

# **Riding the Tigers: American Commercial Diplomacy in Asia**

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## **FOREWORD**

Commercial diplomacy is pursued by all major international economic powers. The focus has been most intense on the emerging--if now temporarily debilitated--economies of Asia. Not surprisingly, the commercial diplomacy programs of the two biggest competitors, the United States and Japan, have developed and operated under very different conditions.

In 1996, the Council on Foreign Relations assembled an independent Study Group on American Commercial Diplomacy in Asia, chaired by Jeffrey Garten of the Yale School of Management and Robert Zoellick of the Federal National Mortgage Association, to assess the future of commercial diplomacy in the United States and abroad. The Study Group Report, written by project director James Shinn and to be published later in 1998, will summarize the findings of the group with a special focus on East Asia. The four essays published here contributed to the Report.

The first two papers argue that U.S. commercial diplomacy is often a necessary evil--either to correct market imperfections or to counter the activities of other governments. Raymond Albright examines the nature and roles of the various U.S. agencies that undertake commercial diplomacy, in particular the Export-Import Bank and the Overseas Private Investment Corporation. He contends that these agencies often succeed in offsetting the export promotion efforts of U.S. competitors and assuming reasonable risks that are shunned by private markets.

Robbin Johnson focuses on a particularly complex sector for U.S. commercial policy, agriculture. He provides a historical overview of U.S. farm policy, and suggests that "freedom to farm" legislation will shape the global food market for years to come. He concludes that market-based domestic farm policies, improved market access, and meaningful supply assurances will emerge as key ingredients both for U.S. export prospects and for feeding a wealthier but more populous world.

The second pair of papers provides an interesting look into the politics and economics driving distinct commercial diplomacy programs. In the third essay, David Rothkopf tracks the ascent and decline of commercial diplomacy as a priority of the Clinton administration. He outlines the various forces that have shaped the fate of U.S. commercial diplomacy, and offers recommendations for salvaging what remains of a once-formidable initiative.

Christopher Johnstone explores the outwardly successful, but inwardly troubled, commercial diplomacy of Japan. He argues that, although Japan's commercial policies in Asia seem impressive, in fact their effectiveness is curtailed by bureaucratic infighting. These tensions will of course be exacerbated by the 1997-98 financial crisis. And this financial crisis will make exporting to East Asia even more difficult. Given that many fundamental features of the regional economies are solid, both the United States and Japan will be reluctant to lose market share. By examining the history of commercial diplomacy, these papers provide insight into the determination of the U.S. and Japanese governments to maintain their footholds in the Asian marketplace.

While the Clinton administration has largely abandoned its first-term attempts at "semi-managed" trade, the arguments for a measured degree of commercial diplomacy remain strong. Significant barriers to entry still exist in many markets. The recent financial crisis in East Asia--the region targeted by the commercial diplomacy efforts of the United States, Europe, and Japan--will make exporting to that region even more difficult. In a perfect world, commercial diplomacy instruments would not be necessary. These papers underscore the complexities of a foreign economic policy that embraces the long-term goal of global free trade but employs short term measures to ensure equal access for U.S. exporters.

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## EX-IM BANK AND OPIC: TRADE PROMOTERS OR WELFARE PARIAHS?

Raymond J. Albright

In the larger scheme of U.S. trade, government financing agencies do not loom as large as fiscal and monetary policies, dollar exchange rates, the World Trade Organization (WTO), and the North American Free Trade Agreement (NAFTA). Yet, the acronym financial agencies--the Export-Import Bank (Ex-Im), Overseas Private Investment Corporation (OPIC), and Trade Development Agency (TDA) --are prominent in the current debates of what is needed to keep American exports competitive, especially in the most dynamic areas of U.S. trade growth--Asia and Latin America.

Ex-Im and OPIC particularly are being challenged as agents of "corporate welfare,"<sup>1</sup> with critics recommending drastic cuts in their budgets--or even their elimination. When Congress and the administration are searching all possible ways for balancing the federal budget and the administration continues its aggressive "reinventing" of the executive branch, it is logical and appropriate that all federal activities be scrutinized. However, it would be prudent to dig below superficial slogans and review the facts before fundamentally changing the acronym agencies.

"Corporate welfare" is an easy slogan. But I received another perspective on the issue when I was negotiating with Europeans in the Organization for Economic Cooperation and Development (OECD) to reduce government subsidies to export financing. A senior French official told me, "It's very simple to us. We would rather give government subsidies to exports than use the budget for welfare to support unemployed workers."

The objective of this paper is to offer history and insights into the operations of Ex-Im and OPIC to facilitate a reasoned debate about the future of these agencies and their role in American commercial diplomacy. It will discuss TDA in the context of its cooperation with Ex-Im and OPIC, but will not examine three other agencies that finance exports--the Agency for International Development (AID), the U.S. Department of Agriculture (USDA), and the Maritime Administration of the U.S. Department of Transportation. These three agencies have unique charters, missions, programs, and rationales. Among them, only the USDA programs have historically supported significant volumes of exports (see companion paper by Robbin Johnson).

My discussion addresses the following topics with respect to Ex-Im and OPIC:

- basic missions;
- current rationale;
- international agreements;
- legislative mandates;
- roles in U.S. commercial diplomacy and interagency coordination;
- factual base of Ex-Im and OPIC activity in Asia;
- comparisons with European and Japanese government finance agencies;
- legislation issues: rechartering, budgets, and congressional oversight;

- issues from changing dynamics of international business;
- key issues and recommendations.

## BASIC MISSIONS

Ex-Im supports export financing for the sale of U.S. goods and services to foreign buyers. It does not support financing for non-U.S. items or funding of equity investments by U.S. firms abroad. Its programs are designed to supplement, but not compete with, banks or other private financing. Ex-Im financing assistance may include:

- direct loans by Ex-Im to a foreign buyer or bank;
- guarantees to commercial lenders that their loans to foreign borrowers will be repaid;
- insurance that protects exporters or banks against nonpayment by foreign buyers;
- working capital guarantees to commercial lenders that their loans to small U.S. companies for producing or marketing exports will be repaid.

OPIC supports financing to encourage private-sector investment overseas by U.S. companies. Its support is untied; that is, it is not limited to U.S. exports, and OPIC is available for supporting equity as well as debt. Like Ex-Im, its programs are designed to supplement, but not compete with, banks or other private financing sources. OPIC support may include:

- political risk insurance for equity investments or debt financing, protecting against risks of political violence, expropriation, and currency inconvertibility;
- direct loans by OPIC in small amounts (maximum \$30 million) for projects involving U.S. small businesses (OPIC takes the commercial as well as the political risks);
- guarantees to commercial lenders that their loans will be repaid by a project (again, OPIC takes the commercial as well as the political risks).

TDA assists U.S. companies to export by funding feasibility studies, orientation visits, specialized training, business workshops, and technical assistance related to infrastructure and industrial projects in middle-income and developing countries. Funding is in the form of grants for part of the costs, and generally is in the range of \$500,000 per transaction, with few exceptions for larger amounts to meet foreign government competition.

## CURRENT RATIONALE

Ex-Im was created in 1934 by executive order and established on a statutory basis in 1945. The charter act of 1945 has been renewed periodically, most recently in 1997 for a four-year period ending September 30, 2001. Ex-Im today designs its operations to neutralize two basic problems in financing U.S. export sales: the limited capacity of commercial financing sources to absorb credit risks of foreign government and private-sector borrowers; and competition from official export credit agencies (ECAs) of foreign governments.

To economists, these "market imperfections" offer a legitimate rationale for government intervention. In an ideal world, exports would be financed only by private sources. Indeed, among developed countries, this is overwhelmingly the case. However, trade growth with developing countries would be greatly reduced if ECAs and other official financing institutions did not exist. Funded by developed world governments, these institutions can take a higher degree of risk, because they are not accountable to the same bottom-line loss limitations as private financial houses. However, the public institutions still must keep their portfolios within reasonable risks, as defined by their respective budget procedures.

As the currently emerging markets develop into less risky investing and lending environments, they will "graduate" to less reliance on national ECAs and multilateral finance sources, such as the World Bank. Historically the "Asian tigers" of Korea, Taiwan, Hong Kong, Singapore, Thailand, and Malaysia have been major recipients of financing from ECAs and multilateral banks. In recent years, they all attracted private equity and debt investors and relied much less on support from public financial institutions. However, the 1997 currency crises in Asia have at least temporarily reversed this process.

Commercial lenders are constrained by different types of international risks, which limit the amounts or length of repayment they can offer. In some countries, for example, private borrower commercial risks may be acceptable, but political risks, such as currency inconvertibility, may be excessive. Ex-Im programs can offset such risks through guarantees and insurance, for which the exporter or lending bank pays a premium.

