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GENERAL AGREEMENT ON TARIFFS AND TRADE

EXPORT INFLATION INSURANCE SCHEMES

Report of the Working Party

1. At its meeting on 15 July 1976 (C/M/115) the Council established the Working Party on Export Inflation Insurance Schemes with the following terms of reference:

> "To examine, from the point of view of their effects on international commerce and in the light of the GATT provisions, export inflation insurance schemes and any other measures, direct or indirect, brought to the Working Party's attention, used to attenuate or compensate for the effects of cost inflation, and to report to the Council" (L/4415/Rev.1).

2. The Working Party met on 5 November 1976 and on 14-15 March, 16-17 May, 25-26 July and 12-13 September 1977 under the chairmanship of Mr. E. Selmer (Norway).

3. The Working Party had available the following documents:

L/4464	- Report (June 1976) of the OECD Group on Export Credits and Credit Guarantees, dealing with cost inflation insurance schemes, made available by that organization.
L/4467 and Addenda 1-3	- Information submitted by contracting parties relating to export inflation insurance schemes and other measures.
L/4491	- Communication from the European Communities.
L/4493	- Communication from Finland.
L/4506	- Statement by France.

I. EXAMINATION OF INDIVIDUAL EXPORT INFLATION INSURANCE SCHEMES

4. The Working Party carried out a detailed examination of the schemes introduced by Finland, France, Italy, Portugal, Spain and the United Kingdom based upon information supplied by these countries. In the course of this examination

questions were raised and answers were given by members of the Working Party concerning specific issues such as the products or sectors covered, the exporters' costs covered, the basis for calculation of cost increases, the threshold levels and premium rates, the limits on total coverage, the administration of the schemes, the budgetary implications, if any, historical data on financing including losses, the length of time the schemes have been in operation, any modifications to the schemes, and the rationale behind the introduction of the schemes and behind any modifications. In this context reference was made to the information submitted by contracting parties and reproduced in document L/4467 and Addenda 1-3, as well as to the information made available to the Working Party by the OECD and reproduced in document L/4464. The Working Party noted that the schemes of Italy and Spain were not presently in operation because of the extremely high rate of inflation in these countries.

5. In an introductory statement, the spokesman for the European Communities pointed out that there still existed a number of national systems within the European Communities. The issues relating to these systems were being studied at a Community level, especially as regards their relationship to the relevant provisions of the Treaty of Rome, and in respect to substantive issues which might arise through the nature and operation of such schemes, taking account of international obligations. This fact had certain consequences for the participation of the European Communities in the work of the Working Party.

6. In reply to a question why the schemes maintained by some of the member States of the European Communities did not apply to trade with other member States, the spokesman for the European Communities referred to Article 92 of the Treaty of Rome and pointed out that the status of these schemes under that provision had no bearing on their compatibility with the General Agreement because the latter did not stipulate the stricter obligations contained in the Treaty of Rome.

II. OTHER MEASURES

7. The Working Party discussed the issue of whether certain exchange rate guarantee schemes should be examined under its terms of reference. Communications on this subject were submitted to the Working Party by the European Communities (L/4491) and by Finland (L/4493).

8. The spokesman for the European Communities said that the issue of exchange rate guarantee schemes had been raised in the present context and should be discussed by the Working Party. In further explanation of this notification, he said that it was well established that there was a clear link between movements in national inflation rates and currency movements. It would not be claimed that inflation was the sole factor involved; but, especially in the period after the general floating of currencies, economic analysis had shown a very close

correlation between movements in inflation rates and currency performances. The European Communities believed that the effects of frequent currency movements had created general problems for international trade, e.g. in anti-dumping cases, and had led to certain modifications in the nature of export support systems. It would be necessary, if any analysis were to be fully valid, to consider the implications of these changes for the GATT rules as a whole, rather than attempt to reach conclusions based on examination of one element of this situation in isolation from the others.

