanderson and Forsythe 2012). China has thus developed substantial institutional capacity and capability in this area.

On export credit, there is a convergence between the strategic objectives of the Chinese government and the commercial interests of its firms. Its ECAs and business work closely together to structure and execute transactions, which advance both national and

[10] Interview, March 2009.

corporate interests concurrently (Downs 2011). A representative of a rival ECA characterized China's strategy as follows:

> What China does is develop an industry domestically, then uses export credit to make markets for them abroad. There's a strategically well-implemented plan to start an industry, grow that industry and then internationalize it, and these are the three agencies that do it for them. And what we've seen is that when they pick a sector, they can dominate it. They start domestically, then use below-market financing to start moving into emerging markets in Africa, Latin America, and poorer parts of Asia, then into industrialized countries like the US, EU, Canada. They're not in it for the short-term game. They're in it for the long-term, 50 years down the road, when they'll be dominating every sector economically. There is a plan and they've done it damn well so far – and there's no sign anyone is about to slow it down.[11]

As a result, he continued: "Frankly, everyone can see what's coming and everyone is scared to death." While other successful recent developers, such as the East Asian newly industrialized countries (NICs) – Korea, Singapore, Taiwan and Hong Kong – also made use of export credit as part of their development strategies (World Bank 1993), China has been characterized as conducting "the most aggressive export credit financing campaign in history" (Ezell 2011). And this strategy is proving highly effective. To quote one WTO official: "In almost every capital goods sector, China is going from a bit player to being one of the biggest."[12]

Export credit has been the driving force behind the much-publicized expansion of China's activities in Africa, Latin America and elsewhere (Bräutigam 2009; Gallagher et al. 2012). While often mistakenly described as aid, much of China's overseas lending is in fact export credit – loans tied to the export of Chinese goods (Bräutigam 2009). China's massive new Belt and Road Initiative (BRI) provides similar avenues for using its financial might to support its industries and the "going out" of Chinese enterprises abroad. Although considerably smaller in scale, the other BRICs are using export credit strategically in key

[11] Interview, July 2015.
[12] Interview, July 2016.

sectors to significant effect – including Brazil in construction, Russia in nuclear energy, and India in transportation and energy. Given the extremely large volumes of financing it is providing, China's use of export credit is seen as a serious competitive challenge to the US, EU and other advanced-industrialized states and the most significant threat to the export credit regime.

Erosion of the Export Credit Governance Regime

While the global regulatory regime centered on the OECD Arrangement worked effectively to govern export credit until recently, its disciplines are now being undermined by the substantial increase in export credit provision by China and other emerging economies. The international export credit regime addresses what Arthur Stein (1982) calls a "dilemma of common interests," where cooperation is necessary to avoid an undesirable outcome (in this case, a war of competitive subsidization that could destabilize the trading system) but individually each state has an incentive to deviate (by providing credit subsidies to support their exports). As Stein (1982: 312-3) states, "All regimes intended to deal with dilemmas of common interests must specify strict patterns of behavior and insure that no one cheats." This requires institutional structures for policing compliance: the regime must specify "what constitutes cheating, and each actor must be assured of its own ability to spot others' cheating immediately," through "verification and monitoring procedures" that ensure cheating is "observable." Accordingly, the export credit regime has developed a detailed set of rules defining the terms on which states are allowed to provide export credit, with extensive monitoring procedures to ensure compliance. For the regime to work, however, states need assurance that their competitors are not cheating; China's absence therefore presents a significant problem.

Information-sharing is recognized as one of the most important functions of regimes (Keohane 1984). Uncertainty about other states' behavior, and the difficulty of observing

others' actions clearly, is a significant obstacle to international cooperation (Koremenos et al 2001). International regimes reduce risk and uncertainty by increasing the flow of information among member states, making regimes most valuable in cases where information is asymmetrically distributed (Keohane 1984). In the case of export credit, where states have extensive information about their own activities but not those of others, a central function of the Arrangement is providing increased transparency and information-sharing among participants: indeed, its "detailed transparency provisions" have been identified as the "most important part of the regime" (Moravsik 1989: 204). By requiring states to provide information about their export credit activities, the transparency provisions of the regime act as both a method of monitoring and an incentive for compliance with its disciplines, and have therefore played a crucial role in ensuring its stability.