Commercial lenders charge market interest rates, which vary according to market conditions. ECAs often provide fixed interest rates beyond market repayment terms as an enhancement to exports. While interest rate subsidies have been eliminated for ECAs based in OECD countries through multilateral agreements, the longer than market repayment term remains. So long as other governments continue to support exports through their ECAs, Ex-Im needs to provide similar loans for U.S. exporters. In this way, U.S. exporters can compete on the basis of price, quality, service, and technology--on a financial "level playing field."

OPIC's programs encourage U.S. private investment abroad. While Ex-Im's support is limited to sales of U.S. goods and services, OPIC's support is "untied"--it is not restricted to U.S. goods and services. OPIC's charter legislation in 1971 arose from a development objective in the Foreign Assistance Act, and supporting economic development of emerging nations and advancing U.S. foreign policy interests remain in the OPIC rationale.

OPIC also supplements, but does not compete with, the private sector. It shares equity risks with investors, developers, and lenders by offering political risk insurance, with the insured parties taking all the commercial risks. It also guarantees loans by commercial

lenders, thereby absorbing both commercial and political risks, but not for the entire debt of the project.

Like Ex-Im Bank, OPIC helps to level the playing field, because other governments operate agencies similar to OPIC. Throughout its history, the loans and guarantees offered by OPIC have focused on nonrecourse or limited-recourse project financing: the loans will be repaid solely from cash flows of the project without guarantees from governments, banks, or established companies.

OPIC in recent years has responded to high-priority foreign policy goals by establishing investment funds. Of its current 24 funds, several were established at times and for areas of high foreign policy interest:

- Southern Africa and Sub-Saharan Africa, 2 funds;
- Newly Independent States of the U.S.S.R. (NIS)/Baltics, 3 funds;
- Central Europe, 3 funds;
- NIS/Russia, 2 funds;
- West Bank/Gaza, Jordan, Oman, 1 fund;
- Middle East/North Africa, 1 fund.

Through its loan and guarantee facilities, OPIC supports the capitalization and operation of these privately owned and managed direct investment funds. These funds invest in a diversified portfolio of new or expanding private enterprises that involve U.S. companies in their operations.

TDA, set up in 1981, originally operated under AID as a technical assistance vehicle for developing countries, particularly for project feasibility studies. Subsequently, in 1992, it became an independent agency. With growing budgets, its role has focused more on offsetting competition from the more aggressive programs of other governments. In the competitive marketplace, winning a feasibility study often yields a significant advantage for exporters from that same country to win follow-on contracts. Technical specifications may be geared to one supplier country, and the engineering company doing the study may have close ties with suppliers of the same nationality.

## LEGISLATIVE MANDATES

In its current charter, certain key mandates define the scope and constraints of Ex-Im operations:

### Policy Mandates

- Foster expansion of exports to promote high levels of employment and income.
- Be fully competitive with foreign government export financing and seek international agreements to reduce subsidized financing.
- Establish a Tied-Aid Capital Projects Fund to counter foreign tied aid credits.

- Consider possible adverse effects on U.S. industry from its support for a transaction.
- Deny support for defense articles and services, except under certain circumstances for drug interdiction purposes.
- Provide special support for environmentally beneficial exports or projects, and deny support on adverse environmental grounds.
- Set aside annually 10 percent of its new commitment authority to directly benefit small business.
- Foster support to services, renewable energy, small business, and high-technology exports.
- Foster opportunities for U.S. insurance companies to provide insurance to transactions supported by Ex-Im.
- Deny financing to Marxist-Leninist countries, countries violating nuclear safeguard treaties, and countries in armed conflict with the United States.
- Deny financing to countries for balance-of-payments assistance.
- Increase Ex-Im commitments to sub-Saharan Africa.

#### Operating Mandates

- Deny credits for nonfinancial or noncommercial reasons only when the president makes a national interest determination that such action would advance foreign policy interests in such areas as terrorism, nuclear proliferation, environmental protection, human rights, or child labor (this provision largely removes Ex-Im from foreign policy loans).
- Operate as an independent agency and like a bank (not an aid agency).
- Base transactions on "reasonable assurance of repayment."
- Supplement and not compete with private commercial financing.

Ex-Im operations are affected also by legislation other than the Ex-Im charter. For example, there is a requirement to ship on U.S. vessels items supported by Ex-Im long-term financing; there are prohibitions on support to countries that act contrary to U.S. law in such areas as freedom of emigration, missing personnel in Southeast Asia, chemical and biological weapons control, international narcotics, and terrorism; and there are sanctions on Iran, Iraq, and Libya.

Clearly, some of these mandates create "dynamic tension" between conflicting objectives. Ex-Im must follow banking principles but also must be "fully competitive" against ECAs of other governments. It must find "reasonable assurance of repayment," but other government ECAs may be willing to take certain risks in certain countries or cases where Ex-Im would not find "reasonable assurance." Ex-Im must judge cases on financial and commercial merits, but it is often pressured to act in countries or cases that advance U.S. foreign policy objectives. On this issue Ex-Im has developed a practice that parallels some grandfatherly advice from my youth: "Don't marry for money, but there is no harm in letting your heart go where money is." Ex-Im's pragmatic parallel is: "Don't lend for foreign policy reasons, but there is no harm in presenting a loan of acceptable risk for Ex-Im in coordination with a priority foreign policy action."

OPIC was established as an independent agency by amendment to the Foreign Assistance Act in 1969, and began operations in 1971. Its antecedents first appeared as government guarantees against currency inconvertibility in the Marshall Plan (the 1948 Foreign Assistance Act) to foster private investment in postwar Europe. In the 1950s, the guarantees were expanded to cover losses from war and expropriation, and project financing was added. During the 1960s, activity expanded to reach more developing countries, primarily administered by the Agency for International Development. When beginning operations in 1971, OPIC inherited a portfolio of \$8.4 billion in outstanding insurance to U.S. investors against political risks and a loan guarantee portfolio of \$169 million.

The current OPIC charter, which was renewed for two years in 1997, is embodied in the Foreign Assistance Act of 1961, as amended, and includes key operating mandates in the following areas:

- Support projects that respond to development needs of the host country and foster private initiative and competition;
- Deny projects support where the host government engages in policies that reduce the potential U.S. trade benefits (such as local procurement requirements, or offsets and buy-backs);
- Conduct an environmental assessment of transactions that would significantly affect the environment of the host country (OPIC usually applies World Bank standards);
- Deny projects that contribute to violations of internationally recognized worker rights;
- Give preferential treatment to projects that involve U.S. small business participation;
- Advance U.S. balance-of-payments and employment goals;
- Deny support to "runaway" plants overseas that make the same product for the same market as a plant being shut down in the United States;
- Conduct operations on a self-sustaining basis;
- Maximize use of private credit and investment institutions.

Like Ex-Im, OPIC is subject to other legislative prohibitions with respect to denial of financing for countries violating certain treaties or at war with the United States, or for countries subject to U.S. sanctions related to nuclear proliferation, international terrorism, or narcotics trafficking. In addition, OPIC has adopted its own major policy guidelines, such as the action in 1994 to expand its transaction limits from \$50 million to \$200 million for a financing guarantee (\$30 million remains the loan limit), and from \$150 million to \$400 million combined support for insurance and financing to a single project.

## INTERNATIONAL AGREEMENTS

Ex-Im, OPIC, and other U.S. finance agencies, such as TDA, USDA, and the Maritime Administration, must operate their programs within the guidelines of international agreements. The most comprehensive is the Arrangement on Guidelines for Officially



Supported Export Credits (OECD Arrangement). USDA and Maritime programs have only recently come under the scope of OECD discipline.

The Arrangement is an executive agreement among the United States, the European Commission (representing 15 European Union [EU] members), Japan, Australia, Canada, Norway, and Switzerland. It has evolved since 1975, largely from U.S. initiatives, through a series of negotiated packages, which are designed to lower financial subsidies provided by ECAs to support their exporters, reduce trade distortions caused by the use of tied aid, and level the export finance playing field through guidelines about terms and conditions that ECAs may offer. The Agreement is self-enforcing through the practice of required notifications and the right of any participant to match an offer outside the Arrangement guidelines.

The Arrangement has steadily increased its scope, as reflected by its changing name from "Gentleman's Agreement" to "Consensus" to "Arrangement." It sets standards in such areas as down payment, maximum repayment term, minimum interest rate, local cost support, capitalized interest, contract eligibility, and rules for tied aid financing. It also spells out notification procedures among participants, matching offers, and consultations. Annexes set special terms for aircraft, nuclear power, and ship transactions. The Arrangement deals only with financing tied to an offering country's exports. It does not cover untied financing. The "transparency" of untied financing to assure open eligibility to suppliers from all countries remains a difficult issue. Untied financing usually is related to country aid programs, and the largest amounts and greatest transparency issues relate to France, Germany, and Japan. OPIC's financing is untied with respect to procurement, although applicants for insurance or financing (loans or guarantees) are restricted to U.S.-owned companies. Being untied, OPIC's finance terms do not need to follow OECD guidelines; nor does the comparable untied investment finance support from other governments.