9. In considering the impact of exchange rate guarantee schemes in these conditions, the European Communities felt it necessary to consider two examples, a high-inflation country and a low-inflation country. In the former case some support for the international competitivity of exporters was required because, against a background of rapid cost inflation, buyers would be unwilling to contract except at fixed prices - even if they might expect to benefit from the currency depreciation which often accompanies such continuing high inflation. In the second case inflation would not directly affect costs; but low inflation expectations were likely to lead to currency appreciation, and exporters in this situation equally required some protection of their competitivity, which would otherwise be eroded by the rising cost of their goods in foreign exchange terms. In both cases it was necessary to provide some mechanism to assist the exporter to overcome the differing phenomena resulting from the effects of inflation so that he could remain fully competitive.

10. In the cases described the difficulties arose where the contract was made in the currency of the exporter. It was evident that these problems could be avoided to some extent by contracting in other currencies which might be more favourable to the buyer or, in some cases, even to the exporter who faced a loss of competitivity due to appreciation of his own currency. In these cases the exporter could protect himself against the exchange risks involved either through the banking system or through government schemes where available. Where, however, these schemes were not financially self-supporting, the exporter had the same possibilities to quote a firm price without having to include the full cost of exchange risks, as was alleged to be the case under cost inflation insurance schemes. Exchange rate guarantees, therefore, constituted a means of protecting his competitivity which was precisely analogous to the cost escalation insurance schemes already examined.

11. The representative of Finland associated himself with the argumentation of the European Communities and said that the terms of reference should be interpreted in a flexible manner, including all schemes which might directly or indirectly attenuate or compensate for the effects of cost inflation. Thus, the exchange rate guarantee schemes should also be discussed in the Working Party. He said that these schemes in many cases might have similar motivations and

effects as the export inflation insurance schemes, and they might in certain circumstances lead to budgetary deficits for the governments operating such schemes. They should, therefore, be brought to the attention of the Working Party as an essential part of the terms of reference. If it were not deemed to be feasible by the Working Party to discuss such schemes, his authorities would, however, be open to other procedural solutions with respect to them.

12. The representatives of Japan, Switzerland and the United States did not agree that exchange rate guarantee schemes fell within the terms of reference and urged the Working Party to focus its attention on schemes or measures used to attenuate or compensate for the effects of c[illegible]ation in the exporting country. Some of these delegations stated that th[illegible] be opposed to discussing exchange rate guarantee schemes and simil[illegible] in a different GATT context if this were decided.

13. The representative of Switzer[illegible]idered, furthermore, that the link made between the exchange rate and inflatio[illegible] justify extending the Working Party's terms of reference was excessive, to say the least. The value of a currency was not always influenced by inflation rates and, moreover, other more important factors intervened to determine the exchange rate of a currency: trend in the balance of current payments, payment modalities for current transactions, capital movements, monetary conditions in the various countries, interventions by central banks, etc. Inflation in one country in relation to other countries was, therefore, only one of the numerous variables that influenced the exchange rate of a currency.

14. He underlined that exchange rate guarantee schemes ensured the exporter of earnings agreed to in foreign exchange, taking account of the cost as foreseen at the time when the contract was concluded and of the rate of exchange prevailing then. The exporter bore the effects of any subsequent deterioration in costs, which was not the case under a cost inflation insurance scheme.

15. He did not dispute that the two schemes tended to maintain exporters' competitivity. It noted nevertheless that the Working Party's terms of reference explicitly mentioned export inflation insurance schemes and measures used to attenuate or compensate for the effects of cost inflation. In that connexion it underlined that inflation insurance schemes were essentially designed to cover inflation of costs of domestic origin. The two methods were not comparable because they were designed to cover different situations and were subject to different influences. Exchange rate guarantee schemes were not, therefore, within the Working Party's terms of reference.