The Agreement's information-sharing requirements provide a powerful deterrence against cheating by giving other participants the opportunity to match the terms of any bid a state is providing. Since China is not subject to the regime's reporting requirements, however, states have no means to verify and monitor its behavior and no assurance that it will not subsidize. As an ECA official stated:

> If you want to provide export credit, you provide a confidential notification to Arrangement participants with the details of the transaction, with all the specific terms of the transaction going out to all of your competitor ECAs. So participants are constantly monitoring each other's activities. The only recourse is matching, but everyone agrees this surveillance mechanism works. Because the moment you break the terms, your competitors will just do the same thing. Whereas if China wants to break the terms, it just does it. There's nothing to stop them – and we won't even know it's happening.[13]

Other states cannot know the frequency or extent to which China is breaching the Arrangement, but they know China has strong incentives to do so. Moreover, China's unwillingness to join the regime heightens distrust by signaling to participants that it wants to

[13] Interview, July 2016.

remain free to deviate from Arrangements terms, intensifying fears that China is using export credit to undercut their exports.

Because China is not bound by the information-sharing requirements of the export credit regime, other states lack reliable, comprehensive information about China's activities. According to an OECD study, "there is a scarcity of concrete information about the Chinese export credit programs, both about the types and volumes of export credit support and the terms and conditions for them" (Skarp 2015). As one negotiator indicated, "In terms of the terms and conditions they offer, we just don't know. We don't have access to that information."[14] Given the highly opaque and non-transparent nature of China's financing, publicly available data on its export credit practices are extremely limited, and the terms and conditions of specific transactions are usually not known. States are forced to rely on anecdotal evidence, gleaned from rare instances where Chinese lending terms have been leaked or otherwise become publically available.

Based on this information, many OECD countries believe that China is using its ability to extend credit on more favorable terms to gain an advantage over participants in the Arrangement and related sectoral understandings. According to an ECA official, "What China is doing is riskier transactions, with fewer rules, at slightly less cost, with longer terms and a lot more flexibilities – when you combine all of those things, it can be quite an attractive package."[15] Moreover, he continued, "They don't have to go far off the market in any one term to get an overall package that is very attractive, plus they use all these side programs as further inducement [e.g., combining export credit with development aid]."[16] Since financing can often account for as much as 40% of the cost of a project, attractive

[14] Interview, July 2015.
[15] Interview, July 2015.
[16] Interview, July 2015.

export credit terms can be enough to give China's exports a significant competitive edge (Pomfret 2010).

The issue is not just the interest rate that China is charging. The interest rate is only one factor in determining the competitiveness of a loan, and thus whether state-backed lending will distort trade. Relaxing other terms and conditions of lending to depart from prevailing market conditions can also act as a subsidy and be used to gain a competitive advantage. This is why the Arrangement regulates each of the key terms and conditions of export credit – including the interest rate, premium rate, repayment period, grace period, down payment, and portion of the contract supported – to ensure a level playing field among participants (Figure 2). For a non-participant like China, deviating from the Arrangement on any of these terms can be used to underbid competitors who are required to abide by its rules.

Figure 2: OECD Arrangement Requirements

OECD Arrangement major disciplines:
• *Minimum interest rate:* commercially-indexed rates calculated monthly by the OECD for each participant based on the interest rate on its government bonds + 1% (Commercial Interest Reference Rates, CIRRs) • *Minimum premium rate to cover credit risk:* ECAs are required to charge a premium, in addition to interest charges, to cover the risk of non-repayment of export credit; calculated based on country risk and commercial risk associated with the buyer • *Maximum loan repayment period:* 8.5 years for loans to developed countries and 10 years for loans to developing countries; 12 and 14 years for rail infrastructure; 12 years for non-nuclear power plants; 18 years for nuclear power plants • *No grace period:* the first instalment of principal and interest payment must be made within 6 months of the start of the credit, and a maximum of every 6 months thereafter • Minimum 15% down payment • Maximum support of 85% of export contract value
OECD Arrangement rules on tied aid (Helsinki Package):
• Tied aid not permitted for commercially viable projects or countries above lower-middle-income • Requires a minimum concessionality level of 35% (50% for LDCs)