In the past two years a number of OECD participants have become concerned that the agencies financing investments may be indirectly linking their support to exports from their country. The issue has been compounded by the rising number of large investment projects in emerging markets, particularly in electric power and other infrastructure sectors. This has led to increasing numbers of cofinancing operations that combine the tied export credit and untied investment credit support of the same country, or combine the tied export credit of one country with untied investment credit of another country. These practices are prompting a new look at added discipline under the Arrangement.

To avoid undermining the Arrangement, Ex-Im and OPIC have temporarily agreed that when they combine their support to a single project, both agencies will abide by the Arrangement rules. However, if other countries do not comply in the same way, the United States may need to negotiate new OECD guidelines.

Ex-Im and OPIC also participate in the Berne Union, an association of 43 private and government export credit and investment insurers founded in 1934. Membership is more extensive geographically than OECD countries and involves private insurers as well as

government agencies. The Berne Union seeks international voluntary acceptance (with great success) by its members of sound underwriting principles for export credit and investment insurance. The members seek to follow common practices for transactions, generally under five years repayment, in such areas as cash payment, repayment term, and contract eligibility. Technical studies and workshops also enhance common underwriting practices.

## ROLES IN U.S. COMMERCIAL DIPLOMACY AND INTERAGENCY COORDINATION

Ex-Im and OPIC traditionally have reacted to transaction initiatives from the private sector, rather than set "export strategy" priorities.

At the macro-policy level, their charters are mandated by Congress, and their program character and budget resources are guided by the Office of Management and Budget and congressional oversight. When national security or foreign policy priorities embrace U.S. government financing capabilities, special working groups chaired by the National Security Council (NSC) or Department of State or Treasury may be formed to coordinate U.S. agency programs, and Ex-Im and OPIC may be asked to participate. The key word is "coordination," because Ex-Im and OPIC always retain their independence as to what financing risks and commitments they can absorb.

Recent examples of special interagency groups include:

- NSC-chaired, to support the Gore-Chernomyrdin--level U.S.-Russia Joint Committee;
- NSC-chaired, to support other similar U.S.-(defined on p. 6) NIS Joint Committees;
- State-chaired, to coordinate Freedom Support Act assistance to countries of the NIS and Central Europe;
- State-chaired, to coordinate assistance to such priorities as Bosnia, Haiti, Turkey, and the Middle East.

At the micro-operating level, Ex-Im and OPIC usually take the initiative for necessary coordination with other agencies. Ex-Im may contact the desk officers at State, Commerce, or Treasury for background information about countries or borrowers involved in transactions seeking Ex-Im support.

Sometimes a transaction itself involves broader U.S. national interests to the extent that special ad hoc procedures are set up by mutual agreement between Ex-Im and other agencies. Recent examples were:

- The 1993 Boeing and McDonald Douglas applications to Ex-Im for sales of up to \$6 billion of commercial aircraft to Saudi Arabia;
- The 1994 commitment by Ex-Im for financing Westinghouse services to the Russian-designed nuclear power plant at Temelin in the Czech Republic;

- The 1994 commitment by Ex-Im for Raytheon to construct a billion-dollar communications system in Brazil to monitor the Amazon environment and drug trafficking;
- The 1995 application to Ex-Im by several suppliers for sales to the multibillion-dollar Three Gorges hydroelectric project in China.

In addition to these traditional macro- and micro-coordination procedures, two significant committees established by law have oversight and coordination responsibilities for Ex-Im and OPIC: The National Advisory Council on International Monetary and Financial Policies and the Trade Promotion Coordinating Committee. The National Advisory Council (NAC) was established under the Bretton Woods Agreements Act in 1945 and by Executive Order in 1965. Chaired by the secretary of treasury, members include officials from State, the U.S. Trade Representative, Commerce, Ex-Im, the Federal Reserve, USDA, and AID. OPIC and Maritime Administration officials attend when their items are considered. The NAC coordinates the policies and operations of U.S. representatives to the International Monetary Fund (IMF), World Bank, and other multilateral development banks, as well as any U.S. agencies participating in credit or financial transactions. This includes Ex-Im, OPIC, AID, TDA, USDA, and Maritime Administration. The NAC has established working procedures that enable its members to review financing offers of other U.S. agencies before these are issued, and to develop coordinated U.S. positions for U.S. representatives to the international financial agencies.

In practice, the NAC meets only rarely at the assistant secretary or higher level to resolve agency differences or to set policy guidelines. It is primarily an information-sharing channel at the staff level on agency financial transactions, and a vehicle for Treasury to coordinate guidance that it initiates for U.S. representatives to international financial institutions.

The Trade Promotion Coordinating Committee (TPCC) was established by the Export Enhancement Act of 1992. Chaired by the secretary of commerce, members include officials from AID, Environmental Protection Agency, Agriculture, Labor, State, Treasury, Defense, Ex-Im, Council of Economic Advisers, Energy, U.S. Information Agency, National Economic Council, TDA, U.S. Trade Representative, Office of Management and Budget, OPIC, Small Business Administration, and Transportation. The primary missions of the TPCC are to develop central sources of information for the U.S. business community on government export promotion and financing programs; identify, evaluate, and recommend solutions to gaps in the programs; and assess the appropriate allocation of resources among U.S. trade agencies.

In its first report, in 1993, the TPCC laid out 65 recommendations embodied in a National Export Strategy. In its 1996 report, the TPCC describes the status and new directions for agency efforts in trade finance, advocacy, and small business assistance. It also addresses U.S. approaches to major new commercial policy issues--bribery and corruption, international standards, technical assistance to promote exports, and defense offset agreements. Recommendations are driven by the need to meet foreign competition in the global marketplace.

So far as Ex-Im, OPIC, and TDA are concerned, the effects of the TPCC have occurred in the following areas:

- Working groups set up according to geographic regions to coordinate early identification of projects, types of potential financing needs, timing of TDA feasibility study funding, and possible Ex-Im and OPIC follow-on financing;
- Working groups to develop coordinated publicity and marketing activities by Ex-Im, OPIC, and TDA targeted at potential users of their financing at home and abroad;
- Coordinated participation in trade missions and bilateral government-to-government joint economic and trade committees;
- Closer cooperation between Ex-Im and OPIC in allocating their resources, and combining support in some cases to enhance the capability of U.S. business to win more transactions in the rapidly growing and highly competitive sector of nonrecourse and limited-recourse project financing in emerging markets.

#### FACTUAL BASE OF EX-IM AND OPIC ACTIVITY IN ASIA

Ex-Im is most important to U.S. exports in the area of medium- and long-term financing. Of Ex-Im's annual commitments, about one-third are for short-term insurance to exporters offering up to 180 days' repayment. However, it is in the medium- to long-term repayment range (5 to 12 years) that OPIC also operates, and it is in that range that U.S. exporters face their greatest competition from foreign ECAs.

Export financing competition arises particularly in the large emerging markets, where suppliers from all over the world are trying to establish market share. This led to the U.S. government's Big Emerging Market Initiative (BEMs) in its national export strategy developed by the TPCC. Between 1990 and 1995 the BEMs accounted for 30 percent of global import shares and 44 percent of growth in world imports. U.S. government estimates place the BEMs at 43 to 48 percent of the world market in 2020, and infrastructure projects in the BEMs at over \$1 trillion in the next ten years.<sup>2</sup> The BEMs with the largest economies and the most dynamic growth are in Asia: the Chinese economic area (China, Hong Kong, Taiwan), Association of Southeast Asian Nations (Brunei, the Philippines, Malaysia, Singapore, Thailand, Indonesia), India, and South Korea. Asian countries represented about 30 percent of U.S. exports in 1995.

Export growth accounted for one-third of U.S. output growth since 1990, and capital goods exports to developing countries increased from 40 to 51 percent of total capital goods exports. In key markets for the United States, Ex-Im financing was linked to significant shares of U.S. capital goods exports over the past five years:<sup>3</sup> Argentina, 18 percent; Brazil, 20 percent; China, 13 percent; India, 45 percent; Indonesia, 45 percent; the Philippines, 18 percent; Russia, 40 percent.

The annual activity of Ex-Im supported \$11.5 billion in U.S. exports in FY 1996, translating into over 200,000 U.S. jobs directly and another 1 to 2 million indirectly.<sup>4</sup> OPIC FY 1996 activity supported \$9.6 billion in U.S. exports and 30,000 jobs.<sup>5</sup> In export

manufacturing industries wages are on average 15 percent higher than in nonexporting plants, according to a 1995 study. Moreover, employee benefits are significantly higher, as are productivity and employment growth and stability.<sup>6</sup>

Over 80 percent by number of all Ex-Im transactions in FY 1996 were for small business, and amounted to 20 percent in value of total new financing commitments. Over half of all suppliers identified to OPIC projects are small businesses. More than 40 percent of TDA awards in 1996 were won by small businesses.