16. There was also a brief discussion of a tax measure maintained by Japan which had been brought to the attention of the Working Party followed by bilateral consultations between the delegations principally concerned. It was noted by some delegations that this measure appeared to offer certain tax accounting advantages in relation to specified contracts for overseas construction projects where the period of the contracts was in excess of three years. According to the information available these advantages were not available for similar contracts in the domestic market. Some delegations took the view that these advantages might enable enterprises of the country concerned to offset price increases to some degree and stabilize their contract price during the period of construction. The representative of Japan stated that the tax measure aimed to allow a company to disperse in a flattening manner the profit accruing from the contract over the whole accounting period which fell within the gestation period, rather than to concentrate it in the particular accounting period which coincided with the time of completion of contract object. The measure did not provide a company with tax exemption or tax refund. It was only applicable to such a company that made advance payment of the full amount of tax liability concerned. In this sense, it was not a tax deferment. This measure, therefore, did not aim at or entail any consequent effect to attenuate or compensate for the effects of cost inflation. He stated that the measure did not fall within the terms of reference of the Working Party, a view which was supported by some other members.

III. EFFECTS OF EXPORT INFLATION INSURANCE SCHEMES ON INTERNATIONAL COMMERCE IN THE LIGHT OF THE GATT PROVISIONS

17. The representative of the United States stated that his authorities considered export inflation insurance schemes to be subsidies in contravention of Article XVI:4 of the General Agreement, that they should be notified under the provisions of Article XVI:1 and that they should be dismantled promptly. He said that such schemes distorted international trade. In addition to being a disincentive to control costs, they conferred a competitive advantage to beneficiary exporters who could bid more aggressively on individual transactions in the international markets, secure in the knowledge that they would not have to bear alone their cost increases due to inflation. Moreover, since the guarantees applied only to the costs of products destined for export, they resulted in lower prices abroad for a given product than in domestic markets. He pointed out that efforts had been made in the Working Party to elicit information on individual transactions and on transactions by product category so as to show the extent of dual-pricing, but that those members maintaining such schemes would not divulge such information. He added that by their nature, whereby these guarantees were available for export transactions but not domestic transactions, they carried a presumption of dual-pricing. The evidence showed that such schemes tended to run significant budgetary deficits over time. In this connexion he noted that Italy had suspended its scheme because high inflation rates had made it too costly to

the Government, that Spain had not instituted a proposed scheme because of high inflation rates, and that France admitted its scheme had been in deficit for several years. He understood that the French scheme was likely to remain in deficit for the indefinite future. He said that even where such schemes were presently inactive, their mere existence constituted a potential threat to third-country exporters. He noted that these schemes lead other countries to develop similar subsidies in order to counter the trade distortions inherent in these schemes. He noted, although cost inflation insurance schemes were not included in the 1960 illustrative list of measures[1] considered to be export subsidies under Article XVI:4, that the 1960 list was not intended to be exhaustive and that export inflation insurance schemes fell within the general prohibition of Article XVI:4. He stressed the seriousness with which his Government viewed these schemes, called for their abolition, and noted that his Government reserved its rights to pursue this matter further either in the GATT or by other available means.

18. The representatives of Norway and Sweden said that their authorities' examination of the situation revealed that to the extent the schemes resulted in budgetary deficits, they constituted very substantial export subsidies incompatible with Article XVI. Furthermore, even when such schemes were designed to be self-financing, some governments had found it impossible, despite their best intentions, to meet claims for payments out of the premiums collected. In the view of their authorities, the schemes distorted competition in export markets and made it increasingly difficult for third-country exporters to include effective cost escalation clauses in their own contracts. In their countries, as in others, this had led to pressures to institute similar schemes. Moreover, the schemes tended to serve as a disincentive for modernization of production facilities and discouraged efforts aimed at countering inflation. They called for a dismantlement of the schemes, on a step-by-step basis, if necessary.

19. The representative of Japan expressed the strong concern of his authorities at the existence of the schemes under examination. Seen from a macroeconomic viewpoint, chronic inflation would continually hamper any efforts at running such schemes on a self-supporting basis, because over the longer term virtually all insured exporters would eventually be entitled to make claims for payment. He contrasted measures such as export credit insurance with the guarantees provided by the schemes under examination, and stressed that the likelihood of chronic inflation over a period of time meant that an insurance theory could not be applied to protection against cost inflation. He said that when such schemes resulted in a budgetary deficit and permitted exporters to sell at lower prices than in the domestic market, they constituted subsidies and were accordingly incompatible with the General Agreement and should be abolished as soon as possible.

