WORKING TOWARDS COMPLIANCE: ADDRESSING CHINESE EXPORT CREDIT PROGRAMS

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INTRODUCTION

In 2011, the United States Export-Import Bank (the “United States Bank”) secured over 700 American jobs in Erie, Pennsylvania when it helped General Electric (“GE”) match a financing offer from the Chinese Export-Import Bank (the “Chinese Bank”).1 At stake was a U.S.D. $500 million contract to supply diesel-electric locomotives to Pakistan.2 The Chinese Bank offered to finance the deal at below market rates – in breach of international standards – in order to give its exporter an advantage in the bidding process.3 Although the Pakistani government favored GE for the high quality of its merchandise, a deal of this magnitude is often decided not only by the price and quality of the goods, but by the terms of available financing.4

The United States Bank is usually not privy to the details of the Chinese Bank’s financing offers, making it time-consuming and difficult to ascertain the terms – and expensive to match them. This time, however, the United States Bank discovered the terms of the Chinese Bank financing package from the Pakistani government and matched it.5 By equalizing the financing offers, the United States Bank allowed GE to compete with foreign producers on a “level playing field” – where success is determined on the basis of the price and quality of the merchandise. This little-known function of the United States Bank is critical to the success of American

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2 Id.
3 Id.
4 Id.
5 Id.
exporters competing for international contracts. Unfortunately, this outcome is difficult to achieve.

China’s export credit regime poses a unique challenge to American export interests. The Chinese government offers trade finance packages that support the sale of Chinese goods at below capital-market rates. China’s extensive government resources, coupled with its lack of transparency, have made it difficult for the United States Bank to compete with its Chinese counterpart for major international contracts. However, the Chinese market holds enormous opportunity for American businesses, and it will undoubtedly play a key role in the future of international commerce. The United States must determine the best legal mechanism to encourage China to comply with international trade standards, without triggering a retaliatory response that would jeopardize the expansion of American exports into China.

Export-Import Banks are government-backed agencies that help domestic exporters seize opportunities in international markets. The banks offer financing in the form of officially supported export credits. Export credits are a form of subsidy in which the government assumes an exporter’s risk of a foreign buyer’s default. Export credits come in the form of direct loans, guarantees, or insurance, and are typically used in medium to long-term financing situations in which traditional private financing is not available because of the high risk. The United States Bank strives to level the playing field for American exporters by matching the financing that other governments provide to their exporters. Most countries now have some form of Export Credit Agency that facilitates the export of that country’s goods and services to other developing and

7 Id at 108.
8 See Oversight, supra note 1, at 8.
11 Id.
12 Id.
13 Id. at 147.
14 Id. at 148, 158–59.
developed markets. Therefore, failure to provide the same services to American firms would put them at a comparative disadvantage when vying for foreign business.

Theoretically, international trade promotes efficiency by allowing states to produce goods and services in which they have a comparative advantage, while importing those that are more cheaply developed elsewhere. In reality, exports are heavily influenced by political relationships between states, and each state must find an acceptable balance between protecting domestic industries and engaging with foreign markets. Economists disagree, however, on the appropriate level of government intervention in trade between states. Proponents of Export Credit Agencies claim that they provide a vital service by correcting market failures that prevent companies from exporting at the optimal level. The most widely cited market failure is imperfect information regarding exporting opportunities, available financing, and export regulations. Advocates contend that a national government is in the unique position of having both the resources and the incentive to step in and correct this inefficiency.

Opponents of export credit programs argue that they are ineffective, inefficient, and damaging to private sector financing, specifically, and international free-trade efforts, generally. These critics claim that the free market will optimize the level of exports and that export credits create market distortions that benefit select industries to the detriment of the economy as a whole. In addition, economists worry that government funding of exports could lead to an international “race to the bottom” with states becoming entangled in “subsidy wars” that undermine the benefits of international trade. In response to this legitimate concern, several international trade organizations have developed criteria governing the

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15 See Id. at 158.
17 Id. at 9.
18 See Id.
19 Id. at 27.
20 Id. at 24.
21 Id.
22 Ilias, supra note 16.
23 Id. at 27.
24 Id.
25 Id.
terms and conditions of such lending.\(^{26}\) Unfortunately, enforcement of the export credit criteria has been costly and uneven, especially in regards to developing countries, like China, that do not belong to the Organization for Economic Cooperation and Development (“OECD”).\(^{27}\)

Section one of this note examines United States-China trade history, compares the export credit programs of the two countries, and outlines the international legal framework for export credits. Section two analyzes the difference between the OECD Arrangement on Officially Supported Export Credits (“the Arrangement”) and the World Trade Organization (“WTO”) rules under the Agreement on Subsidies and Countervailing Measures (“ASCM”) and postulates that the OECD Arrangement provides the most effective legal framework for encouraging transparency and compliance in China’s export credit programs.