Of Ex-Im's total commitments in FY 1996, 30 percent were for exports to Asia. About 10 percent of OPIC's total commitments in FY 1996 were for projects in Asia. The two main reasons for OPIC's lower presence in Asia are that China is closed for OPIC owing to congressional sanctions following the Tiananmen Square massacre, and Latin America has traditionally been the largest area of activity by U.S. investors.

In terms of cumulative outstanding exposure, Asia represents 36 percent of Ex-Im's portfolio, about the same as Latin America. Its largest exposure in Asia in sequential order is in China, Indonesia, the Philippines, and India. In terms of sectors, Ex-Im's commitments are in electric power, aircraft, telecommunications, and oil and gas projects, in that order.

For OPIC, its largest cumulative outstanding exposure lies in Latin America, with 4 percent. Asia is next, with about 20 percent. OPIC's major markets in Asia (not in rank order) include India, Indonesia, Malaysia, the Philippines, Taiwan, and Thailand. In terms of sectors, OPIC's portfolio lies, in sequential order, in electric power, financial services (largely equity funds), manufacturing, telecommunications, and oil and gas projects. (See Tables 5 and 6 in Additional Tables for more detail about about Ex-Im and OPIC activity.)

## COMPARISONS WITH EUROPEAN AND JAPANESE GOVERNMENT FINANCE AGENCIES

In the OECD countries that are the larger U.S. competitors, governments sponsor export credit systems that are able to provide two principal forms of support: insurance or guarantees against repayment risk; and support for fixed interest rates. These support systems have different structures, which makes exact comparisons difficult in terms of operations. However, the OECD Arrangement keeps the types of government finance support roughly comparable. Countries do vary considerably in the volumes of trade receiving government finance support and related budget resources. In recent years, U.S. government support to export financing has been near the bottom. (See Table 1.)

One reason for the high Japanese percentage is the Japan ECA requirement that exporters purchase "whole turnover" risk insurance, so that the insurer, EID/MITI, is assured diversified risk. That means that Japanese exporters insure their large export volumes to developed countries as well as to weaker markets.

Looking at the direction of commitments by the major export credit agencies, one notes a major focus on Asia in recent years. About 40 percent of global export credits committed and outstanding on a medium- and long-term basis are for seven Asian markets--an indication of the targeting by their exporters to China, India, Indonesia, Philippines, Malaysia, Thailand, and Pakistan.

Medium- to long-term finance is the area of intense competition among capital goods exporters. For most of these seven recipient countries, six nations were the primary sources of their total outstanding export credit. About 85 percent of their new commitments came from France, Germany, Italy, Japan, the United Kingdom, and the United States.

France was highest in China, Malaysia, and Pakistan and second in India. Germany was highest in India and Indonesia and second in China, Thailand, and Pakistan. Japan was highest in Thailand and second in Indonesia and Philippines. The United States was generally third or fourth across the board, except where it was first, in the Philippines. (See Table 7 in Additional Tables for greater detail.)

Special comment is necessary about Japan. The rankings presented above for new risk-taking commitments in 1996 included only the insurance issued by EID/MITI. Japanese exports also are assisted by the Export-Import Bank of Japan (JEx-Im). JEx-Im offers several forms of support:

- Export loans to Japanese suppliers (for relending to foreign buyers) or directly to foreign buyers; the export loans to suppliers are included in the EID/MITI insurance data because JEx-Im requires this insurance as part of its repayment security; these loans are tied to procurement from Japan.
- Import loans to Japanese companies for foreign projects to develop natural resources or manufactured goods for import to Japan; these loans are not tied to procurement from Japan.
- Investment loans to Japanese companies for equity or debt to develop investment projects overseas; procurement is tied to Japan.
- Untied loans to foreign governments, banks, corporations, and multilateral development banks for projects and economic restructuring programs in developing countries; procurement is untied.
- Purchases of public bonds issued by foreign governments and banks.
- Guarantees for Japanese companies to borrow from other financial institutions for purposes that would qualify for JEx-Im lending programs, or to Japanese private financial institutions for their cofinancing with JEx-Im loans; procurement rules follow the related JEx-Im loan rules.

The volume of JEx-Im activity in its various programs has moved away from tied export credit increasingly to untied loans and guarantees. However, the data on procurement benefits to non- Japanese companies are just beginning to emerge. In Table 2, data in the JEx-Im annual report of 1996 show the following procurement shares from JEx-Im untied loans as of December 1995.

Table 2. Sources of Procurement Using Untied Loans from Export-Import Bank of Japan (%)

|               |      |                |     |
|---------------|------|----------------|-----|
| United States | 18.0 | United Kingdom | 3.7 |
| Japan         | 17.7 | Switzerland    | 3.7 |
| Germany       | 10.2 | Sweden         | 3.5 |
| Italy         | 6.3  | Canada         | 0.9 |
| France        | 6.3  | Spain          | 0.9 |

SOURCE: JEx-Im, Annual Report 1996.

The supporting data need to be clarified in future reports.

Both the new commitments for JEx-Im in its FY 1995 (ending March 31, 1996) and its cumulative activity since 1950 show Asia as the largest portfolio share, 53 percent of new commitment volume and 37 percent of cumulative activity. China and Indonesia are the largest single credit recipients, with 50 percent and 15 percent, respectively, of new commitments and 20 percent and 25 percent, respectively, of cumulative exposure.

In China, of the 450 billion yen (\$4.5 billion) in new commitments, about two-thirds were untied (resource loans and untied loans and guarantees). The balance were tied investment loans and export loans. In Indonesia about 80 percent of the 150 billion yen (\$1.5 billion) in new commitments was for tied investment loans. The sectors emphasized in China were resources for Japan, infrastructure (including electric power, transportation, and pipelines for gas and oil), and general manufacturing. In Indonesia, key sectors were liquified natural gas (LNG) for Japan, electric power, and general manufacturing. (See Table 8 in Additional Tables for more detail about JEx-Im and EID/MITI activity.)

Another Japanese institution that brings large financing to Asia is the Overseas Economic Cooperation Fund (OECF). It provides development loans in yen on soft terms, i.e., long repayment and low interest. For loans committed in JFY 1995, the average interest rate was 2.54 percent and the average repayment term was 29 years. OECF has steadily increased the share of its new project commitments that allow procurement to be untied (from 67 percent to 97 percent over the past ten years). As a result the share of procurement supply from Japan has declined. (See Table 3.)

Table 3. Sources of Procurement Using Untied Loans from OECF: Country Categories (%)

|      |       |      |      |
|------|-------|------|------|
|      | Japan | LDCs | OECD |
| 1986 | 67    | 24   | 9    |

|      |    |    |    |
|------|----|----|----|
| 1995 | 27 | 60 | 13 |
|------|----|----|----|

SOURCE: OECF, Annual Report 1996.

However, the "transparency" of these data continues to need clarification in the eyes of many observers.

The importance to non-Japanese suppliers of a truly untied procurement policy lies with the large annual volumes of OECF activity. In JFY 1996, it made new project commitments of 1,093 billion yen (\$10 billion), and 81 percent went to Asia. In Asia, 16 percent were for Indonesia, 13 percent for China, 13 percent for the Philippines, and 12 percent for India--all large importers of major interest to U.S. suppliers. The major sectors of OECF activity have been electric power and transportation, and more recently social services. China and Indonesia have been the largest cumulative recipients.

The untied loans of Japan remain a highly sensitive issue with non-Japanese suppliers. Aside from questioning the statistics--for example, whether Japanese joint ventures in less developed countries are classified as LDC firms--they mainly seek full transparency through early alerts of bidding opportunities and a fair bidding process. They urge Japan to monitor the bidding reviews by the recipient countries and to publish all contract awards.

A further concern is the very large volume of Japanese tied funds that are provided for feasibility studies by Japanese agencies--about five times the level of the U.S. TDA annual budget of \$40 million. When a country's engineering companies design projects, they often lock in standards and specifications, as well as their relationships with national suppliers, which link the follow-on business to their own country's suppliers. Since these tied feasibility studies frequently are required before borrowing governments can qualify for an untied Japanese project loan from JEx-Im or OECF, non-Japanese firms may not really have a competitive opportunity at the project bid stage.

