TIED AID PRACTICES OF U.S. COMPETITORS

Y 4.F 76/1:T 44/3

Tied Aid Practices of U.S. Competit...

HEARING

BEFORE THE

SUBCOMMITTEE ON
ECONOMIC POLICY, TRADE AND ENVIRONMENT

OF THE

COMMITTEE ON FOREIGN AFFAIRS
HOUSE OF REPRESENTATIVES

ONE HUNDRED THIRD CONGRESS

SECOND SESSION

MAY 25, 1994

Printed for the use of the Committee on Foreign Affairs

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WITNESS

TIED AID PRACTICES OF U.S. COMPETITORS

WEDNESDAY, MAY 25, 1994

HOUSE OF REPRESENTATIVES,
COMMITTEE ON FOREIGN AFFAIRS,
SUBCOMMITTEE ON ECONOMIC POLICY,
TRADE AND ENVIRONMENT,
Washington, DC.

The subcommittee met, pursuant to call, at 2:30 p.m. in room 2172, Rayburn House Office Building, Hon. Sam Gejdenson (chairman of the subcommittee) presiding.

Mr. GEJDENSON. The Subcommittee on Economic Policy, Trade and the Environment will come to order.

Today we are privileged to have with us Chairman Brody of Eximbank and Dr. Alan Mendelowitz, who has been an invaluable aide to this committee for a number of years on a number of topics. I will start with a brief opening statement and then we will hear from our two witnesses.

TIED AID HAS LONG BEEN OF INTEREST TO THE COMMITTEE

Tied aid has long been of interest to the committee because it distorts trade, providing unfair advantages to the practitioners. Because the Organization on Economic Cooperation and Development, OECD, keeps imperfect statistics on tied aid practices of our major competitors, it has been difficult to ascertain just how much competition our exporters face in overseas markets.

Under prior administrations, the U.S. policy was to continue to negotiate with our OECD competitors to try to eliminate the problem. While the policy of "negotiate to eliminate" did not work, the Bush administration was able to enter into a 1992 general agreement on tied aid. Though an improvement on the past policies, that agreement contained so many loopholes that it would be stretching it very far to call it a solution to tied aid. In fact, many of our competitors are now changing the way they offer tied aid in order to exploit the loopholes of that agreement.

THE EFFECT OF TIED AID CAN BE LONG-LASTING

The effect of tied aid can be long-lasting since the practice is most common in the highly competitive areas of telecommunications, power generation and transportation, and the loss of a first sale can lead to a loss of future and follow-on sales sometimes worth millions and even billions of dollars.

In 1989, the Bush administration released a report on tied aid which stated that the Nation lost between $400 million to $800 million in missed trade opportunities. This subcommittee had the privilege of seeing that report before it was sanitized by OMB. The original report stated the United States lost between $1.5 to $3 billion in exports a year due to competitors' tied aid practices.

Because inadequate information leads to poor public policy, last year Congressmen Bereuter, Roth, and I requested a study of the tied aid practices of our major competitors. At that time we asked the GAO to determine how much U.S. exporters lost each year to this practice, how accurate is the data on tied aid, and what can be done to improve our competitive position.

It is my hope that today's distinguished witnesses, Chairman Brody, of the Export Import Bank of the United States, and Dr. Alan Mendelowitz, of the General Accounting Office, will be able to provide us with more definitive information on the tied aid practices of our major competitors, and also the expectations of the new policy on tied aid.

It is indeed a pleasure to have Ken Brody at the helm of Eximbank. Finally, we have a chairman of the bank, who understands the needs of exporters, and not just in the areas of export finance. I think most members of the subcommittee are aware of the key role he plays in the Trade Promotion Coordinating Committee and on export promotion in general. I want to thank both our witnesses for the work they have done in the past and again tell them both how privileged we are as a committee to have them before us.

I would now like to yield to my colleague and partner in these efforts, Mr. Roth.

[The prepared statement of Mr. Gejdenson will not be a part of the printed hearing record.]

Mr. ROTH. Well, thank you, Mr. Chairman. And you are getting better and better all the time. You are starting on time. I thought we would be late and here we are starting on time.

But I am glad to see Chairman Brody, Mr. Mendelowitz, with us again. It is a real pleasure to see you here, and so I join our Chairman in welcoming you.