I. BACKGROUND

A. History of United States-China Trade Relations

The United States opened trade relations with China in 1980 through a bilateral trade agreement (the “1980 Agreement”).\(^ {28}\) Under the 1980 Agreement, the two countries agreed to afford each other “most-favored-nation treatment” and to establish “their trade relations on a non-discriminatory basis.”\(^ {29}\) The treaty also included an explicit agreement to “facilitate the availability of official export credits on the most favorable terms appropriate under the circumstances.”\(^ {30}\) However, certain provisions of the “Jackson-Vanik Amendment”\(^ {31}\) of the Trade Act of 1974\(^ {32}\) prohibited


\(^{29}\) Id.

\(^{30}\) Id.

normalized trade relations with Marxist-Leninist countries, and as a result, trade relations with China had to be renewed annually through a Presidential waiver.  Congress could have overturned this annual waiver, leaving the status of the 1980 Agreement uncertain and putting stress on the relationship between the two countries.

Since that first agreement, the United States and China have entered into several agreements concerning questions of market access, intellectual property rights, and agricultural cooperation. In 1999, China and the United States signed a new bilateral treaty in anticipation of China’s accession to the WTO. WTO accession procedure calls for bilateral negotiations between the applicant state and any concerned member state. As part of the negotiations between the United States and China, the United States retained the right to treat China as a non-market economy for twelve years following its accession into the WTO. As a result, the United States was allowed to “proclaim increased duties or other import restrictions” when Chinese imports were considered to be causing a “market disruption.” Then in 2000, the Permanent Normal Trade Relations for China Act (the “PNTR Act”) amended the Trade Act of 1974 and rendered the Jackson-Vanik Amendment inapplicable to China. While these steps helped to stabilize trade relations between the two countries, there remained an air of distrust and hostility.

The PNTR Act established various Congressional committees to monitor China’s compliance with its trade as well as human rights commitments. These requirements are unique to China in United States trade legislation. When the United States signed bilateral trade agreements with the former Soviet bloc countries and even with the U.S.S.R. directly, it did not require the wide array of compliance

34 Wise, supra note 33, at 568.
36 Wise, supra note 33, at 571.
40 Wise, supra note 33, at 571.
41 Id. at 579.
42 Id.
monitoring programs utilized in the Chinese agreement. These unusually stringent standards and restrictions further undermined trust and cooperation between the two countries. China’s meteoric rise as an economic world power, coupled with its protectionist policies and export-driven economy, has added to the fears in the United States that China represents a threat to American interests.

Despite the political and economic tensions between the two countries, China is the third largest market for United States exports, behind Canada and Mexico. In 2010, China imported U.S.D. $91.9 billion of American goods. Exports to China rose 32% in 2010 and have risen by at least 15% annually since 2000. In fact, total American exports to China rose by 468% between 2000 and 2010, compared to a 55% increase in total American exports to the rest of the world. Not only does China represent a consistent and expanding market for American exports, generally; it is also the third largest market for goods and services produced by American small businesses. However, there is still significant room for growth in American exports to China. According to the U.S.-China Business Council, “the United States [is] only the fifth-largest source of imports” to China and the United States’ share of imports has actually declined since 2000.

In response to the current recession, the Obama administration has made expansion of American exports a priority. In the 2010 National Export Initiative, the President outlined a strategy to boost the ailing United States economy by improving access to export financing, including export credits. The Administration cited the need to “create good high-paying jobs” through exports and vowed to help American companies increase exports to foreign markets. Although the Chinese market is one of the fastest growing economies in the world, the United States has struggled to

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43 Id.
46 Id.
47 Id.
48 Id.
49 Id.
50 Id.
52 Id.
53 Id.
gain access to its consumers.\textsuperscript{54} In addition, the Chinese Bank provides trade finance packages to Chinese firms at below market rates, allowing Chinese competitors to outbid American firms for other international contracts.\textsuperscript{55} In light of the contraction of economic opportunities at home, the United States has refocused on the necessity of improving and expanding trade relations with China.\textsuperscript{56}

In recent years, the United States has engaged with China to solve trade finance and other issues through the U.S.-China Strategic and Economic Dialogue (the “S&ED”).\textsuperscript{57} The S&ED is the second generation of the Strategic Economic Dialogue, which was established in 2006 between former President George W. Bush and Chinese President Hu Jintao.\textsuperscript{58} In 2009, President Obama and President Hu agreed to continue the long-term, high-level strategic discussions but split the program into two separate tracks – one strategic and one economic.\textsuperscript{59} The economic track, run by the Secretary of the Treasury, focuses on financial and economic issues, including export finance.\textsuperscript{60}