Since it is not bound by Arrangement rules, China is able to offer more flexible financing packages and more favorable terms. While it is believed that China's standard

interest rate on export credit is generally similar to Arrangement or market terms, there are many instances (see examples below) where China has strategically provided lower interests rates (EU 2011). Even a slightly lower rate can give Chinese exports a significant advantage: a difference of just 1-2% in the interest rate increases total financing costs by 18-30% for a 12-year loan (Gallagher et al 2012). The other key element of pricing is risk premiums. Under the Arrangement, the minimum interest rate a lending country must charge is based on its *own* cost of borrowing (i.e., a flat rate, irrespective of the transaction or borrower); the regulation of risk premium fees is therefore an essential part of the Arrangement, which makes government-backed financing mimic the market by requiring ECAs to charge higher costs for riskier transactions. Since the premium rate charged by an ECA is often the largest component in the overall price of financing, a low (or no) premium rate could be the decisive factor in awarding a bid, making the Arrangement's risk premium rules essential to ensuring a level playing field (Gonter 2011). These fees can be considerable: on a 10-year loan, for example, risk premium rates average between 6-19% of the value of the loan, depending on the credit-worthiness of the buyer.[17] OECD countries are concerned that Chinese ECAs often do not charge risk premiums, and when they do, the fees do not approach the levels required by the Arrangement (Exim 2015). The lack of adequate fees to cover credit risk would represent a significant subsidy by the Chinese government, lowering the cost of financing for Chinese exporters and providing them with an advantage compared to those in the OECD.

In addition, China is also believed to gain an advantage through longer grace and repayment periods than permitted under the Arrangement (EU 2011). Extended repayment periods, like interest-rate subsidies, increase the attractiveness of financing. Importers, who evaluate financing in terms of its present value, prefer longer repayment periods, which allow them to discount the loan over a longer period, as well as shifting risk to the lender

[17] Calculated based on Arrangement Country Risk Classifications (CRCs) as of June 25, 2018.

(Moravcsik 1989). While the Arrangement stipulates a maximum repayment period of 8.5 or 10 years for most loans, China's loans usually come with a maturity of 12-15 years (Bräutigam 2011) and it is not unusual to see Chinese loans with terms of 20 years or more, and even as high as 28.5 years (Bräutigam and Gallagher 2014). By offering longer loan tenure periods, China is able to provide more competitive financing, giving its exporters an advantage. Similarly, loans with longer grace periods are also less costly to service. While the Arrangement prohibits grace periods, China's loans often include a grace period of 2-5 years (Bräutigam 2011), which makes their terms considerably more favorable.

China also appears to violate Arrangement rules through its use of "mixed credits", or blended financing – combining standard export credit with development finance (grants or concessional loans at below-market rates) on the same transaction to produce an attractive financing package that gives its exporters an advantage in winning export contracts. Tied aid (aid tied to the procurement of goods and services from the donor country, which can be used to circumvent the objectives of export credit disciplines) and mixed credits are strictly regulated by the Arrangement. The Arrangement's Helsinki Rules are intended to minimize the trade-distorting effects of tied aid and ensure it is directed towards genuine development purposes, by mandating minimum concessionality levels, preventing such financing from being used for projects in higher-income countries that can be financed commercially and ensuring it is instead exclusively used to support developmental projects in lower-income countries (Figure 2). The Arrangement substantially curtailed the practice of using tied aid for export promotion by OECD countries (Hall 2011; Tvardek 2011). However, China's tied aid frequently takes the form of low-concessionality loans, which are most distortionary from a trade perspective and violate the terms of the Arrangement (Exim 2016). China issues many large loans with tenors between 20-25 years, a 7-year grace period, and interest rates between 0-3% – terms which "likely fall outside the range permitted by OECD disciplines"

by violating the minimum 35% concessionality requirement (Exim 2014). Furthermore, under the Arrangement, tied aid is only permitted for lower-middle and low income countries and non-commercially viable projects. However, China has contravened Arrangement rules by extending concessional loans to commercially viable projects in upper-middle income countries (EU 2011). Through its use of tied aid and mixed credits, China is thus providing more attractive financing terms than available under the Arrangement (EU 2011; Exim 2018).