The 1992 OECD rules tightening the use of tied aid have increased non-Japanese supplier focus on difficulties in competing for projects funded by untied aid. Before the OECD 1992 "Helsinki Agreements," tied aid commitments were at the level of \$10 billion annually, and they have dropped to a \$4 billion annual level. The major recipients continue to be China and Indonesia, although annual amounts to those markets have dropped about \$1 billion each. Moreover, the rules now channel tied aid primarily to aid-type projects in social sectors and rural areas, rather than to commercially viable projects, as in the past.

As the economic growth of less-developed Asian countries, like the Philippines, Indonesia, India, and China, accelerated in the 1980s and 1990s, U.S. suppliers complained about their rejected bids in these growing economies, owing to the use of tied aid by other governments. Tied aid for an entry contract in a burgeoning growth sector like transportation, telecommunications, or electric power could help to lock up multiples in follow-on sales. The U.S. Treasury responded with initiatives to negotiate tighter



OECD rules over tied aid; and the U.S. Ex-Im started matching offers from other ECAs in significant demonstration cases. At the same time Congress debated the establishment of a "war chest" of up to \$5 billion to offset the aggressive use of tied aid by other countries. This carrot-and-stick approach helped win acceptance of the tighter Helsinki rules in the OECD Arrangement.

While the Helsinki rules are an important improvement, the United States needs to sustain adequate funding to match tied aid offers by other ECAs as a discipline to reinforce the OECD Arrangement and to secure the presence of U.S. suppliers at key market openings. Although reduced in total volume, tied aid continues to be a major commercial effort by certain countries. France and Germany made 28 percent of the commitments in 1992, and 38 percent during 1993--95. Japan remains by far the largest aid donor, but it claims most of the aid is untied.

Responding to congressional legislation and a mandate from the TPCC, in 1994 Ex-Im set up a Tied Aid Capital Projects Fund to operate an aggressive tied aid matching program. It has received special appropriations at annual levels of \$100 million to \$150 million, which leverage into financing volumes of \$300 million to \$450 million annually if needed. During 1994--96 Ex-Im used the fund to counter over \$2.5 billion of actual and potential foreign tied aid credits. American suppliers received indications of possible Ex-Im matching support as early in the negotiating process as another country offered possible tied aid. U.S. Ex-Im does not initiate tied aid, because it does not want to expand its use globally and because it faces budget constraints. However, the potential availability of Ex-Im support has had good results:

- 11 cases won with use of the Tied Aid Capital Projects Fund;
- 3 cases won without needing the fund;
- 16 cases where an offer of fund use remains on the table;
- 6 cases lost to competition, but for other reasons than financing;
- 3 cases where tied aid offers by other ECAs were withdrawn after the United States matched;
- 15 cases where U.S. suggestions that tied aid would not be appropriate were accepted by other OECD participants, yielding a "level playing field" for U.S. exporters.

The carrot-and-stick approach used to enforce the Helsinki agreements also could be useful in achieving greater discipline in the untied aid arena. In fact, Ex-Im has stated to suppliers that it will use its current Tied Aid Fund to match offers by others that, while allegedly untied, are demonstrably tied in practice. However, this intention has not yet been transformed with the U.S. Treasury into a broader negotiating strategy.

Another issue that complicates the transparency of untied aid is the action by Germany in 1994 to introduce a new untied aid facility through its government-owned bank, Kreditanstalt für Wiederaufbau (KfW). This agency has operated since 1950, originally to rebuild the German economy after World War II. It has evolved to operate in three realms: as a commercial bank taking its own risks; as an official export credit agency to

support tied procurement within the framework of the OECD Arrangement; and as an arm of the German government to administer tied aid credits. By adding an untied facility with partial but significant budget support from the government, KfW operations could become far more opaque. Other competitors will have a hard time knowing when KfW is acting strictly in an untied capacity, rather than combining its lending windows to advance German exports. Other OECD members need more information and assurance that transaction by transaction the tied and untied operations will be kept strictly separate.

## LEGISLATION ISSUES

Major political struggles evolved in Congress in 1997 for both Ex-Im and OPIC. After a heated battle, the charters of both agencies were renewed when they expired on September 30, 1997, Ex-Im for four years and OPIC for two, and each received barely adequate budgets for FY 1998. Both agencies will face major budget challenges in future years. A coalition of conservative "smaller government" representatives, social welfare supporters, and nongovernmental organizations concerned with environmental, labor, and human rights effects of Ex-Im and OPIC have mobilized broad support for sharp budget cuts for both agencies. The rallying cry is "Cut back corporate welfare." The opposition coalition is led by John Kasich (R-Ohio), chairman of the House Budget Committee, who almost won a battle in September 1996 to eliminate OPIC.

Ex-Im authorizations and oversight come under the jurisdiction of the Subcommittee on Domestic and International Monetary Policy of the House Banking Committee, and the Subcommittee on International Finance of the Senate Banking Committee. Appropriations for both Ex-Im and OPIC are controlled by the Foreign Operations Subcommittees of both the House and the Senate appropriations committees. OPIC authorizations and oversight come under the jurisdiction of the Subcommittee on International Economic Policy and Trade of the House International Relations Committee, and under the Subcommittee on International Economic Policy, Exports, and Trade Promotion of the Senate Foreign Relations Committee. Other committees become involved from time to time with the agencies on special issues, such as recently with government reform and reorganization.

During the past year there have been revivals in Congress and the administration of various proposals to merge Ex-Im, OPIC, and TDA, and possibly incorporate them as a single agency into the Commerce Department. The most advanced proposal to merge the three agencies was rejected by a meeting of the National Economic Council just before the February 1997 submission of the president's proposed FY 1998 budget to Congress. Accordingly, separate budget proposals were submitted at slightly lower program levels for FY 1998 than FY 1997 for Ex-Im and OPIC and with a slight increase for TDA. (See Table 4.)

Table 4. Proposed Budgets for U.S. Trade Finance Agencies

| (\$ million) | FY 96 | FY 97 | FY 98 |
|--------------|-------|-------|-------|
|--------------|-------|-------|-------|

|                |     |     |     |
|----------------|-----|-----|-----|
| Ex-Im programs | 687 | 626 | 632 |
| Tied aid       | 100 | 100 | 0   |
| Total Ex-Im    | 787 | 726 | 632 |
| OPIC           | 72  | 72  | 60  |
| TDA            | 40  | 40  | 43  |

SOURCE: Fact Sheet, National Foreign Trade Council, Washington, DC.

A major reason for not pushing ahead with the merger was political reality. At a time when "corporate welfare" was challenged by Congress, it would be a complicated effort to develop and justify new legislation for merging these agencies. It appeared more practical to renew each agency on its merits with reduced budgets. Also, past merger proposals sparked opposition from different congressional committees that want to retain jurisdiction. Indeed, both within the administration and in Congress, other issues have much higher priority.

#### ISSUES FROM CHANGING DYNAMICS OF INTERNATIONAL BUSINESS

The roles of Ex-Im and OPIC in U.S. commercial diplomacy are evolving partly from the impact of international business dynamics. The expansion of multinational firms has led to new questions revolving around such issues as company eligibility for Ex-Im, OPIC, or TDA support (must the recipient be a U.S. company, and how is that defined?); transaction eligibility for support (must it be a U.S. export, and how is that defined?); how the U.S. job benefits are maximized (would support for a non-U.S. company yield significant U.S. jobs?).

Moreover, rising demand in emerging markets for nonrecourse and limited-recourse financing (including large electric power and other infrastructure projects) requires the U.S. acronym financing agencies to adapt. The pressure to do so is increased by the need to remain competitive with the finance agencies of other governments that are also adapting to the changing business world.

Today, Ex-Im does not require an applicant to be a U.S. company. Eligibility is based on evidence of exports of goods or services from the United States. In contrast, OPIC requires the applicant to be a U.S. company (OPIC's definition: more than 50 percent owned by U.S. citizens, or a foreign company at least 95 percent U.S.-owned). As with Ex-Im, TDA funding for a feasibility study is limited to services sourced from the United States. The company in the United States providing the services may be foreign-owned, but TDA will support the study only if it foresees major follow-on procurement from the United States. OPIC support is untied, so procurement from its financing can occur in or outside the United States. However, OPIC informally encourages substantial procurement from the United States, partly to satisfy Congress.

Just what a U.S. export is becomes more complicated as multinationals increasingly source their procurement globally and through diverse subassembly locations. While a final product may be shipped from the United States, it may contain extensive subassemblies ("foreign content") from non-U.S. plants. Today Ex-Im allows its full financing only to a U.S. export that contains no more than 15 percent "foreign content." For greater amounts, the amount of support is proportionately reduced; above 50 percent "foreign content," Ex-Im support is denied. Multinational firms have access to ECAs wherever they have manufacturing plants. If those ECAs are liberal in accepting of "foreign content" (and most are more liberal than Ex-Im) some multinationals have switched their main assemblies to those countries--with a consequent loss of U.S. jobs.