Since President Obama assumed office, there have been four economic track sessions.\textsuperscript{61} These sessions have aimed to deepen bilateral cooperation and expand Chinese participation in international economic forums, as well as to encourage the continued reform of Chinese economic policies.\textsuperscript{62} Specifically, the May 2010 S&ED session produced a pledge to “[e]stablish a cooperative mechanism between the U.S. Export-Import Bank and the Export-Import Bank of China on trade finance, and to develop initiatives to promote exports by [small and medium sized firms].”\textsuperscript{63} Two of the other pledges were to “[s]ign a cooperation protocol on small and medium sized firms (SMEs)” and to “[b]oost investment opportunities and transparency.”\textsuperscript{64} Despite this language, China is not mentioned in the United States Bank’s strategic plan for 2010 through 2015, which was

\textsuperscript{54} See THE U.S.-CHINA BUS. COUNCIL, supra note 9 (“America’s share of imports into China has fallen to 7 percent from 10 percent in 2000, making the United States only the fifth-largest source of imports there.”).

\textsuperscript{55} See Oversight, supra note 1.

\textsuperscript{56} See WAYNE M. MORRISON, CONG. RESEARCH SERV., RL33536, CHINA- U.S. TRADE ISSUES 43 (2012).

\textsuperscript{57} Id.

\textsuperscript{58} Id.

\textsuperscript{59} Id.

\textsuperscript{60} Id. at 43–44.

\textsuperscript{61} Id. at 43–45.

\textsuperscript{62} Morrison, supra note 56, at 43–44.

\textsuperscript{63} Id. at 44.

\textsuperscript{64} Id.
published by the Bank two months after these encouraging objectives were set in the S&ED.\textsuperscript{65}

The United States Bank’s strategic plan outlines specific goals and objectives, the first of which is to “[e]xpand awareness of Ex-Im Bank services through focused business development and effective partnerships.”\textsuperscript{66} This goal asserts that the United States Bank must develop partnerships and identify strategic outreach areas in order to maximize job creation and growth.\textsuperscript{67} One of the specific objectives highlighted under this overarching goal is to “[t]arget business development to countries with high potential for U.S. export growth.”\textsuperscript{68} The plan then identifies nine “focus countries” in which to concentrate outreach efforts.\textsuperscript{69} The countries are selected based on the size of their export market for American firms, their projected growth and infrastructure needs, and the United States Bank’s current penetration into their markets.\textsuperscript{70} Despite meeting all of these criteria, China is not one of the nine countries identified.\textsuperscript{71}

For the countries that are identified, including India, Brazil, and Vietnam, the plan indicates that the United States Bank should develop an outreach strategy that includes identifying targeted buyers in the public and private sectors, as well as areas where pre-approved credit facilities can be utilized to support SMEs.\textsuperscript{72} The strategic plan strives to “create an integrated business development function to manage activity and outcome-based measures in [the target countries]” and to “[a]lign senior bank officials’ outreach with these high-priority countries.”\textsuperscript{73}

Given that China faces a looming threat of WTO action from the European Union or the United States for its expansive export subsidy program, the S&ED offers an alternative forum for China to accede to international standards before being faced with expensive litigation.\textsuperscript{74} The


\textsuperscript{66} Id. at 11.

\textsuperscript{67} Id.

\textsuperscript{68} Id. at 12.

\textsuperscript{69} Id.

\textsuperscript{70} Id.

\textsuperscript{71} Strategic Plan, supra note 65, at 12.

\textsuperscript{72} Id.

\textsuperscript{73} Id.

S&ED meetings are generally comprised of the top fifteen to twenty agency heads from each country, striving to address the long-term and over-arching challenges that confront both sides. While this forum provides an invaluable opportunity to build partnership and understanding between the United States and China, its centralized and high-level structure may not be the best way to affect the United States’ goals of achieving greater market access and collaboration on the ground level.

B. *Export-Import Bank Programs in the United States and China*

The Export-Import Bank of the United States was created by executive order in 1934 “in an effort to stimulate the economy” through exports in the face of the Great Depression. The Export-Import Bank Act of 1945 eventually established the United States Bank as a United States government corporation and outlined the law that still largely governs the United States Bank’s activities. As a government corporation, the United States Bank’s existence is contingent on its periodic reauthorization, which must clear the Senate Committee on Banking, Housing, and Urban Affairs, be passed by both houses of Congress, and be signed into law by the President. A Board of Directors appointed by the President manages the Bank.

The United States Bank offers several financial instruments that contribute to its mission of “turn[ing] export opportunities into real sales that help to maintain and create U.S. jobs and contribute to a stronger national economy.” The primary products offered include direct loans, working capital and loan guarantees, and commercial and political risk insurance. The Bank can extend these tools directly to foreign buyers of American goods, or to private lenders who would not be willing to finance risky export ventures without the backing of the United States Bank. United States Bank products are backed by the full faith and credit of the

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75 Morrison, supra note 56, at 43.
77 Id.
78 Id.
79 Id. at 745.
81 Bryant, supra note 76, at 746–47.
United States government, which allows private lenders to offset their exposure to the export transaction against the United States Bank guarantee.\(^8\) Therefore, the lenders are able to provide financing that would have otherwise been unavailable to an aspiring American exporter.\(^4\) However, United States Bank financing is not available for all potential export transactions.