Rail equipment exports provide an illustration of how China's ability to provide more favorable credit terms advantages its firms and buoys its industrial upgrading. Representing an annual market of $120 billion, this is one of the ten priority industries that the Chinese government has targeted for overseas expansion as part of its effort to transform China into one of the world's most competitive advanced manufacturers. China has the world's largest high-speed rail network and its firms now participate in hundreds of overseas rail projects. In 2015, China's two state-owned railroad equipment makers (CSR Corp. and CNR Corp.) merged to create CRRC Corp., a $130 billion giant that is now the world's second-largest industrial company, behind GE, and dwarfs rivals such as Siemens and France's Alstom. The motive behind the merger is to leverage economies of scale that will allow China to compete overseas even more aggressively. China's rail exporters have been targeting emerging markets in Africa, Latin America, and Southeast Asia, while also winning high-profile contracts in advanced countries. According to analysts, although China's rail technology is less sophisticated, its main competitive strength is that its technology is offered as part of a package that includes attractive export credit financing (Bloomberg 2015).

Although it is extremely rare for the pricing terms of Chinese bids to become publically available, one of the few cases where such terms are known was a $500 million sale of rail locomotives to Pakistan: while the Arrangement would require a minimum risk premium fee of approximately 21%, China Eximbank offered a fee of just 8% (Financial

Times 2011). In another instance for which terms are known, CDB extended a $10 billion line of credit to Chinese rail equipment companies for sales to Argentina at LIBOR+6%, well below market rates that would be at least LIBOR+9.35% (Gallagher et al 2012). The loan also involved a 19-year repayment period, violating the maximum loan tenor permitted by the Arrangement. The Arrangement provides repayment terms of up to 12 years for railway infrastructure exports to developed countries and up to 14 years for developing countries, but China's repayment terms for its rail exports often exceed 20 years (Akhtar 2015). These differences in interest rates, fees and repayment terms provide China's exports with a significant advantage over its OECD competitors and have helped to fuel the global expansion of its rail industry.

Rail is just one of many industries in which China is using more favorable export credit terms to give its firms a competitive edge in global markets. The telecommunications sector provides another example. China Development Bank has provided one company alone – Huawei Technologies – with a massive $30 billion line of credit, enabling it to offer financing rates and terms that are unmatchable by competitors. While transaction details are usually masked in secrecy, Brazil's largest landline telephone company, Tele Norte, publically confirmed that it chose to purchase network equipment from Huawei rather than competing European and American suppliers specifically because of access to that financing, which CDB offered with an interest rate of about 4% (compared to market rates of about 6%) and a two-year grace period on payments (Sanderson and Forsythe 2012: 158). America Movil, the largest mobile phone carrier in Latin America, likewise confirmed that access to below-market financing from CDB was its major reason for choosing Huawei for a $1 billion deal to upgrade its network (Hufbauer et al. 2011). Huawei's cheap credit line from CDB is seen as playing a similarly critical role in enabling the company to increase its sales to India from $50 million to $2.5 billion in just one year (Ezell 2011). Fueled by such support,

Huawei has become the world's largest telecommunications equipment manufacturer, overtaking Ericsson, the European-based multinational, in 2012. The global expansion of ZTE, China's other major telecom equipment manufacturer, has been similarly driven by $25 billion credit lines from CDB and China Eximbank. An EU investigation found that "such facilities are a major selling point which enables ZTE to clinch deals on its export markets ahead of its competitors, while shifting the entirety or majority of its risk of payment onto the Chinese policy banks" (Wall Street Journal 2011). China is thus using attractive export credit terms to fuel the global expansion of national champions.

Other instances of China undercutting the terms of the Arrangement abound. China Eximbank provided a $45 million loan to Jamaica for construction of a convention center at 2% interest with a 20-year repayment period (Gallagher et al 2012); however, the Arrangement would require a minimum interest rate of approximately 5%, along with a 20% premium fee and a maximum loan tenor of 10 years.[18] A Chinese company was awarded a contract to build a €170 million bridge in Serbia, without any call for tender, based on a loan from China Eximbank providing an interest rate of 3% and a 15-year repayment period (OA 2010). The Arrangement would require a minimum 5% interest rate plus premium fees of approximately 12-25% and a maximum 10-year repayment period. Similarly, a $1.25 billion contract to modernize and expand a Serbian coal power plant was awarded to a Chinese company, CMCEC, with financing provided by China Exim at 3% interest over 15 years (OA 2010). The Arrangement, in contrast, would require approximately 4% interest plus premium fees of 12-25% and a maximum 12-year repayment period. Other projects in Eastern Europe awarded to Chinese firms with ECA backing including several $500-750 million power plants, a €3 billion high-speed rail link between Belgrade and Budapest, and a €600 million highway. In violation of the terms of the Arrangement, China is generally charging between

[18] Calculated based on historical CIRR and CRCs.