The bank's commitments for next year, while reducing the bank's cost to the taxpayers, it is fine to receive a report like that. Tied aid may be an arcane subject to most people, but as this GAO report shows, it has a real world impact on American exports and on export-related jobs.

GAO RECOMMENDS A MORE AGGRESSIVE APPROACH SHOULD BE USED IN THE AREA OF TIED AID

GAO recommends a more aggressive approach should be used in the area of tied aid, and I agree with that conclusion. And I would go even further. Despite all the current emphasis on GATT, free trade agreements and negotiations with Japan, the reality is that trade is not carried out under Marquis of Queensberry Rules. If tied aid is necessary in some markets, Asia, for example, then so be it.

Eximbank's policy on a more aggressive use of the war chest I think is a right step, but we need to completely rethink our tied aid and I think governmentwide. Frankly, if a majority of the Congress keep ramming foreign aid through, then at least it should be tied to American exports so that our own people get something back from this money. That is why this subcommittee has taken the lead in pushing legislation to tie foreign aid for capital projects to American exports. In today's world we need more tied aid, not less.

I look forward to our witnesses' comments on these observations and others, and I again thank the chairman for this hearing and welcome our witnesses.

[The prepared statement of Mr. Roth will not be a part of the printed hearing record.]

Mr. GEJDENSON. Mr. Chairman.

STATEMENT OF HON. KENNETH D. BRODY, PRESIDENT AND CHAIRMAN, EXPORT IMPORT BANK OF THE UNITED STATES

Mr. BRODY. Thank you, Mr. Chairman.

THE ADMINISTRATION HAS A COMPLETELY NEW PHILOSOPHY AND A NEW ACTIVITY WITH RESPECT TO TIED AID

The administration has a completely new philosophy and a new activity with respect to tied aid. In the debate over whether or not to go with the new philosophy, it is clear to me that the chairman's efforts over many years played a not insignificant role in having the administration come out the right way.

Essentially, what we had was purists, philosophers and intellectuals on one side, who would like to see the world as they would wish, losing out to the realists who see the world as it is. The new philosophy that we have has two simple objectives: One is to use tied aid, matching responses, to reduce worldwide subsidy. Use it as a tool. And, two, while tied aid is being used, particularly in dynamic developing countries, to create a level playing field for our exporters so that we can capture market share and create American jobs.

We are off to, I think, a very good start with our new philosophy and our new activity. We officially put our new tied aid capital projects fund into operation with defined rules just within the past month. However, we did not wait until all the rules were put down on paper. We started up shortly after the President last September made the decision to go with this new philosophy.

WE HAVE MADE TIED AID OFFERS IN EXCESS OF $500 MILLION

During this period of time, we have made tied aid offers in excess of $500 million. So far none of those offers have resulted in actual deals, but there are a few that are still pending that are likely to result in actual deals. Now that we have a well defined policy, which is highly aggressive in matching but not initiating tied aid offers, I expect to see many more exporters with many more cases coming in to Eximbank.

A discussion on tied aid would not be complete at least without a discussion on untied aid. The numbers require that kind of look. For, after all, in 1991, there was approximately $15 billion of tied aid. That number, the corresponding number in 1993, was just a little bit less than $7 billion, a substantial decrease.

However, in 1993, the so-called untied aid was $12 billion, almost all from one country. There is great concern among exporters that the so-called untied aid is explicitly in some cases and implicitly in many cases has the same effect as tied aid, and we will be turning our attention to untied aid in the very near future.

It will be interesting to see if in fact we can accomplish our objective of using this as a tool to reduce subsidy. We have perhaps one early signal that at least some others think that this should be the course. And I will now read from an editorial in the *Financial Times* dated May 16, 1994, entitled "Uncle Sam, Salesman."

The first part of the editorial decries the fact that the United States is going down to the level of the other countries in helping our companies compete and win in the global marketplace. The end of the editorial, I think, gets exactly at what we are trying to achieve.

The editorial says: Instead, the European Union should seek talks with the United States and Japan aimed at reversing the proliferation of government-sponsored export drives. One aim should be to strengthen the controls and subsidize export credits negotiated in the Organization for Economic Cooperation and Development, and to provide for stiff sanctions against offenders, preferably by bringing the whole area under the new world trade organizations. In addition, tougher international rules are needed to prohibit tied aid.

And the editorial goes on: Clinton administration officials say they would be prepared to scale down or even eliminate export promotion efforts if other governments did the same.