In order for a transaction to be granted financing assistance from the United States Bank, the product, producer, buyer, and the structure of the deal must all meet the specific criteria of the Bank.\(^5\) The United States Bank is only permitted to fund the export of goods or services that meet the required threshold of content made in the United States.\(^6\) In addition, because the United States Bank is not permitted to compete with private sources of financing, it “operates in a narrow band, creating additional exports that are not attractive financing candidates in the private sector but nonetheless offer the United States government a ‘reasonable assurance of repayment.’”\(^7\) Potential projects are subject to restrictions based on the type of product, the identity of the purchaser, and the possible uses for the good or service.\(^8\) The Bank must also consider whether there might be adverse impacts on human rights, American jobs, and a host of other political considerations.\(^9\)

In comparison, the Chinese export finance system has significantly fewer restrictions and exponentially deeper pockets. China’s export financing infrastructure consists of three main institutions: Sinosure, the China Development Bank, and the Chinese Export-Import Bank.\(^10\) Sinosure provides short, medium, and long-term export credit and foreign investment insurance.\(^11\) Sinosure also offers direct lines of credit and comprehensive support to companies in strategic industries, such as telecommunications and photovoltaics.\(^12\) Neither the United States, nor any other G7 country, offers such a program.\(^13\) The China Development Bank also supports

\(^8\) Id. at 72–73.
\(^4\) Id. at 73–74.
\(^5\) Id. at 74.
\(^6\) Id.
\(^7\) Id. at 73–74 (quoting 12 U.S.C.A. § 635(b)(1)(B) (West 2012)).
\(^8\) Levit, supra note 82 at 74.
\(^9\) Id.
\(^10\) EXP.-IMP. BANK, supra note 6, at 108.
\(^11\) Id. at 111.
\(^12\) Id. at 111–12.
\(^13\) Id. at 112.
strategic industries with direct loans.\textsuperscript{94} In 2010, the Development Bank issued over $112 billion in foreign loans to Chinese companies doing business overseas.\textsuperscript{95} For the purposes of this note, I will focus on the Chinese Bank programs, which are closely analogous to United States Bank export credit programs.

The Chinese Bank provides concessional loans, lines of credit, and guarantees.\textsuperscript{96} The Concessional Loan Program is loosely comparable to the concept of “official development assistance,” which provides loans containing at least a 25% grant to developing countries for “anti-poverty” projects.\textsuperscript{97} However, the Chinese Bank is believed to provide these loans for projects not directly tied to development initiatives, at terms as low as 1-2% interest with a twenty to thirty year repayment schedule.\textsuperscript{98} Generally, international standards require repayment schedules of twenty years or less at Commercial Interest Reference Rates (CIRR).\textsuperscript{99} In addition, the concessional loans are given as a form of “tied aid,” which requires that the recipient country use the funds to purchase Chinese goods.\textsuperscript{100} Tied aid is a prohibited practice according to international standards, except for loans made to least-developed countries.\textsuperscript{101} Although there are no official figures published on the volume of China’s tied aid loans, annual volume is estimated to be in the billions of dollars.\textsuperscript{102} China is not a member of the OECD and is therefore not bound by the terms of the Arrangement.\textsuperscript{103} Since the United States is a participant in the Arrangement, it abides by the various restrictions that the Arrangement outlines regarding terms of repayment, interest rates, and restrictions on concessional lending.\textsuperscript{104}

The Chinese Bank also extends individual lines of credit to Chinese companies in order to finance the export of Chinese goods and services to complete projects in foreign countries.\textsuperscript{105} A single line of credit under this program has been known to exceed $1 billion, and the total volume of these

\textsuperscript{94} Id.
\textsuperscript{95} Id.
\textsuperscript{96} EXP.-IMP. BANK, supra note 6, at 108–110.
\textsuperscript{97} Id. at 110.
\textsuperscript{98} Id.
\textsuperscript{99} Id. at 109–13
\textsuperscript{100} Id. at 108.
\textsuperscript{101} Id.
\textsuperscript{102} EXP.-IMP. BANK, supra note 6, at 109.
\textsuperscript{103} Id. at 108.
\textsuperscript{105} EXP.-IMP. BANK, supra note 6, at 109.
loans in 2010 is believed to have been over $30 billion. In addition to the tied aid and general industry funding programs, the Chinese Bank provides about $3-5 billion annually in financing for specific export transactions, such as the Pakistan locomotive project discussed in the introduction to this note.