2-2.5% for these loans, with 20-30 year repayment periods (Karnitschnig 2017). Eastern Europe is seen as a strategic entry point for Chinese companies in the European market, and Chinese ECAs are reportedly using aggressive financing practices to undercut competitors and expand their foothold in these markets (OA 2010; EU 2011).

It is not necessary for all, or even most, of China's export credit to be subsidized for it to pose a competitive threat to OECD countries or jeopardize the Arrangement. By operating outside the Arrangement, China has maximum flexibility to adjust the terms and conditions of its financing, based on competitive conditions and its strategic interests. As one ECA official stated: "They like their flexibility and use it tremendously."[19] Chinese rates and lending terms vary considerably: Chinese ECAs may often provide financing not far from Arrangement or market terms, but for strategically important transactions, they are able to undercut the Arrangement and use discounted financing to gain a competitive advantage (Exim 2006). This is akin to a "loss leader" strategy – where an initial subsidy serves as an investment in winning subsequent sales – with China using cheap credit selectively to win key contracts that enable its firms to gain a foothold in a new market, establish their technology and technical standards, and develop brand recognition.

OECD ECAs are receiving mounting complaints from their exporters that they are losing contracts to Chinese firms because of the more favorable financing packages the latter are able to offer. According to an American business representative, "US multinationals are facing with greater frequency the problem of subsidized export credit financing from China in international tenders" (Schewel 2011b). In the words of the US Export-Import Bank Chair: "They're winning deals in part because they're not playing by the rules" (Reddy 2011). As one ECA official stated, "We've seen them coming in to areas where they are

[19] Interview, July 2015.

competing with our exporters, often with very cheap money, and often with tied agreements."[20] Another summarized: "Everyone feels under attack."[21]

Given the massive volume of financing it is providing, incorporating China into global rule making and disciplines on export credit is a key priority of the US, EU and other advanced-industrialized states. As the head of the US Eximbank put it, "it's important that they play by the rules that everybody else is playing by" (Schewel 2011a). However, such efforts have proven largely unsuccessful. Although the US strongly pressed China to join the Arrangement, China refused. Beijing has indicated that it will not join a set of rules that it played no role in creating and that do not reflect its development objectives. China's position, as articulated by Chen Deming, former Minister of Commerce, is that the OECD Arrangement "aims to solve the problem of international competition among developed countries and does not fully reflect the development concerns of developing countries" like China (Deming and Peiru 2016: 209). As a developing country, he argues, China's provision of export credit is distinct and it is not appropriate for China to join the Arrangement. Thus, as OECD negotiators put it, "China has shown no interest in coming here" or "subjecting their export credit to these disciplines."[22]

Participants fear that China's absence significantly undermines the Arrangement and reduces its effectiveness. As one ECA official stated, "the big question on everyone's mind now is whether the Arrangement is becoming obsolete."[23] A negotiator summed up the problem as follows:

> You have this Arrangement that's worked well for decades and over time has gotten better and better as its disciplines bite more and more. The problem is that they were universal rules – everyone who exported capital goods was a member – but now the world has completely changed. … China has traditionally been an exporter of consumer goods, but now there is almost no sector where China is not a major exporter of capital goods. What happens to

[20] Interview, November 2016.
[21] Interview, July 2015.
[22] Interviews, June and July 2016.
[23] Interview, December 2017.

> your export credit Arrangement if China is not a participant? If the Arrangement is going to operate in a meaningful way, it has to involve all the major exporters of capital goods, meaning it has to involve China. Everyone who exports capital goods needs to be part of the system or it can't work.[24]

Similarly, another participant echoed this in stating that, for the Arrangement to work effectively, "The major providers of export credit need to be there. The Arrangement becomes pretty irrelevant pretty quickly if the world's biggest exporter won't participate. There's no point agreeing on reciprocal restraint if doesn't include all actors."[25] This has already begun to hamper the ongoing process of negotiations to continually strengthen the Arrangement. Negotiators report that there are now many issues that "members don't want to talk about" because "why would they agree to rules when China is not there and China is the biggest producer?"[26] States are reluctant to commit themselves to any new disciplines that will not also bind China.