So at least we are getting a signal from outside the United States that our new policies are being felt and at least, if folks would listen to the editorialists of the Financial Times, our competitors would go in the direction we want them to.

Thank you, Mr. Chairman.

Mr. GEJDENSON. Thank you, Mr. Chairman.

[The prepared statement of Mr. Brody will not be a part of the printed hearing record.]

Mr. GEJDENSON. Allan.

STATEMENT OF DR. ALLAN I. MENDELOWITZ, MANAGING DIRECTOR, INTERNATIONAL TRADE, FINANCE AND COMPETITIVENESS, GENERAL ACCOUNTING OFFICE

Mr. MENDELOWITZ. Thank you, very much, Mr. Chairman and members of the committee. I am happy to be here today to discuss our recent work for you on the problem of tied aid. I will be happy to make a short oral statement and submit my full written statement for the record.

COMPETITOR TIED AID IS A CONCERN BECAUSE IT PUTS U.S. EXPORTERS AT A SEVERE DISADVANTAGE

Competitor tied aid is a concern because it puts U.S. exporters at a severe disadvantage. Rather than having export sales based on product price, quality and service, it is foreign government subsidies that actually determine the outcome of the bidding.

While all U.S. aid to developed countries provides aid that is tied in some way, there is a significant difference between what the United States offers and what other countries offer. Generally, a relatively smaller share of U.S. aid is tied than that of our competitors, and the way in which it is tied is consistent with U.S. aid objectives that have driven our aid programs over the past two decades. Namely, the predominant share of U.S. aid and U.S. tied aid is directed toward basic human needs, such as education, health and food assistance. Competitor tied aid generally has a higher tied aid portion, and most of that tied aid is linked to major capital projects requiring high value added capital goods and holding out the prospects of significant follow-on sales.

We estimate that for the period 1989 to 1991 U.S. capital goods exporters lost as much as $1.8 billion per year in capital goods exports because of competitor tied aid practices. In 1992, the United States and 20 other OECD countries reached a new agreement to restrict trade distorting tied aid. The agreement is an improvement over previous agreements, and in 1993 there was a significant drop in notifications to the OECD of tied aid offers.

THIS AGREEMENT DOES NOT EITHER END OR FORBID TIED AID

However, it is important to remember that this agreement does not either end or forbid tied aid. Furthermore, there are ways in which you can be in compliance with the letter of the agreement and still implicitly tie aid to the advantage of your exporters.

Tied aid funding for feasibility design and engineering studies can skew the technical terms of a project so that your country's exports have an advantage. Multilateral institutions and international bodies, such as the European Union, are not covered by the agreement even though the European Union member states are.

Very long-term financing for a variety of capital projects are still permitted. Portions of larger products can still be covered with tied aid. There is some difficulty in defining what commercial viability means under the agreement. Compliance is voluntary. Notifications and data provisions are voluntary, in the sense that the data is neither confirmed, audited, or double checked. And other countries have close business-government relations that lead to early identification of projects in which they can benefit from their country's provision of aid.

For the first 2 years that the agreement was in effect, the Eximbank's war chest was used only to enforce the terms of the agreement. If a tied aid offer conformed to the terms of the agreement, it was not matched even if U.S. interests were harmed. However, last month Eximbank adopted a new policy on use of the tied aid capital projects fund, which was first announced with the release here in this committee of the first TPCC strategic plan.

The new policy, I believe, is a good balance between identifying how to use the fund to aggressively protect U.S. interests by opposing foreign subsidized exports without either undermining the OECD agreement or profligately or irresponsibly giving away taxpayer funds.

However, for such a policy to be credible, we need to have two elements in place: One, there has to be an assurance for the U.S. business community that the U.S. Government is willing to take a competitor trade distorting tied aid on and they can count on that willingness; and, secondly, there has to be sufficient funds available to give meaning to the commitment stated in the policy.

THE NEW POLICY STATED A FIRM COMMITMENT TO BE AVAILABLE TO U.S. EXPORTERS IN OPPOSING FOREIGN TIED AID PRACTICES

The new policy stated a firm commitment to be available to U.S. exporters in opposing foreign tied aid practices. The new policy also outlines mechanisms to provide earlier assurance to U.S. businesses that if they get involved in bidding on a project for which foreign tied aid becomes available, they get an early indication from Eximbank that in fact the funds in the capital projects' tied aid fund can be made available. But for the policy to be fully credible, there has to be an assurance of adequate funds and there needs to be, I believe, more proactive intelligence on developing tied aid projects.