In these transactions, the Chinese Bank competes directly with the United States Bank to facilitate its exporter’s competitiveness in international markets. Unfortunately, the United States Bank is regularly unable to match financing packages offered by China Bank, which provides more favorable terms than international standards allow. The United States Bank protests that Chinese subsidies distort the export market and unfairly disadvantage United States exporters by preventing competition based on the quality and price of exported goods. The United States government contends that China’s extensive program of export support is in violation of WTO regulations on export subsidies and international standards established by the OECD. In aggregate, the Chinese export credit programs are estimated to total over $100 billion a year.

C. The International Framework for Export-Import Banks Generally

During the 1960s, the export credit system began to drag states into a costly and inefficient subsidy war. States were competing for export market share by offering below market interest rates and financing packages through their export credit agencies. Each state fought to make its own exports the most attractive, resulting in rising government costs and severe market distortions. When the oil crisis took hold in the early 1970s, it made the export financing battle prohibitively expensive and prompted the beginning of international cooperation to set standards for export credit programs. Finance ministers from major exporting countries first discussed an agreement in 1973, and in 1976, member countries of OECD

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106 Id.
107 Id. at 109–10.
108 Id. at 110, 112-13.
109 See generally Id. at 110–17.
110 Id. at 110.
111 EXP.-IMP. BANK, supra note 6, at 113.
112 Levit, supra note 82, at 66.
113 Id.
114 Id. at 75–76.
115 Id.
formed the “Consensus on Converging Export Credit Policies.” In 1978, this agreement matured into the Arrangement on Guidelines for Officially Supported Export Credits (the “Arrangement”).

The goal of the Arrangement is to “facilitate fair, efficient and transparent competition among OECD members and other partners.” Essentially, the Arrangement is meant to “level the playing field” by preventing competition between export credit agencies so that the exporters themselves can compete fairly on the basis of the price and quality of their goods. Although the Arrangement is not legally binding, it nevertheless enjoys widespread compliance from OECD member countries.

On its website, the OECD describes the Arrangement as a “gentlemen’s agreement’ under which governments negotiate, monitor, and review the rules, conditions, and changing market realities that impact the use of state financing in trade.” However, because the Arrangement is administered through the OECD, pressure to comply with the terms of the Arrangement generally extends only as far as the OECD’s 34 member countries.

Unfortunately, this excludes some major emerging economies that have become significant players in the export market, such as India and China. In 2010, at the OECD’s 50th anniversary celebration, the Secretary General recognized that “our next major objective must be extending existing co-operation to the emerging economies, which represent a new and important group of global export competitors.”

Although the major developing countries are not participants in the Arrangement, they are still subjected to Arrangement terms indirectly through their membership in the WTO. The ASCM separates subsidies into two classes: prohibited subsidies, which are conditioned upon export performance or local content requirements; and actionable subsidies, which

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116 Id. at 76.
117 Id.
118 Trade, supra note 27.
119 See Levit, supra note 82, at 77.
120 Id. at 77, 88–91.
121 Trade, supra note 27.
123 Id.
124 Trade, supra note 27.
includes all other kinds of subsidies.\textsuperscript{125} Actionable subsidies require a showing of adverse effects on the domestic market of a member country, impairment of benefits, or serious prejudice.\textsuperscript{126} Prohibited subsidies are considered per se actionable and only require evidence that the prohibited subsidy exists.\textsuperscript{127}

Export credits, export credit guarantees, and export insurance programs are all prohibited subsidies, unless they are provided at premium rates that are sufficient to cover the cost of administering them.\textsuperscript{128} Export credits are also illegal if “they are used to secure a material advantage in the field of export credit terms.”\textsuperscript{129} However, the ASCM pulls directly from the Arrangement to create a safe-haven for the use of export credits under certain terms and conditions.\textsuperscript{130} The ASCM provides that any export credit issued within the interest rate provisions proscribed by the Arrangement will not be considered a prohibited subsidy.\textsuperscript{131} A credit that offers more favorable rates than the OECD minimum would therefore be illegal and challengeable in the WTO Dispute Settlement Body (“DSB”).\textsuperscript{132}

The allusion to the Arrangement in the ASCM has been interpreted by WTO Panels as “evolutionary” in nature – meaning the current version’s Arrangement rates are incorporated into WTO law.\textsuperscript{133} Therefore, although only OECD Participants can update the Arrangement, changes to the Arrangement’s interest provisions would be binding on all WTO members.\textsuperscript{134} Brazil has challenged this setup as procedurally flawed because the ASCM could essentially be altered without the necessary

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\textsuperscript{126} Id. at 401.
\textsuperscript{127} Id.
\textsuperscript{129} ASCM, \textit{supra} note 26, at Annex I.
\textsuperscript{130} Id.
\textsuperscript{131} WORLD TRADE ORGANIZATION, \textit{supra} note 128.
\textsuperscript{133} WORLD TRADE ORGANIZATION, \textit{supra} note 128.
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Brazil advocated an amendment that would tie the ASCM to the interest rate provisions in the Arrangement as they were at the end of the Uruguay Round. However, no such change has been implemented.