International Working Group on Export Credits

Thwarted in its efforts to convince China to join the Arrangement, the US tried a different tack. In 2012, the US drove the creation of a new International Working Group on Export Credits (IWG), involving 18 major developed and developing countries, including China, to negotiate a successor to the OECD Arrangement. This was a US-led initiative pushed at the highest levels that came out of the bilateral US-China Strategic and Economic Dialogue. After many years of pressure by the US, following a meeting between President Barack Obama and soon to be President Xi Jinping, the two countries jointly announced agreement "to establish an international working group of major providers of export financing to make concrete progress towards a set of international guidelines on the provision of official export financing."[27] The resulting IWG came to include the nine participants in

[24] Interview, July 2016.
[25] Interview, July 2016.
[26] Interviews, June 2016.
[27] "Joint Fact Sheet on Strengthening US-China Economic Relations," White House, Washington, February 14, 2012.

the OECD Arrangement (the US, EU, Canada, Japan, Korea, Norway, Switzerland, New Zealand and Australia) as well as nine non-participants (the BRICS plus Indonesia, Israel, Malaysia and Turkey). It was China that insisted on the participation of the eight other emerging economies, in order to ensure balance between developed and emerging economies and bolster its side in the negotiations by ensuring that it would not be outnumbered by the Arrangement participants. As a result, compared to the Arrangement, the IWG is considerably more inclusive, in that nearly half of its participants are developing countries.

From the perspective of the US and other developed countries, the IWG was a second-best solution: as one negotiator stated, "we had dreamed of dragging China into the OECD Arrangement, but the failure of that effort is what led to the IWG."[28] Seeking to reign in export credit provision by China, the IWG represented an attempt by the US to maintain a liberal regime of export credit governance by replacing the Arrangement with a new version that would incorporate the major emerging economies. The US identified this as a key strategic priority in its economic relations with China and, negotiators report, "pushed China very hard" to enter into and engage in the negotiations.[29] As one US official stated, "Everyone's hope are resting on the IWG – that it will be able to control China's ability to take everyone's lunch."[30] Other advanced-industrialized states have placed similar emphasis on the IWG as a means to create new, more universal rules on export credit.

Yet, given the centrality of export credit to their development strategies, China and the other emerging economies have little incentive either to join existing governance arrangements or subject themselves to new disciplines that could inhibit their future growth prospects. A representative of the US Chamber expressed it thus: "Their economies depend on their ECAs. I don't see a world where they're suddenly going to say 'OK, we don't need

[28] Interview, December 2017.
[29] Interview, July 2015.
[30] Interview, July 2015.

our ECAs'. That's just not realistic."[31] A party to the negotiations provided a similar assessment:

> China has vast resources – the amount of money available now is almost beyond belief. Their view is 'why the hell should we agree to not use these resources? These guys are trying to constrain our ability to achieve our rightful place in the world.' They don't see anything in it for them. It's not in their interest to accept these constraints. They provide so much export credit it's astounding. Beside the Chinese, the US Exim Bank looks like a corner bank in Aimes, Iowa. China is doing this on a scale that just dwarfs what's happening in the rest of the world. Why should they let anyone stop them? [32]

Not only does export credit form part of China's development strategy, but as China's growth has slowed in recent years, it has increasingly sought to export its excess industrial capacity. In this context, China has little or no interest in accepting restrictions on its use of export finance.

Consequently, despite significant pressure from the US, as well as other advanced-industrialized states, there has been little progress in the IWG. The IWG has held meetings every three to six months, but has been working at a "glacial pace" and yielded "negligible results" (Bergsten 2014). According to participants, this is primarily due to resistance from China: "China has been foot-dragging in meetings, slowing the process down and refusing to put any real proposals on the table. If China wanted to do a deal, than we could move quickly, but the fact is it doesn't."[33] Negotiators indicate that China has been "throwing up all kinds of process-based hurdles and obstructions" and "its actions indicate that it is not interested in moving forward."[34] As a result, there has been "very little movement" and "very little in the way of real negotiations."[35]

For the first three years of the IWG, China refused to engage in negotiations on a set of general, horizontal rules – the approach favored by the majority of participants. Instead,

[31] Interview, July 2015.
[32] Interview, July 2016.
[33] Interview, June 2016.
[34] Interview, July 2015.
[35] Interviews, June 2016.