Other multinationals may have predominant non-U.S. ownership, but they have large export operations from the United States. Should they be denied OPIC support, even when they place the majority of their procurement from the United States? After all, foreign-owned companies are among some of the largest U.S. exporters with Ex-Im support.

In the nonrecourse and limited-recourse project finance area, both Ex-Im and OPIC have taken major steps to provide competitive support. OPIC greatly expanded its support in 1994, from \$150 million maximum support per project (insurance and finance combined) to \$400 million, with a subceiling of \$200 million for finance. (In the finance area, loans remain a maximum of \$30 million and usually are less, since they are limited to small business users). Also in 1994, Ex-Im established a separate division for project finance, hired two experienced executives from the private sector, and overhauled its program support for such projects.

Results have been extraordinary and place U.S. agencies in the forefront of project financing among ECAs. Ex-Im in the last two years has approved 15 projects supporting \$3.8 billion of U.S. exports. OPIC in the same period has supported U.S. investors with \$4 billion in project finance. Ex-Im and OPIC have joined together in a few projects.

However, problems remain to be addressed. Confusing and complicating are the different eligibility and procurement requirements. In some cases, applicants can benefit from combining their support; for example, for a large project use Ex-Im because of OPIC limits (Ex-Im has no size limit), or secure OPIC support for non-U.S. procurement because of Ex-Im restrictions. However, each agency has different credit procedures and standards, different documentation requirements, different management procedures, and different turnaround times. These differences add to the arguments for merging the two agencies, although there are arguments on the other side as well.

## KEY ISSUES AND RECOMMENDATIONS

### Philosophy/Rationale for Ex-Im, OPIC, TDA

Of the major countries with export financing agencies, only the United States stresses the need for "additionality" of export benefits from the government support. The U.S.

agencies by statute and policy must design their programs so as not to compete with but supplement private financing. The government is not to do what the private sector can do. Moreover, the resulting exports should be "additional" to the economic benefits that would otherwise accrue to the economy if the government did not intervene through the financing agencies.

Various economic studies have addressed the additionality issue, but the basic rationale of these agencies' activities remains essentially the following: offset and neutralize competition from finance agencies of other governments to allow U.S. exporters to compete on a level playing field; assume risks beyond those that can be absorbed by the private sector to finance exports that otherwise would not occur.

Other ECAs mostly operate on an entitlement basis: if they are open in the market, an exporter can count on support. However, Ex-Im seeks, on a transaction-by-transaction basis, evidence of need before extending medium- or long-term support.

### Recommendation

U.S. agencies should retain the underlying philosophy of additionality: it is important for keeping budget requests at a minimum and for ensuring congressional support. Wherever possible, additionality should be applied on a generic rather than transactional basis. For example, when commercial banks clearly are not offering term financing in a market, or to types of borrowers, Ex-Im should be open for business. At the same time, the United States should maintain a strong negotiating posture in the OECD to refine fixed interest rate rules and to achieve comparability in risk premium rates.

### Trade Finance Linkage to Foreign Policy Objectives

Within the existing Ex-Im and OPIC charters are various congressional mandates to further certain foreign policy goals. These include human rights, labor rights, antinarcotics, and antinuclear proliferation among others. These agencies also are subject to sanctions in other legislation. While many of these objectives are worthwhile, how the United States pursues them can have disastrous consequences for U.S. exporters and investors.

When the Ex-Im charter severely limited amounts that Ex-Im could provide to the U.S.S.R. in 1973, and this was combined with the Jackson-Vanik amendment about freedom of emigration, the Soviet Union decided not to work with U.S. companies. Meanwhile, the Europeans and Japanese staked out new market shares. The Tiananmen Square sanctions in the Foreign Assistance Act preclude OPIC and TDA from operating in China, just at a time when U.S. investors need their maximum support to help win market share in the dynamic Chinese economy. (However, Ex-Im does not come under that act.) When U.S. drug-trafficking sanctions recently were applied to Colombia, investors and ECAs in other countries that were cooperating with their U.S. counterparts became alarmed and now hesitate. Similar situations have occurred in Indonesia and other markets.

## Recommendation

The executive branch should retain flexibility, through presidential discretion, in implementing sanctions legislation. With this context, sanctions should be applied less frequently and less capriciously. U.S. "light-switch" diplomacy has damaged U.S. economic presence in the dynamic emerging markets and limits U.S. influence over political evolution in those countries.

## Feasibility Studies

The significance of winning feasibility study contracts for success in winning follow-on procurement suggests the following actions.

## Recommendation

A larger budget for TDA is needed than the \$43 million recommended by the administration for FY 1998. This should be linked to an aggressive program to fund such studies for countries that are major recipients of untied aid and feasibility study support from other governments. Meanwhile, the United States should negotiate bilaterally with Japan (the largest source of tied funding for feasibility studies) to untie its funds, while simultaneously pursuing a similar agreement within the OECD.

## Untied Aid

One key to U.S. companies' winning procurement contracts funded by other governments' untied aid is an early presence in the planning agencies and technical ministries of recipient countries, in order to influence projects and develop relationships. This is better than just bidding on projects at a later stage when competitors have already become involved. Another key is full transparency in the bidding process.

## Recommendation

Increase the number of AID technical assistants made available in the planning and technical ministries of major emerging markets. Maximize links between Commerce attachés abroad and these ministries, and introduce TDA studies and AID technical assistants on a timely basis. Intensify current efforts in the OECD and bilaterally with Japan, Germany, and France for full transparency in the bid process, including early notification with wide dissemination of bid opportunities, active supervision by the donor of the recipient bid review, and publication of all awards. Give special attention to clarifying the new KfW untied aid program. Incorporate in this strategy active use of the Ex-Im Tied Aid Capital Projects Fund to match untied aid offers with competitive financing when the allegedly untied offer is demonstrably tied.

## Tied Aid

While the OECD Arrangement has made major progress in controlling tied aid, the United States needs to maintain maximum discipline over the process. Simultaneously, it needs to be sure that Ex-Im has ample funds to maintain an aggressive matching program, and that exporters are fully informed about how to use the Ex-Im facility. A large remaining problem is the use by some donor governments of "protocols" that offer a recipient country an annual amount of tied aid as an incentive to procure from the donor country.

#### Recommendation

Assure adequate funding for the Ex-Im tied aid "war chest" for matching other countries' offers after they are cleared by OECD review. Provide at least \$150 million annual appropriation, including carryover authority from one fiscal year to the next, to convince other countries of U.S. capabilities to discipline practices in both tied and untied aid. Develop Ex-Im contingency "matching protocols" with the countries that receive the largest "offer protocols" from other governments. The recipient country should know in advance that it can rely on the United States to match any other offer under a "protocol," when the project has cleared the OECD eligibility procedure for tied aid funding and the U.S. supplier is competitive in its contract offer.

#### Organization of Ex-Im, OPIC, and TDA

These agencies have significant differences in several areas: charter mandates, missions, eligibility and procurement criteria, credit and documentation systems, and management structures. These differences are compounded by historic experience and staff perceptions.

#### Recommendation

Conduct an executive branch objective study of the merits of merging the three agencies, with outside participants from private business (and possibly the General Accounting Office or Library of Congress). An objective study would take the matter off the immediate political agenda but would enable legislative proposals during the present administration.

If the study does not recommend a merger, then special attention needs to be paid to the differing program support, credit analysis, documentation, and management decision cycles of the agencies. This is particularly important because of accelerating global use of project finance, an area where considerable confusion and complexity confront potential U.S. users of Ex-Im and OPIC.

#### Additional Tables

Table 5. U.S. Ex-Im Bank Activity 1. New Commitments (\$ millions)

|  | FY 95 | FY 96 |
|--|-------|-------|
|--|-------|-------|

|            | Total    | Asia          | Total    | Asia          |
|------------|----------|---------------|----------|---------------|
| Loans      |          | \$ 1,598      |          | \$ 1,236      |
| Guarantees |          | 5,712         |          | 6,413         |
| Insurance  |          | 4,555         |          | 3,869         |
| total      | \$11,865 | \$3,671 (30%) | \$11,518 | \$3,428 (30%) |

2a. Current Exposure: Outstanding Commitments  
(medium and long term; amounts rounded)

| Geographic Area      | (\$ millions) | %   |
|----------------------|---------------|-----|
| Asia                 | \$16,700      | 36  |
| Latin America        | 17,800        | 37  |
| NIS & Eastern Europe | 4,600         | 10  |
| Middle East          | 1,750         | 4   |
| Africa               | 6,000         | 13  |
| total                | \$46,850      | 100 |

b. Largest U.S. Export Sectors Supported in Asia  
(highest 5 in rank order)

Electric power, commercial aircraft, telecommunications, oil and gas projects

c. Largest Markets in Asia  
(highest 4 in rank order)

China, Indonesia, the Philippines, India

Sources: Ex-Im Bank; commitments from FY 95 and FY 96 Annual Reports. Exposure data as of December 31, 1996.