In the event that a WTO member believes that another member is supporting a prohibited subsidy, the complaining member can request consultations with the offending country. A request for consultations must include a statement of evidence regarding the nature and existence of the challenged subsidy.

II. Analysis

Two major bodies of law shape the international system of export credit regulation: the ASCM and the Arrangement. While the Arrangement is considered non-binding “soft law,” its interest rate provisions have been codified into public international law through the safe-haven provision of the ASCM. The ASCM is considered “hard law” and is binding on the actions of member countries, with violations resulting in punitive enforcement action against the perpetrator.

Realistically, all public international law is to some degree soft because there is no direct enforcement mechanism at work to demand compliance. Any enforcement procedure ultimately relies on the cooperation of sovereign nations to comply with a ruling or take action against a non-compliant member. However, the differences between the two systems may prove instructive on eliciting Chinese compliance. Since the Arrangement is considered soft law, it anticipates, and therefore guards against, the natural inclination of participants to shirk the agreement when it proves inconvenient.

While the Arrangement and the ASCM strive to achieve the same results, there are several instructive differences between the two systems. Divergences in accession, rule-making, and enforcement procedures

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135 WORLD TRADE ORGANIZATION, supra note 128.
136 WORLD TRADE ORGANIZATION, supra note 134.
137 WORLD TRADE ORGANIZATION, supra note 128.
138 ASCM, supra note 26, at Art. 4.1.
139 Id. at Art. 4.2.
140 See Levit, supra note 83, at 119–21.
141 Id. at 115–16, 119–21.
142 Id. at 120–21.
143 Id. at 115–116.
144 Id. at 115–18.
elucidate the effects of subtle variations in compliance mechanisms in international trade law. Although shortcomings in international law are often blamed on the absence of strong commitments and substantial enforcement mechanisms, the juxtaposition of these two systems shows that a soft approach might achieve a greater degree of compliance from emerging economies, such as China.

A. The Arrangement’s Undefined Legal Status Provides Reputational Capital with Minimal Legal Risk

The Arrangement offers China a forum to build trust and transparency in the realm of international trade finance. The legally ambiguous form of the Arrangement provides reputational capital with very little legal risk. Given China’s reticence to taking a leadership position in international regulatory matters, the Arrangement’s fluid structure would most likely be an attractive option. Considering that over half of all trade subsidy challenges globally are levied against Chinese products, it is in the government’s immediate and long-term interest to cultivate international goodwill in order to minimize litigation costs. China’s participation would also benefit the United States, as China would be drawn into substantive discussions that would help shape the future of export credit regulation. Presumably, if China were integrally involved in developing regulations, they would be more inclined to adhere to them. The Arrangement’s low barriers and vague legal status encourage an important first step toward compliance – substantive engagement in the regulatory process.

The Arrangement does not require a lengthy and complex accession process. Countries may join the Arrangement simply by applying its guidelines and then receiving an invitation from existing participants to become a member. Countries may also participate in Arrangement discussions as observing members, as China currently does under the Aircraft Sector Understanding. Participants may also withdraw at any time by providing notice to the other Participants. In contrast, accession

146 Arrangement, supra note 26, at 5 (Current participants can invite other OECD members and non-members to become participants).
147 Id. at 9.
149 Arrangement, supra note 26, at 7.
to the WTO requires extensive hearings and negotiations to address the concerns of each member state. The applicant’s membership is only granted when concerned states have worked out individualized bi-lateral agreements with the applicant and every member state assents.

Although it seems counterintuitive, a less demanding legal structure may produce better compliance results from China than the regimented ASCM structure. The Arrangement’s regime is based on positive reinforcement and the benefits to participants are significant. For example, China would be able to help shape the direction of future export finance regulations because rules are promulgated based on the unanimous consensus of participants. As a participant, China would be able to prevent the formulation of new standards that would be too costly or detrimental to its emerging economy. Instances, and therefore costs, of future litigation may also decline as a result of this rule-making power.

Another benefit of the Arrangement’s flexible structure is its use of a notification and matching procedure in lieu of formal litigation. Although the Arrangement does import a sanction-based mechanism through its association with the ASCM, China is already exposed to the ASCM system through its WTO membership. Therefore, China would not expose itself to an additional adjudicatory system by participating in the Arrangement. In addition, if China joined the Arrangement and determined that the costs of transparency were too high, it could simply withdraw from the Arrangement and, because of its soft law form, suffer only reputational repercussions.