China insisted that the IWG should begin only with "discussions" of export credit practices in two specific industrial sectors. At China's insistence, the sectors chosen were ship-building – although the US and several other IWG members have no export credit activities in that sector – and medical equipment – a sector without any significant export credit intervention (as one participant put it, "not even a real sector" from the perspective of export credit).[36] China also insisted on keeping core issues related to export credit provision – such as interest rates, premiums and transparency – out of the discussion. As a result, according to negotiators, the sectoral negotiations were "essentially useless" and "didn't really mean anything."[37] It was not until 2015 that China even agreed to begin discussions on a general, horizontal system of rules. In the words of one Western ECA official, "Now they've agreed to go to horizontal negotiations – it took 3 years to get to where we should have started in the first place."[38] And negotiators report that even now: "There's nothing *in* the negotiations yet" and no prospect of any agreement on the horizon.[39]

As a result, many participants have significantly lowered their expectations for the IWG. In the words of one senior US ECA official,

> What the US, EU and other OECD members want is a new version of the Arrangement – a comprehensive set of rules that incorporates the emerging economies. But that's exactly what China is *not* going to participate in. They're not going to play that game – negotiating a new version of the Arrangement. The best we can likely aim for is improved transparency. That alone would be quite an accomplishment in the world we have today.[40]

For the US and other advanced-industrialized states, improved transparency, even simply about what programs China is using, is an important objective of the IWG. But negotiators report that even this has been a "huge struggle."[41] So far within the IWG, it is only the

[36] Interview, June 2016.
[37] Interviews, June 2015.
[38] Interview, July 2015.
[39] Interviews, June 2016.
[40] Interview, July 2015.
[41] Interview, June 2016.

OECD members that have shared this kind of information – something they are already doing under the Arrangement – while China has refused to provide comparable information on its own programs.

One participant thus summed up the IWG negotiations as follows: “The process has been going on for years and there has been zero progress.”[42] Efforts by the US and other advanced-industrialized states to engage China and the other BRICs in multilateral negotiations to create new restraints on export credit – or even to share basic information about their practices – have proven fruitless. Though formally cooperating in the negotiations, China’s behavior has primarily served to subvert rather than advance the goal of arriving at a new set of disciplines. It is a sign of China’s newfound power that it has been able to exert such control over the agenda, process and pace of the negotiations and refused to be pressured or coerced into accepting rules that it views as against its interests.

The international regulatory regime for export credit has worked well for decades, but what was once a highly effective governance mechanism is now in danger of being subverted by the rise of new powers outside of that system. In the contemporary world of export credit, to quote one ECA official, “China is the 800-pound gorilla.”[43] Its substantial economic and political power have enabled China to act outside the bounds of the Arrangement and to resist pressures from the US and other traditional powers to agree to the creation of a new set of disciplines that would restrict its use of export credit. As one negotiator bluntly put it, “China is the new actor breaking everything to pieces.”[44] Among export credit practitioners, the rise of China and other emerging economies is therefore widely seen as the greatest single challenge to the existing governance regime.

[42] Interview, July 2016.
[43] Interview, July 2015.
[44] Interview, July 2016.

Inadequacy of WTO Disciplines

Amid the weakening of the OECD Arrangement's authority and the inability to reach agreement on a new version to replace it, one might expect the US and other advanced-industrialized states to turn to the WTO to compel China and other emerging economies to reign in their use of export credit. However, for the purposes of disciplining export credit, the WTO is a poor substitute for the Arrangement. Export credit is covered by the WTO Agreement on Subsidies and Countervailing Measures (ASCM), which disciplines the use of export subsidies. The OECD Arrangement is incorporated into the ASCM as a carve out to the illustrative list of prohibited export subsidies. This operates as a "safe harbor clause", ensuring that any use of export credit by a WTO member that is in conformity with the Arrangement's disciplines will not be considered a prohibited export subsidy under WTO rules (Wright 2011). Consequently, any WTO member who acts within the conditions set out in the Arrangement, regardless of whether they are a participant to it, is deemed to be in compliance with their WTO obligations (Shaffer et al. 2015).