The reason why we need to assure that there is adequate funds is that if the funds available are too small and they are not consistently available year after year, we will not have credibility. A decade ago the United States made the decision that we wanted to take away a subsidized flower market from the French. The market was in North Africa, in the country of Egypt.

In the course of 1 year the United States made available $1 billion subsidy, and in that year we took that subsidized flower market away from the French. The next year we provided no additional subsidy, we did not maintain our consistency of purpose, and the French just moved back in and took over the market.

Any time we engage in these particular undertakings, where the end objective is not just to subsidize U.S. exporters but really to bring our trading partners to the negotiating table to get them to reduce and refrain from undesirable trade distorting practices, any time we do that we need sufficient funds to be credible. And, therefore, we believe there has to be an indication of sufficient funds and, secondly, we believe that there needs to be more proactive intelligence gathering and provision of information to the business community so they know what deals are in the offering and when tied aid may be a problem.

If the United States waits until the consultation process in the OECD after notification of tied aid offers, it is too late in the game. Because even if we want to make a competing offer, if there is not a U.S. bidder on the ground with a proposal on the table, it is too late to find one who can put together a proposal in time to be seriously considered.

Thank you.

Mr. GEJDENSON. Thank you.

[The prepared statement of Mr. Mendelowitz will not be a part of the printed hearing record.]

Mr. GEJDENSON. Mr. Roth.

Mr. ROTH. Thank you, Mr. Chairman.

Mr. Brody, you were in charge in fiscal year 1993. I would like to ask you about how the war chest was used during that period. As I understand it, there was only one payment out of the war chest during 1993. How many requests did you have from exporters for help and were any turned down and what was the reason? Can you enlighten us in that area a little bit?

Mr. BRODY. Congressman, I am sorry, I did not hear the first sentence. You said something about I was in charge.

Mr. ROTH. You were in charge during fiscal year 1993, as I understand it, or part of 1993.

Mr. BRODY. A small part.

Mr. ROTH. A small part. My question is this: When did you give out money, why was it given out, were some people refused that asked for help? In other words, give us a little more enlightenment how this works.

Mr. BRODY. In 1993, the Eximbank was working in the tied aid area, as it had been for the few prior years. I was confirmed in May of 1993. The fiscal year ends in September. And I would describe the bank's efforts at, one, to discourage companies from coming in to seek tied aid; two, to only or primarily be interested in giving tied aid if there was a clear violation of the new OECD agreement concerning tied aid. As a result, there was very little tied aid dollars used——

Mr. ROTH. Can I ask you how many were used so we get some idea?

Mr. BRODY. It was less than $30 million used in tied aid in fiscal year 1993. I forget the exact number of cases, but I am sure it is fewer than five and——

Mr. ROTH. Somebody told me it was only one; is that possible?

Mr. BRODY. One or two, it is quite possible; 1993 was an absolute continuation of the policy which I talked about as being supported by the purists, intellectuals and philosophers, who wanted to see the world as they wished it to be instead of as it was.

Mr. ROTH. I recall someone once said if you wish to punish a province, put a philosopher in charge.

Mr. GEJDENSON. Would you yield for one second?

Mr. ROTH. Be happy to yield to the chairman.

Mr. GEJDENSON. Let me add two questions to that. One is the number of actual instances. That does not mean you only offered in one case. That was of all the cases you offered, only one came to a final deal. Is that what you are saying?

Mr. BRODY. Yes, but the offers would have been very few.

Mr. ROTH. Because you discourage offers so you are not looking for them.

Mr. BRODY. Frankly, I have paid very little time analyzing anything that we did during 1992–93, because once one took a look at the total picture, saw very little being done and saw the bank absolutely trying to discourage anybody from coming in to apply for any tied aid, and had, as a stated purpose, that tied aid would only be used or primarily be used if our foreign competitors violated the OECD rules, that is so far from where we are today that it seemed to make little sense to study that.

Mr. GEJDENSON. If the gentleman would continue to yield.

Agreeing that we have a new set of rules that are going to be more productive, and it seems that you have positioned us in that way for the major economic force in the globe, we are still essentially playing, because of the limited dollars that you have, defensive ball.

Mr. BRODY. Let me try to address that in two ways, one, in the narrow sense involved with Eximbank and then in a broader governmentwide sense.