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20. The representative of Canada said that his authorities were concerned about the large budgetary deficits that some export inflation insurance schemes had caused, and cited in this connexion the very large losses suffered since 1969 by the French scheme. In connexion with this particular scheme, he noted that although it had been revised, the basic elements remained in his view unchanged, and he also noted that losses incurred by the previous scheme would not be factored into the revised scheme. Therefore these losses should be considered to represent export subsidies. With regard to the scheme introduced more recently by the United Kingdom, he was of the view that this scheme also did not contain the necessary elements to ensure that it would be self-financing. He expressed the view that the restructuring of a scheme with the intent to achieve self-financing operations in the future would still amount to an overall subsidy to exporters unless provisions were made to absorb the losses already incurred prior to the modification. He noted that none of the schemes contained a formula or mechanism for frequent adjustment of premiums or scope of cover or both in case of losses. His Government, too, had found itself subject to pressures aimed at the establishment of a similar scheme so as to offset the competitive disadvantage suffered by his country's exporters. His authorities were, however, keenly aware of the need to avoid any proliferation of such schemes and sought their termination so as to prevent the global inflationary spiral that would inevitably result otherwise.

21. The representative of Switzerland said that although the existence of export inflation insurance schemes in some other countries had not yet appeared to have had serious repercussions in his own country, in the view of his authorities these schemes were nevertheless incompatible with the General Agreement and constituted an unfavourable influence on world markets. For these reasons the schemes should be eliminated.

22. The representative of France said that there were in existence several methods of covering export contracts in basically similar conditions. They included the adjustment of exchange rates under a floating rate system instead of maintaining fixed rates, the grant of guarantees against inflationary cost increases, the use of fiscal facilities or exchange guarantees, and the encouragement of exporters to conclude contracts in soft currencies. Before embarking on a detailed examination of one or other of those methods, it was important to ascertain the economic effects, both national and international, of those various devices. He rejected the idea that export inflation insurance schemes inevitably led to budgetary losses, and he quoted the example of France's own scheme, which had been designed to be self-balancing, and indeed had been self-balancing for some ten years, until unforeseen large-scale disorder in the economic and monetary fields had rendered that impossible since 1969. He also maintained that, in any case, the mere fact that an insurance scheme led to a charge against the budget did not render it incompatible with the GATT. Furthermore, the concern

expressed in the Working Party by certain other members of GATT had recently led the French Government to amend the structure of its scheme so as to enable it in future to operate independently. He also considered that the information that had been furnished, both officially and unofficially, answered the various questions that had been put to his Government in so far as those questions were compatible with the usual rules governing commercial confidentialities. In that connexion, he noted that no delegation had found any instance of dual-pricing, on the basis of the information furnished. Indeed, it was not the purpose of the scheme to establish a dual-pricing system, and there was no factual basis for asserting that the system had produced any such results.

23. The representative of Finland said that the unexpectedly high rate of world inflation had amplified the need to protect against cost increases, especially in those countries where the inflation rate had been significantly higher than the world average. His authorities recognized that in the light of the GATT provisions any schemes designed to reduce the effects of inflationary cost increases should not distort international trade, but should provide only partial compensation to exporters and should in the long run be self-supporting. The mere existence of the scheme could not constitute a subsidy, especially when the threshold and the premium were being continuously adjusted in order to maintain the scheme self-supporting. In his country, over the last few years the scheme, though being actively used, had in fact not only been self-supporting but seemed to have produced a slight surplus. He added that all relevant information had been made available to the Working Party.