Despite the indefinite legal status of the Arrangement, its reputational bonds are quite strong. Not only does the small, relatively constant representation provide a “club like” atmosphere of mutual trust and respect, it also greatly compounds reputational repercussions from non-compliance. In contrast to the WTO, which has 153 member states, the Arrangement has only nine participants (counting the European Union as one). This small group consists exclusively of major players in the

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150 See ACCESSIONS, supra note 37.
151 Id.
152 Levit, supra note 82, at 109.
153 Arrangement, supra note 26, at 10.
154 ASCM, supra note 26, at Annex I (k).
155 Arrangement, supra note 26, at 7.
156 Levit, supra note 82, at 107–08.
158 Arrangement, supra note 26, at 5.
export finance market, which results in focused debate and meaningful progress on export finance issues. Representatives to the WTO are general ambassadors charged with pursuing a wide array of trade-related initiatives. In comparison, representatives to the Arrangement are usually lifetime bureaucrats from each country’s export credit agency. These representatives have direct responsibility for the export credit programs and policies in their own countries, including responsibility for negotiating and implementing the agreed upon standard.

B. The Arrangement Encourages Ex-Ante Resolution of Conflicts Instead of Ex-Post Litigation

The Arrangement’s soft law flexibility could be a useful tool for China as it works to liberalize and balance its economy. As the former Chinese ambassador to the WTO noted, “new challenges are rising for Chinese exports” as a result of the global recession. Contracted global demand and increased litigation against Chinese export programs have slowed China’s export driven economy. In response to the recent intensification of international scrutiny, the Chinese government has pledged to expand imports in order to balance trade and mollify competitors.

Similar to the conditions that gave birth to the Arrangement, the current economic recession seems to have highlighted the dangers of an overly export reliant economy and illuminated the benefits of minimizing costly disputes. Although China still enjoys a significant trade surplus, trade remedy cases have hurt Chinese exports and are expensive to defend. It is unrealistic to assume that trade disputes between the United States and China would dissipate if China were to join the Arrangement. However, the dispute resolution mechanisms available under the

160 Levit, supra note 83, at 108–09.
161 Id.
162 Qingfen, supra note 145.
163 Id.
165 Qingfen, supra note 145.
Arrangement would provide an alternative forum to solve disagreements before final financing deals are reached.

One such mechanism is the enquiry system. The enquiry system allows participants to ask other participants for the most favorable terms that they would be willing to support for any given project. Enquiries must include the anticipated offer of the enquirer and a list of the addressees on the enquiry. Copies of all documentation surrounding enquiries must also be sent to the Secretariat in the interest of transparency. This system permits Participants to ascertain the competing financing offers and effectively “level the playing field” on any given deal.

The Arrangement also provides for unilateral derogation from the terms of the Arrangement, as long as the derogating party provides notice to the other Participants ahead of time. This notice-and-match function provides countries the flexibility to deviate from Arrangement rules while preserving the spirit of fair play. When a country notifies the Participants of its intention to deviate from the Arrangement, the other Participants are given the opportunity to match the deviant offer. As long as notification protocol is met, any such deviation is not considered a violation of the Arrangement.

Additionally, if the United States had reasonable grounds to believe that China continued to offer export credit terms outside of the scope of the Arrangement without proper notification, it could inform the Secretariat and request Special Consultations. This procedure would require China to clarify the terms of its financing offer and, if disagreement persists, to convene a Participant meeting to discuss the terms.

Another option would be to create a Common Line, which would allow the United States and China to establish a recognized and legitimate exception to Arrangement rules. The Arrangement defines a common line as follows:

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166 Arrangement, supra note 26, at 29.
167 Id.
168 Id.
169 Id.
170 Id. at 26.
171 Id. at 25.
172 Levit, supra note 82, at 113.
173 Arrangement, supra note 26, at 26.
174 Id.
175 Id. at 30–31.
[A]n understanding between the Participants to agree, for a given transaction or in special circumstances, on specific financial terms and conditions for official support. The rules of an agreed Common Line supersede the rules of the Arrangement only for the transaction or in the circumstances specified in the Common Line.176

The Common Line mechanism allows deviations from Arrangement provisions where the issue is reoccurring or falls outside the scope of Arrangement procedures. The goal of these flexible remediation options is to resolve export credit disputes prior to closing a financing deal. These processes foster trust and transparency and lower transactional costs by avoiding ex-post litigation.

C. Extent of Current Engagement with China on Export Issues

So far, the United States government has elected to employ a highly centralized carrot-and-stick approach to guide China toward opening its markets and reducing its government subsidies for exports. The largest stick in the United States arsenal for combating China’s unfair trade practices is the WTO. Since China became a member of the WTO in 2001, it is bound by WTO regulations regarding export subsidies, even though it is not a member of the OECD arrangement from which the bulk of the WTO regulations are derived. Some American groups have advocated for the government to file a WTO challenge regarding China’s excessive export subsidies.177 Proponents of this course of action cite the documented and “egregious” violations of international rules and call for a more hard-lined stance to protect American jobs and industry.178