In the narrow sense involved with Eximbank, when we are talking about capital projects, tied aid funds, in fact, the amount of money that we have today, it will enable us to be at the same level of total dollars used in tied aid as the most aggressive of the tied aid funders in 1993, if they do not increase their level.

So I would argue that, in fact, the amount of money that we have gives us a big step up in being able to deal in the tied aid arena. Point one.

Point two, we are playing defensive ball. I would call it aggressive defensive ball, and so far we have seen the New York Knicks with aggressive defensive ball do pretty well. So I do not think being defensive means that you are a loser.

WHAT WE ARE TRYING TO DO IS TO NOT INITIATE A WAR OF SUBSIDIES

What we are trying to do is to not initiate a war of subsidies. And for that major reason we are not going into the business of initiating tied aid offers. But what we are doing, in being aggressive matchers, is letting our exporters know very early on in the process that there is a deal that we will support if in fact there is tied aid being used on the other side.

What we also do, once we get any wind of the possibility of tied aid being used, and have decided that we will support our exporter, we go around to the other major governments and say, since we are going to step up here, why do you not just fold your tent and not offer tied aid. So we have, I would say, a very aggressive defensive posture.

Mr. ROTH. Mr. Brody, that is fine. It is like playing poker. You can raise but if the guy matches, you cannot bluff him out, you know.

Mr. BRODY. Well, one of the reasons that I read this *Financial Times* article is because their response is exactly the response that we wanted to see. For, after all, if country *x* sees that starting to do a lot of work and getting ready to initiate a tied aid offer is only going to be met by a U.S. company right there on the spot, ready to do the same thing, backed up with their government, after a while there is some possibility, and I think the possibility is a pretty good one, that that other country is going to say this is not getting us too much advantage here.

Mr. ROTH. You know, Mr. Chairman, I have an export conference every year, and we have some of the leading people from all over the world that come to it, people like Peter Grace, and people like that, have come to it. We have done it for 10 years. Now, when we have the companies that say, hey, these companies overseas are being subsidized by their governments and so on, what I am getting from you is if I have a company in Green Bay, Wisconsin, I can say, go see Chairman Brody or those people and the welcome mat is going to be out, and you are going to say, hey, we are going to help you fight them off? Is that what I am hearing you say?

Mr. BRODY. Not only is the welcome mat out, but since we started our new philosophy and our new activity, we have approved five preliminary commitments and we have—totaling in excess of $500 million, and we have another 9 cases before us totaling $600 million plus dollars, and I think that is just the beginning.

THE OBJECTIVE HERE IS NOT TO USE TAXPAYER MONEY

The objective here is not to use taxpayer money. The objective is to create a level playing field for our companies and to convince the other governments to use less subsidy.

Mr. GEJDENSON. Does the gentlelady have a few questions for the chairman? Because I thought maybe since we are about to vote, maybe we would let you go, if we can get this done, and we will skewer Allan Mendelowitz when you leave.

Mrs. MEYERS. I just have one before I leave. I have been supportive of the Eximbank, but when you hear criticism on the floor, it is usually along the lines that it assists very few companies and these are the very largest of the large. Would you comment on that criticism?

Mr. BRODY. Sure. I think that, in part, it is a fair criticism, and we are doing our mightiest to change that. And I think a start was made in the prior administration and we are picking up speed significantly.

And let me just give a few facts. Even today, over half of our cases are in fact small business cases. So to say that we do not do much for small business or ignore them is not really so.

Mrs. MEYERS. Over half are small business.

Mr. BRODY. I think in 1993 there were something like 1,800 cases and something like 1,000 of them were small business cases. However, that is a little misleading, because small business deals are typically small deals, whereas big business deals are typically big deals. So that the total dollar amount that went to support small business was 11 percent of the total.

Now, in part, there are many large businesses that are already internationally oriented and many small businesses that are not but should be. I think that we have a very good governmentwide strategy to try to both do significant outreach for small businesses and then to follow that outreach with real support.

The major element of this strategy are the so-called one-stop shops, where the Commerce Department, SBA, and Eximbank have gotten together. I think they are officially called export assistance centers. We have opened up four in Los Angeles, Baltimore—actually, I hesitate to name them all because I do not have the right names for this committee, but——

Mr. GEJDENSON. An excellent point.