Table 6. OPIC Activity

1. New Commitments (\$ millions)

|                                | FY 95    |         | FY 96    |         |
|--------------------------------|----------|---------|----------|---------|
|                                | Total    | Asia    | Total    | Asia    |
| Financing (Loans & Guarantees) | \$ 1,800 | \$ 360  | \$ 2,200 | \$ 628  |
| Insurance                      | 10,000   | 748     | 16,500   | 1,095   |
| total                          | \$11,800 | \$1,108 | \$18,700 | \$1,713 |



|  |  |      |  |      |
|--|--|------|--|------|
|  |  | (9%) |  | (9%) |
|--|--|------|--|------|

## 2. Current Exposure: Outstanding Commitments (medium and long term)

### a. Geographic Area

- Asia & Pacific: 20%
- The Americas : 41%
- NIS: 18%
- Central & Eastern Europe: 10%
- Africa & Middle East: 11%

### b. Largest Sectors Supported Globally

- Electric power: 29%
- Telecommunications: 11%
- Financial services: 20%
- Oil & gas projects: 9%
- Manufacturing: 16%
- Mining: 7%

### c. Largest Markets in Asia (not rank order)

India, Indonesia, Malaysia, Philippines, Taiwan, Thailand

Sources: OPIC; FY 95 and FY 96 Annual Reports.

Table 7. Major Export Credit Sources for Large Asian Markets  
(Period ending CY 1996)

| Source      | China | India | Indonesia | Philippines | Malaysia | Thailand | Pakistan |
|-------------|-------|-------|-----------|-------------|----------|----------|----------|
| France      | 26%   | 16%   | 11%       | 8%          | 35%      | 11%      | 21%      |
| Germany     | 16    | 28    | 25        | 10          | 11       | 17       | 16       |
| Italy       | 7     | 3     |           |             |          |          | 15       |
| Japan       | 11    | 8     | 17        | 17          | 17       | 26       | 11       |
| U.K.        | 7     | 11    | 9         | 11          | 21       | 2        | 8        |
| U.S.        | 11    | 12    | 10        | 20          | 10       | 12       | 12       |
| Spain       | 5     |       |           |             |          |          |          |
| Sweden      |       | 10    |           |             |          |          |          |
| Switzerland |       |       | 4         |             |          |          |          |

|                   |    |    |    |    |    |    |    |
|-------------------|----|----|----|----|----|----|----|
| Austria           |    |    | 4  |    |    |    |    |
| Netherlands       |    |    | 4  |    |    | 5  |    |
| Korea             |    |    |    |    |    | 16 |    |
| % of total export | 83 | 88 | 84 | 66 | 94 | 89 | 83 |

credits received from these sources

Notes: Seven Asian markets account for 40% of global export credits committed and outstanding on a medium- and long-term basis. For these seven markets the chart shows, by recipient country, the percentage of its total outstanding export credits received from its major sources. The data are based on various reports from export credit agencies and insurers. Data are approximate for indicative purposes. Blank spaces indicate insignificant amounts. Japan: Reflects insurance issued by EID/MITI, and includes Japan Ex-Im Bank "export loans" extended as "supplier credits" but not other Japan Ex-Im Bank activity.

Table 8. Japan Ex-Im Bank Activity

1. Major Countries and Regions (billion Yen)

New Commitments Cumulative

FY 95 Commitments

|                     | (53% of FY 95) | (37% of total) |
|---------------------|----------------|----------------|
| Asia                | 862            | 12,300         |
| Indonesia           | 145            | 3,188          |
| China               | 448            | 2,723          |
| Thailand            | 72             | 987            |
| Philippines         | 60             | 985            |
| India               | 20             | 664            |
| Europe              | 228            | 5,457          |
| Middle East         | 194            | 1,923          |
| Africa              | 76             | 3,277          |
| North America       | 105            | 4,300          |
| Latin America       | 172            | 4,679          |
| International Orgs. |                | 907            |

|       |                  |                    |
|-------|------------------|--------------------|
| total | 1,637 (\$16 bil) | 32,894 (\$328 bil) |
|-------|------------------|--------------------|

## 2. FY 95 New Commitments by Purpose (billion Yen)

|                           | Asia              | Global             | Global Share |
|---------------------------|-------------------|--------------------|--------------|
| Export Loans              | 83                | 82.8               | 11%          |
| Import Loans              | 0.4               | 126.0              | 8            |
| Overseas Investment Loans | 251.2             | 604.6              | 37           |
| Untied Loans & Guarantees | 477.6             | 723.1              | 44           |
| total                     | 811.8 (\$8.1 bil) | 1,636.5 (\$16 bil) | 100%         |

## 3. Untied Loans and Guarantees (billion yen)

total 723.1

Asia 477.6 65% of Total

China 235.1 50% of Asia, 33% of Total a Since 1950; not current outstandings.

Note: Untied loans and guarantees in (3) are included in (2) above. Source: Japan Ex-Im Bank Annual Report 1996. Fiscal year ending March 31, 1996. Table 9. Japan: EID/MITI Activity Total JFY 94 Commitments: Operational Value of Commitments New Policies Outstanding Made Operational at March 31, 1995

|                         |             |      |            |      |
|-------------------------|-------------|------|------------|------|
| Oceania                 | 768         | 4%   | 175        | 2%   |
| Asia                    | 6,960       | 35   | 5,922      | 65   |
| North & Central America | 7,766       | 40   | 1,371      | 15   |
| South America           | 322         | 2    | 399        | 4    |
| Europe                  | 2,986       | 16   | 817        | 9    |
| Africa                  | 557         | 3    | 584        |      |
| total                   | 19,359      | 100% | 8,684      | 100% |
|                         | (\$194 bil) |      | (\$87 bil) |      |

Notes: Data include short-term policies for about 90--95% of the values. This means many 90-day policies could be issued and no longer be outstanding at the end of the year. Japanese companies must generally take whole turnover coverage, which means that they must include sales to the United States and other strong markets as well as weaker ones.

Source: EID/MITI Annual Report. (Fiscal year ending March 31, 1995)

## Agriculture and U.S. Commercial Diplomacy in Asia

Robbin S. Johnson

1996 was a watershed year for American agriculture. Congress replaced a 60-year-old regime of farm subsidies with a new approach designed to give American farmers more freedom to do what they do best: to farm.

The new program, called the FAIR Act, replaced the old, amorphous system of income support tied to production of specific commodities with a new, finite schedule of "decoupled" payments that are made independent of current commodity price levels or production decisions. This shift in domestic farm programs took the U.S. government out of the business of managing production and prices for major field crops.

### COMMERCIAL DIPLOMACY AS EXPORT PROMOTION

The FAIR Act also alters in fundamental ways agriculture's role in commercial diplomacy. Prior to this change, U.S. agricultural export policy was often an extension of domestic farm policy, aimed to prop up prices and help hold down surpluses. Food aid programs, especially P.L. 480, were shaped at least as much to meet the policy goal of preventing surpluses from weighing down on domestic markets as they were to provide development assistance to recipient countries.

High price supports in the face of global crop surpluses also created pressures to subsidize exports. In the case of wheat, this often was done directly through export subsidies that covered the difference between higher domestic and lower world prices.

All major crops except oilseeds also saw the introduction of "target prices" and deficiency payments. These allowed U.S. commodity prices to fall to world market levels while farmers' incomes were protected through direct, per-bushel payments making up the "deficiency" between market and target prices on eligible production.

Another tool in agriculture's export promotion kit was credit. Qualified foreign buyers would receive financing, initially directly from the U.S. government but later through private loans "guaranteed" by the government, on purchases they made of U.S. commodities. Interest rates were generally close to commercial levels (to escape a requirement that government-assisted cargoes had to move on more expensive U.S. flag vessels). However, the length of these credits--18 to 36 months in most cases--was greater than would be commercially prudent for items that are immediately consumed.

A final export promotion tool was market development programs. These spent taxpayer dollars to help promote usage of U.S. commodities in foreign markets. Some, called "cooperator" programs, involved the use of grower check-off funds along with government funds for promotion purposes. Unlike the other promotional tools, however, market development programs funded educational efforts aimed at changing foreign production or consumption practices.

This arsenal of export promotion tools multiplied over the years as policymakers attempted to respond to domestic farm problems and related constituent pressures. With the exception of market development programs, most of these weapons were designed to make U.S. agricultural exports more competitive globally by lowering the effective price foreign buyers would have to pay. Food aid and export subsidy programs lowered transaction prices directly; "deficiency" payments and export credit programs affected transaction costs more indirectly.