The WTO system has proven to be a useful tool for the airing of United States grievances regarding Chinese trade practices, and the United States has enjoyed some recent success in the battle to eliminate China’s illegal trade subsidies.179 For example, in June 2011, the Obama

176 Id. at Annex XI (b).
178 Id.
Administration challenged a Chinese program that supplied several hundred million dollars in grants to encourage Chinese wind turbine manufacturers to purchase domestic parts instead of importing them. Subsidies that support the use of domestic instead of imported materials are prohibited by WTO rules and could result in trade retaliation measures if not eliminated within a reasonable amount of time following a dispute settlement decision. China agreed to abolish the grant program after formal WTO consultations with the United States and before a dispute settlement panel was established. In all three challenges that the United States has brought against China for export subsidy violations, China has voluntarily ended the challenged program before an official dispute settlement case was launched.

While the three-for-three record on export subsidy challenges at the WTO is impressive, it is not necessarily the best or most effective way to combat China’s extensive export subsidy regime. Although the WTO provides a forum to confront and eliminate individual policies, it is a time consuming and expensive process to bring a case to dispute settlement at the WTO. Before the U.S. can pressure China to dismantle a prohibited subsidy program through WTO consultations, it must first collect information and evidence about the subsidy in question. Since China’s export credit programs are not transparent, the United States has to expend enormous amounts of time and energy to collect the necessary information. Without substantial evidence demonstrating that an export credit constitutes a prohibited subsidy, a WTO challenge can languish at the consultation stage for years without progressing to a dispute settlement action and resolution.

Due to the extensive nature of the Chinese export financing system, the elimination of a single grant program or loan fund is unlikely to have a

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180 Id.
182 OFFICE OF THE UNITED STATES TRADE REPRESENTATIVE, supra note 179.
183 Id.
184 ASCM, supra note 26, at Art. 4.1.
185 OFFICE OF THE UNITED STATES TRADE REPRESENTATIVE, supra note 179.
profound effect on the overall playing field.\textsuperscript{187} In comparison, the
Arrangement includes an information sharing provision that, if applied to
China, would improve the United States Bank’s ability to compete with –
and to some extent control – the terms offered by the Chinese Bank. Under
the Arrangement, Participants are required to inform other Participants of
the terms and conditions of any offered export credit package.\textsuperscript{188}
Participants must also share information with non-Participants on a
reciprocal basis.\textsuperscript{189} In the short term, China may be made vulnerable to
DSB proceedings at the WTO as a result of the Arrangement’s extensive
notification and information sharing provisions. Shared data concerning
China’s offered export credits could be used against it in WTO proceedings
if the credit terms fell below ASCM standards. However, the Arrangement
offers several built-in alternatives to DSB proceedings that would hopefully
allow China to negotiate more suitable ex-ante solutions, thereby reducing
their exposure to litigation at the WTO. This would force transparency into
the Chinese export credit regime and eliminate much of the current
excessive cost of bringing an enforcement action at the WTO. In addition,
the prospect of having to disclose export credit deal terms should accelerate
China’s transition away from use of prohibited subsidies in general – a
transition that, according to WTO rules, should have been completed by
2008.\textsuperscript{190}

Unfortunately, the WTO’s adoption of the Arrangement’s notification
and information sharing provisions is extremely unlikely in the near future.
Any modification to ASCM language would have to be made by a
consensus of WTO Members. Although the nine members that are
currently participants to the Arrangement would likely support such a
change, it is unlikely that all members, and especially developing countries,
would support the alteration. As a result, hopes have instead hinged on
convincing China to become a participant in the Arrangement, thus
voluntarily and unilaterally exposing itself to the notification and
information provisions.\textsuperscript{191} Although the Arrangement does not include an
enforcement mechanism grounded in public international law, Arrangement
rules allow for the matching of below-market terms offered by another
country.

\\textsuperscript{187} See Id.
\textsuperscript{188} Arrangement, supra note 26, at 5.
\textsuperscript{189} Id.
\textsuperscript{190} ASCM, supra note 26, at Art. 29.2.
\textsuperscript{191} Levit, supra note 83, at 111–12.
Any increase in transparency that could be achieved through increased Chinese participation in Arrangement procedures would enable the United States to more easily identify and match Chinese credit offers.

CONCLUSION

Although China and the United States have a complicated and tumultuous trade history, the two countries must cooperate to confront the looming challenges of international trade finance. In order to coax China into a more open and accountable application of export credit programs, the United States must use a combination of challenges under the WTO ASCM, high level cooperation through the S&ED, and increased information sharing through OECD Arrangement notification procedures. In order to create a more substantive impact on the trade relationship, the United States must convince China that it is in its interest to reform its current system, increase imports, promote competition, and respect the internationally established rules of trade finance. The legal framework for improving competitiveness and transparency already exists in the Arrangement. The challenge will be making the terms of that framework acceptable to developing countries without sacrificing the benefits and integrity of the system.