Mr. BRODY. Los Angeles, Miami, Chicago, and Baltimore. And 10 more are to be opened in the very near future, and there is a grand strategy to really have terrific outreach so that there is a true information network that can benefit small and medium-sized businesses, because those are the ones who will really benefit by these one-stop shops.

At Eximbank, what we are doing is significantly increasing an enhanced small business activity. On one side, teaming up with Small Business Administration, a 1-year trial to see if they can really come on-line to help with exporting for small business; on the other hand, setting up a true delegation authority so the government can just get out of the way of individual deals and let small exporters do them with banks, banks being supported by the Eximbank. And if that starts to work well, we will increase that kind of activity. And that is what is called a working capital program.

In addition, a medium term, or 5-year lending, or guarantee program. We have introduced a medium-term insurance product, which really is designed to reach the small and medium-sized business, make it a lot easier for small and medium-sized companies to access that.

Having said all that, I cannot resist telling one story which says a lot of where we were. Nine months ago a key executive of Eximbank said to me, give me 3 minutes and I will tell you a lot about Eximbank and I said, fine. Three minutes is an easy investment to learn a lot. Dial 411 and get Eximbank's number. I did that. I called the number, I got a recording saying that the number had been changed, it is a new number. I called the new number and I got a recording and the recording said you have reached the U.S. Treasury Department, our office hours are 9 to 5, if you would like to reach us, please call tomorrow during office hours. However, if you would like tickets to the Bureau of Engraving, please call this number.

That said a lot about how easily accessible we were to those that did not know how to use us. That kind of thing is being changed, has been changed, and we are trying to set ourselves up to be a lot more friendly to small and medium-sized businesses.

I did not mean to go on so much but we are really trying a lot.

Mrs. MEYERS. I appreciate that very much, and I think that that is something, Mr. Chairman, that a lot of the members do not know and it would be important to them.

Mr. GEJDENSON. Do you have time to hang on?

Mr. BRODY. I would be delighted to stay here.

Mr. GEJDENSON. I am sure you would be delighted because we have about 4 minutes left to vote and I will try to get right back.

[Brief Recess.]

Mr. GEJDENSON. Well, Mr. Chairman, I have good news to report. We called information, we got the right number, and we even had the right people at the other end. It is no small feat in the Federal Government.

We had a young lady stop by to see us a couple of years ago who had worked in the Commerce Department. We told her of a new Commerce Department program, and the staff person working on it was out of the office for a while. It took her the best part of a morning to find the people and the program that she had named. So it is no small feat to get the system to work even at that level.

Let me ask two things. Basically, what you have is a system on an automatic ante, so once I am in the program you give me a chit that says no matter how much they raise it, you are there? There is a control on it? That is what I was going to ask. Is there a control on it?

Mr. BRODY. We did not say that. How much——

Mr. GEJDENSON. Right, because they have a guy that can obviously——

Mr. BRODY. You raise, we are there. And, frankly, I would like to kind of keep that a little bit of a mystery for a period of time. You know, there are arguments that one could make that could say that if the other country is going to spend a fortune in supporting tied aid and our offers cause them to do that, they, in effect, will be able to support a lot fewer dollars worth, and maybe we should not match tied aid that goes, keeps on raising the ante a lot.

On the other hand, if we are very clear that we were not going to do that, then people would have an easy mark for knowing where they could be a winner from their side. So I would prefer to keep a little mystery in the game there and really keep more of a game about that.

Mr. GEJDENSON. Is your war chest only to deal with the OECD agreement? For instance, would you use the war chest in a place where you had a bilateral agreement or no agreement at all?

Mr. BRODY. You have hit upon an important point. We do not try to think about whether it is an OECD agreement. We try to think about whether our companies got a fair shot or not. And if they do not have a fair shot because you have a regional organization as opposed to a country government giving tied aid, which some think does not come under the OECD rules, that does not matter to us. If we lose, we lose, and we are not in the business of having our companies lose. We are in the business of creating the level playing field and letting them compete.

So, therefore, there are all sorts outside of the OECD tied aid rules where this capital projects fund could be used.

Mr. GEJDENSON. Let me ask——

Mr. BRODY. And has been used already.

Mr. GEJDENSON. Let me ask this last question to you and then you are free to go, relatively speaking, or we are happy to have you stay and argue with Dr. Mendelowitz.

A year from now, one, will we be seeing a concrete impact? You referenced the story, which, obviously, is important, but how should we judge you a year from now? What should we look at to figure out if you have achieved the goals you were trying to achieve?