24. The representative of the United Kingdom said that his authorities did not agree that export inflation insurance schemes were necessarily incompatible with the General Agreement. In his view there were two provisions of the GATT which were relevant to this question, both contained in Article XVI. Under the terms of Article XVI:1 contracting parties were required to notify the CONTRACTING PARTIES of the extent and nature of any subsidy granted or maintained by them. Under the terms of Article XVI:4 those contracting parties which subscribed to the provision of Section B of Article XVI (of which his country was one) were required not to grant any subsidy on the export of any products other than a primary product which resulted in the sale of such products for export at a price lower than the comparable price charged for the like product in the domestic market. He said that his delegation had produced all of the relevant information within the limits imposed by requirements with respect to commercial confidentiality and, in particular, information giving a breakdown by product category with applications for coverage and an illustrative numerical example. No indication of such dual-pricing had been presented to the Working Party. Particular exporters who made claims on cost escalation insurance were of course likely to derive a net financial benefit from it; but equally those who were not able to make claims would suffer a net financial loss. As with other kinds of insurance such as

export credit insurance and exchange risk insurance, there was no necessary presumption that dual-pricing would occur. In each instance the exporter bought a specified measure of security and paid a price for it. The crucial question was whether that price was a realistic one. The compatibility of the schemes in question with Article XVI in fact turned on the question of financial viability. In this context the 1960 illustrative list of export subsidies contained a useful criterion in relation to export credit guarantees which might be applicable by analogy to export inflation and other insurance schemes. Applying this criterion, he stated that his own country's scheme did not "operate at premium rates manifestly inadequate to cover its long-term operating costs and losses". The scheme was intended to operate as an insurance scheme and not as a subsidy and had not resulted in any budgetary deficit to date. Any judgment about the future financial out-turn had to be based upon the relationship of the premium to the very restricted cover given. An illustrative numerical example had been discussed bilaterally at the request of another delegation in order to clarify this relationship. On the basis of present trends the relation of cover to premium seemed well calculated to maintain the financial viability of the scheme through time. The scheme was in any case subject to periodic review and the cover given under it could be varied if necessary, as could the premium. Other criticisms of export inflation insurance schemes appeared simply to assume that they did not charge realistic premium rates. The claim that such schemes conferred an unfair competitive advantage, distorted competition rather than remedying existing distortions, or presented a disincentive to control costs were not valid where the security purchased by the exporter was bought at a fair price. In sum, it had not been shown that schemes which operated in financial equilibrium caused prejudice to the interest of contracting parties to the GATT.

25. Some members of the Working Party expressed no view as to whether the schemes under examination were incompatible with the provisions of the General Agreement.

IV. GENERAL CONSIDERATIONS

26. The Working Party could not reach any unanimous conclusion as to the compatibility of the export inflation insurance schemes with the provisions of the General Agreement.

27. Several members of the Working Party held the view that export inflation insurance schemes under examination by the Working Party were subsidies in contravention of Article XVI:4 and should be notified under Article XVI:1. These members expressed special concern over the degree of subsidy involved in one scheme which had incurred substantial losses financed by the government.

28. These and several other members of the Working Party expressed concern over the distortive effect which these schemes had on international trade in products covered by the schemes, and over the fact that these programmes encouraged the adoption of similarly distortive measures by other nations. These members called for the termination of existing programmes.

29. Several other members of the Working Party held the view that export inflation insurance schemes were only in contravention of the General Agreement where they could be shown to be subsidies under the terms of Article XVI. Some of these members, particularly those at present operating export inflation insurance schemes, considered that schemes operating in long-term financial equilibrium were not subsidies, were in conformity with the General Agreement and did not have distortive effects on international trade. They did not believe that any indication of dual-pricing as defined in Article XVI:4 or of any such distortion had been produced in the Working Party. In consequence, these members did not subscribe to the call for the termination of existing schemes.

30. Some members of the Working Party expressed no views.

31. The Working Party was also unable to reach consensus on the question whether the other measures mentioned in paragraphs 7 to 15 above fell under its terms of reference. The Working Party therefore decided to draw the attention of the Council to this fact.