This means that, technically, the Arrangement's disciplines are incorporated into WTO rules. However, they are nearly impossible to enforce at the WTO. Part of the reason the Arrangement was created in the first place is that the dispute settlement mechanism provided in the WTO, and its predecessor the GATT, is largely ineffective for disciplining export credit (Moravcsik 1989). First, WTO dispute settlement is generally considered too cumbersome and not fast enough to work well in this area. Given the lengthy nature of the WTO dispute settlement process, which often takes many years for a case to reach a conclusion, even if a country were to succeed in winning a determination that a competitor's financing for a specific transaction constituted a prohibited export subsidy, the case would not be concluded until years after that transaction had been completed and its exporter had lost the contract.

Second, in contrast to the real time transparency provided by the Arrangement, the WTO contains no comparable mechanism for the routine exchange of detailed and confidential transaction data. While Arrangement participants are required to share extensive information about their practices with one another, the export credit practices of non-participants are generally secretive and non-transparent, with the result that their competitors lack detailed information about their export credit policies and programs as well as the specific terms of individual transactions. This lack of information renders it extremely difficult to challenge export credit practices at the WTO.

Third, each time a state provides export credit, whether or not it is considered a subsidy will depend on the specifics of that transaction. As one negotiator stated, in order to challenge a state's export credit policies at the WTO, "you would need to bring a systemic case, but the terms and conditions of each transaction are different, so it is difficult if not usually impossible to bring a systemic case. Since it is very difficult to challenge a whole program, you would be left challenging individual transactions."[45] Consequently, there have to date been only two cases on (non-agricultural) export credit in the history of WTO dispute settlement – out of a total of over 500 disputes.[46]

There are thus fundamental differences in how disciplines work in the Arrangement compared to the WTO, with crucial implications for the governance of export credit. As one WTO official stated,

> The Arrangement works very well. Our rules are completely different in how they work and what they do. Short of prohibiting all use of export credit, there's little the WTO can do. Our structure and the way our rules work are not well-suited to this issue. The system at the WTO really only works for broad systemic issues, and it is almost completely useless for dealing with export credit because it's ex-post. Our system would never provide the day-to-day working and certainty of the OECD Arrangement.[47]

[45] Interview, July 2016.
[46] Brazil-Canada aircraft and EU-Korea shipbuilding.
[47] Interview, July 2016.

As a result of the way its rules and dispute settlement mechanism are designed and function, the WTO is ill-equipped to regulate export credit and cannot provide a viable alternative to the Arrangement.

Thus, while it would be theoretically possible to use the WTO's dispute settlement mechanism to challenge the use of export credit by China and the other emerging economies, WTO trade lawyers indicate that in practice this would be "extraordinarily difficult if not usually impossible."[48] As one indicated:

> China's use of export credit is potentially actionable at the WTO, yes. But the reason they created the system for governing export credit in the OECD in the first place is because our rules [at the WTO] have some profound weaknesses. Here, it's a 2-3 year process to take a case, plus 18 months of implementation, so maybe 5 years later – long after you have lost the contract – you could get a finding that the exporting country violated its WTO obligations. But by then, it's not like the transaction and the financing can be undone. So, in theory, one could challenge China on export credit, you could litigate it for 5 years, but what would you have at the end of 5 years?

In sum, "China could be vulnerable to a WTO challenge, but it would be expensive, take years to occur and be very hard to get a meaningful victory."[49] The WTO system is thus inadequate for disciplining state-backed export credit and provides little means for the US and other traditional powers to compel China to restrict its use of export credit.

Conclusion

As this article has shown, the global governance of export credit has been destabilized by the rise of China. Analysis of the OECD Arrangement and IWG negotiations indicates that contemporary power shifts are making multilateral cooperation to govern export credit increasingly difficult. From its hegemonic position, the US was the driving force behind the creation of the Arrangement and the continual strengthening of its disciplines; however, its current inability to press China into existing or new governance arrangements suggests the

[48] Interview, July 2016.
[49] Interview, July 2016.

capacity of the US to steer global rule-making is diminishing amid the rise of China. China's emergence as a major provider of government-backed trade financing has proven highly disruptive to the transparent, rule-bound, orderly system for the governance of export credit. Reluctant to relinquish an important industrial policy tool that is vital to its continued development, China has valid reasons to resist external disciplines on its use of export credit. But its unwillingness to either join existing governance arrangements or subject itself to new disciplines threatens what has until now been a highly effective regulatory regime and risks prompting a reemergence of destructive competition via export credit subsidies. The case of export credit thus throws into stark relief the tension between the development objectives of China and other emerging powers and the liberal international economic order.

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