Mr. BRODY. Well, let us not get kind of caught in the all too frequent American syndrome of short-term performance versus long-term performance. And remembering that what we have are capital projects funds, which typically have long lead times from them.

I think that in 1 year the fair mark would be to see that we were aggressively and realistically supporting American exporters when they came up against tied aid. Exactly how much we win or do not win, I think is a bit out of our control. I think a lot of times when people try to measure things, they try to—they are much more happy measuring the wrong things precisely than measuring the right things sort of just about.

And I think here, for the first year, it is not a precise measurement but a just about measurement. And, really, there will be evidence as to the number of PC's that we have given out, there will be evidence from exporters as to whether or not we have in fact been timely and being really the aggressive defensive. And I would say that would be the first year look.

Mr. GEJDENSON. Thank you very much and we appreciate the work you have done here and elsewhere.

Mr. BRODY. Mr. Chairman, we appreciate very much your support and your pushing the U.S. Government to go in the right direction. It has its impact. It is clearly a lot of work on your part, and I think we appreciate it enormously.

Before I leave, let me just say one word about the work that Dr. Mendelowitz does. Although I cannot say that we would agree with all of his work in every fine detail, in general, we think his work is terrific; that you have got a wonderful aide to help you in your work, and we get insights from Dr. Mendelowitz which are quite useful to us.

Mr. GEJDENSON. Thank you. Thank you very much.

With all those endorsements, Dr. Mendelowitz, do you have any final instructions for Chairman Brody, as he leaves, on how to improve on his already improved program?

Mr. MENDELOWITZ. I am probably compromised by the praise.

Mr. GEJDENSON. Under the new ethics bill he will not be allowed to praise. He will be prohibited under penalty of law.

Mr. MENDELOWITZ. I think you asked the question about other agreements and the implications of that, and it brought to mind a topic that I talked about last week at a hearing before the Government Operations Committee. The topic of that hearing was the recently concluded new government procurement code that was reached in the GATT Round and the U.S.-EU bilateral that was reached in April under the auspices of the new government procurement code.

That code, I think, has really quite expanded the amount of open competition in government procurement as compared to the previous code, and the EU agreement that was reached also included some important new sectors. For example, heavy electric equipment generating industries.

Mr. GEJDENSON. Under the new code, if I am competing in Europe for a heavy generating, and transformers, transmission equipment, I no longer have to be a European-based company to get——

IF THE AGREEMENT WORKS AS PROMISED, U.S. FIRMS SHOULD BE ABLE TO COMPETE AS EQUALS IN THAT SECTOR

Mr. MENDELOWITZ. If the agreement works as promised, U.S. firms should be able to compete as equals in that sector. However, an important sector that is not included under the agreement is the telcom sector, and this has really a significance for the U.S. industry because not only does it mean U.S. firms cannot compete in the European telcom market on an equal footing, where there is maybe a $15 to $20 billion annual market, but it also means that U.S. firms are at a disadvantage in third country markets, because the national champion telecommunications equipment companies in the European Union, in fact, get an implicit subsidy because the prices they receive in the European market are substantially higher than the prices for comparable equipment in the open market.

Mr. GEJDENSON. Are we blocked from entering those markets in telecommunications equipment?

Mr. MENDELOWITZ. Well, we are—I don't know that we are blocked, but we are severely disadvantaged, so that——

Mr. GEJDENSON. How do they implement?

Mr. MENDELOWITZ. Well, under the European Union agreement, you are permitted to price discriminate against non-European products, which have a minimum of 50 percent European content, and you can completely block a bid if the European content is less than 50 percent. So that no matter how competitively priced a U.S. product may be, it can legally be prevented from——

Mr. GEJDENSON. This is the public procurement to government agencies?

Mr. MENDELOWITZ. Yes, such as the PTTs, the telephone companies.

Mr. GEJDENSON. What if a telephone company were to privatize, would it still be able to have the same kind of disadvantage for American companies, or if it became a public company would it then have to take——

Mr. MENDELOWITZ. Yes, that depends on how it is organized. In the United States, before the breakup of the Bell Company, AT&T in fact was a monopoly which was fully vertically integrated. It produced its own equipment and it provided the telephone service. After the breakup, the split between production and the provision of local service was complete, and the procurement of central switching equipment and other equipment for the local telephone service in the regional Bell operating companies became an open and competitive market.

In the case of Japan, the Nippon Telephone and Telegraph Company, NTT, up until several years ago, was a wholly owned government company. Its procurement discriminated on a national basis in favor of Japanese companies.

We reached an agreement with the Japanese Government to improve procurement opportunities for U.S. firms selling to NTT. And then NTT—the government began the process of privatizing NTT, and in effect the advantages we gained through the government-to-government agreement in a sense diminished in value because of the privatization. So the key is not just privatization, but the fact that the privatization takes place and that you get, along with privatization, open procurement.

But what I—the point I was really trying to make, though, was that the European telecommunications companies like Alkatel in France, Siemens in Germany, Ericson in Sweden, we see two, three, and four times the price of open market prices for the stuff they sell. So that they are in a better position to compete in the U.S. open market, and in third country markets. So that, for example, when I am looking at how the Eximbank should deploy the tied aid capital projects most effectively, I think special consideration should be given to the telecommunication sector because of the disadvantage that exists as a result of things that are covered and not covered under other trade agreements.

Mr. GEJDENSON. The assumption in your work and I think at Eximbank is that the same dollar value or the same quantity of items would be sold whether or not there was the tied aid. Is there any way to get a sense that—I mean, is the tied aid facilitating additional sales that countries wouldn't have been able to afford or companies in those countries wouldn't have been able to afford, thereby really expanding the opportunities?

Mr. MENDELOWITZ. That is the assumption with respect to the specific items, but it is hard to say that. For example, if a developing country had $1 billion to spend freely, it might spend that billion on capital projects in a particular mix. So much for power generating equipment, so much for telcom, so much for roads, so much for other transportation infrastructure. If you provide tied aid with respect to certain items, it might distort the mix, so you might wind up with more telcom, less power generating. It is hard to say.

What I think we can say about that sort of estimate of potentially lost exports is that it gives you a feel for what the ballpark is of, you know, what we are talking about.

Mr. GEJDENSON. And going back to telcom, is there any way within GATT to come back and level the playing field for American companies at least competing within the United States? I mean, within GATT do we not—there is no way to say if our—if our manufacturers in telcom are operating at a 20 percent disadvantage or a 50 percent rule in Europe, you have to live under that rule when you come here?

Mr. MENDELOWITZ. I think that this was the unfortunate aspect of the Bell breakup. We basically had a closed telecommunications market before Bell, AT&T, was broken up. We had a market that was closed in the same way that Japan and our European competitors' markets were closed. AT&T was broken up as a result of a court decree in which, I believe, the presiding judge probably gave very little consideration to the trade implications. And as a side effect of the breakup, we in effect gave our European and Japanese competitors a multibillion-dollar trade benefit, for which we asked nothing in return. It was quite an outlier in the way trade benefits are given. Usually you go to the negotiating table, put something on the table, and expect to get something back. The problem is that once we did that, it becomes very difficult in a GATT legal way to try to recoup the benefits.

Mr. GEJDENSON. So if I am an European country, I can, within GATT, say that if you are selling telecommunications items to government, you know, governments, and 50 percent of your product is made in Europe, the price doesn't matter?

Mr. MENDELOWITZ. The—I can't say for sure exactly what the rule is today, because, you know, these things change. But last time I looked at it, that was the rule. It was a few percentage point price preference, all European products that had——

Mr. GEJDENSON. And that is GATT legal?

Mr. MENDELOWITZ. It is GATT legal because we are talking about government procurement. The GATT never covered government procurement until the 1979 government procurement code, and the government procurement code only covers the procurements of countries that are signatories to that agreement. And there is not that many. And it only covers the specific government entities listed by the signatories as covered.

Mr. GEJDENSON. And——

Mr. MENDELOWITZ. And we are at the disadvantage, because our telecommunications industry is in the private, and mainland in Europe, on the continent in Europe, it is all government owned.

Mr. GEJDENSON. The $1.8 billion figure, that is a conservative estimate?

Mr. MENDELOWITZ. We think it is a ballpark estimate, it is a reasonable ballpark estimate.

Mr. GEJDENSON. What is the upper end of that ballpark?

Mr. MENDELOWITZ. We don't have a confidence interval around it, unfortunately. But it is give or take a few hundred million, maybe.

Mr. GEJDENSON. OK. Thank you very much, Doctor. Hearing is adjourned.

[Whereupon, at 3:45 p.m., the subcommittee was adjourned.]

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