Of course, this government-assisted price competition in export markets did not occur in a vacuum. Since the early 1960s, the original European Community and its successors have been restricting imports of U.S. grains and animal products and subsidizing disposal of surplus output on world markets. A number of exporting countries, and some importing nations like Japan, have dumped surpluses onto developing countries under the guise of food aid.

In addition, monopoly state and parastatal exporting entities have discriminated among foreign buyers in quoting export prices. In some cases deficits in their export budgets were covered by national treasuries, enabling them to subsidize export sales directly.

During this period, governments also attempted to manage world markets through international commodity agreements that frequently contained minimum price provisions. These price floors usually were set too high, resulting first in leakage and then in breaches. When unpredictable state buyers like the former Soviet Union emerged as major importers, major exporting countries negotiated bilateral agreements to set minimum--and, sometimes, maximum--purchase volumes.

Very simply, global agricultural trade for much of the second half of the 20th century represented a marketplace in which governments actively manipulated farm trade through direct subsidies, indirect subsidies, tied aid, dumping, commodity agreements, and other forms of discrimination.

No wonder, then, that the U.S. agricultural community developed its own elaborate kit of export promotion tools. Nor was it any wonder that U.S. taxpayers were willing to finance that kit, which they did generously. Commercial export credit guarantees by the

U.S. Department of Agriculture (USDA) have consistently run in the \$4--5 billion per year range over the last ten years. P.L. 480 and other food assistance programs have averaged \$1.5 billion per year since 1980.

Export subsidies started up again in 1985 after a long hiatus that began in 1973. Over \$7.5 billion was spent subsidizing agricultural exports over the decade ending in 1995.

## THE DOMESTIC POLITICS OF EXPORT PROMOTION

With these aggressive and often expensive subsidy initiatives also came vigorous debate about the degree to which these various tools were successful. Success was defined by

some as actually expanding U.S. farm product exports--the "additionality" test. Others defined success as bringing other unfair traders to the negotiating table--the "bargaining chip" test. Though debates over additionality and bargaining leverage were often heated, they were seldom very illuminating because they depended on conjecture about what would have happened in the absence of such tools.

Without attempting to resolve those debates, it is important to make two related points. First, agricultural export promotion programs were developed in response to domestic farm policy needs--specifically, their perceived role in helping boost prices while avoiding accumulation of surpluses. The use of similar practices by some other exporting nations helped policymakers rationalize the need for these programs. Nonetheless, their origins--and their resilience in the face of growing budget pressures in the 1980s and 1990s--are deeply rooted in the domestic political constituencies that grew up to defend them.

That defense of export promotion programs was anchored in their hoped-for effects on farm programs: that they would help raise prices, reduce surpluses, and contain overall farm program costs. Agricultural export promotion, in other words, had the same domestic political rationale as did the price support, income support, and supply management farm programs from which they grew.

Second, the far-reaching 1996 changes in domestic U.S. farm programs will rapidly erode the political foundation for export promotion programs. Now that the domestic programs of which export promotion was a part are gone, spending on agricultural export initiatives increasingly must stand on its own. Only those programs and initiatives that can be shown to be cost-effective can endure. Others will fade away because they are no longer instruments of domestic market management programs and thus cannot be justified with familiar political arguments.

## THE CHANGING GLOBAL ENVIRONMENT

Contributing to changes in domestic U.S. farm programs were changes occurring in the export marketplace. Three deserve special mention.

First, the Uruguay Round began bringing agricultural trade under General Agreement on Tariffs and Trade--now World Trade Organization--disciplines. Various nontariff import barriers were converted to their tariff equivalents (but often at unreasonably high levels), and a process of tariff reductions was initiated. Minimum access for imports was established, even in highly protected markets. Sanitary and phytosanitary measures were anchored in sound science. Dispute resolution procedures were strengthened. And the most egregious unfair trade practices--export subsidies--were capped in volume and value, with a commitment to gradual reduction in subsidy levels.

Second, a wave of privatization swept across many countries, with far-reaching implications for agriculture. State-buying monopolies were eliminated or at least forced to compete with newly legitimized private buyers. New price-risk management tools

were developed to enable competitive markets to function more efficiently. And government-financed stockpiles largely disappeared, opening the way for greater risk-sharing based on market principles.

Finally, exports became a larger part of the global food marketplace. The 1970s witnessed the largest growth in bulk commodity exports; value-added exports grew more robustly in the 1980s. These came together in the 1990s, with strong expansion in both commodities and value-added exports, as well as diversification of import destinations, led especially by Asia.

That three-pronged onslaught--agricultural trade liberalization, privatization, and food-trade expansion--quickly overtook traditional export promotion tools and has made those tools less useful.

Food aid began losing ground as an export device as government-held surpluses shrank and understanding grew of the negative effects of food aid dependence on farm sectors in recipient countries. Growing budget pressures only added to this effect.

Export credit programs also lost their luster. Cumbersome governmental procedures for allocating credits to different countries and among different commodities burdened these programs, inserting bureaucratic rules between private buyers and sellers, which limited exporters' ability to serve their customers' diverse and changing needs. Delays, inflexibilities, and political uncertainties added costs that increasingly outweighed any price advantages that credit terms may have conferred.

Export subsidies have faded in importance, initially because tight supplies and high prices made them superfluous. But once they were discontinued in the United States, the more systematic disadvantages they presented became more evident to other countries.

Uruguay Round ceilings on the use of export subsidies mean that a growing share of export markets will no longer be subsidized. Moreover, export subsidies can backfire on the United States because two-tier markets create opportunities for state-trading entities to take business away by undercutting U.S. exports in both nonsubsidized, high-priced markets and subsidized, low-priced ones. Finally, experience has shown that export subsidies are more likely to rearrange trade flows than they are to increase exports overall.

One traditional tool has escaped the new disciplines: the large network of American agricultural attachés and counselors stationed around the world to promote U.S. exports. This network remains a valuable resource for analyzing markets, identifying impediments to trade and supporting U.S. efforts to lower those barriers through bilateral or multilateral negotiations. And it is not nearly as expensive as other tools, costing only about \$100 million per year.

But to capture that value fully, this "foreign agricultural service" needs a new approach to commercial diplomacy. The network should be refocused and reenergized as a source of

intelligence on, insight into, and influence over the economic and food policies of newly emerging markets. Such an approach will meet the emerging, more stringent tests for cost-effectiveness by being both less expensive and more responsive to market needs than traditional export promotion.

## A NEW ASIAN COMMERCIAL DIPLOMACY FOR AGRICULTURE

Any program of commercial agricultural diplomacy undertaken on behalf of the U.S. food sector should advance three fundamental interests: enhance global food security; accelerate economic development; and increase environmental protection.

To accomplish these objectives for Asia, U.S. commercial agricultural diplomacy needs to promote an open global food system based on well-functioning markets, assured access to supplies, and ecologically friendly production, processing, and distribution technologies. Those goals, not export promotion per se, provide a more rewarding, enduring foundation for commercial diplomacy.

Asia presents a unique challenge to the ability of the world to eat better with less environmental stress. As world population grows from 5.8 billion today to 8 billion by 2025, 58 percent of that increase will occur in Asia. Virtually all those people will be absorbed by urban areas, creating more than 500 cities with populations above 1 million. Per capita incomes also will rise, with Asia accounting for half of foreseeable growth in economic activity.

Rising population, increasing urbanization, and higher living standards together translate into enormous growth in global food demand. And the magnitude of this demand growth will be overshadowed by the speed at which it develops. Never have world farmers had to accommodate more people more quickly.

To serve the size and speed of this demand growth, food supply lines must lengthen and branch out: Over the next 25 years food demand in North America will grow 20 percent, but it will grow 100 percent in East Asia and 150 percent in South Asia. Yet Asia already has the lowest ratio of arable land to population, one-sixth that of the Western Hemisphere. It will be to the Western Hemisphere, and especially to the rich soils in the temperate heartland of the United States, that Asia must look for food.

### Meeting the Food Security Issue

The only practical way to feed Asia's growing, prospering, urbanizing population is through expanded, more open food trade. In the process, global food security is enhanced.

Freer food trade offsets local shortages here with surpluses there. It offsets Northern with Southern Hemisphere sowing and harvesting times. It gives consumers more choices, which means more ways to satisfy rising demand--but also more ways to compensate for temporary supply disruptions.



But more food security and choice through freer trade cannot happen without assured access to supplies. Importers will not trust long supply lines, and trade cannot buffer regional supply variations, unless there is multilaterally assured supply access (MASA is the acronym sometimes used).

U.S. commercial diplomacy in Asia on behalf of the food and agricultural sector therefore requires two components: barriers to imports must be broken down through trade-liberalizing initiatives; and all food-exporting countries must be convinced to join in a multilateral commitment that assures importers the same access to food supplies that domestic consumers have. The United States needs to put agricultural trade liberalization at the top of its foreign economic policy agenda and renounce the use of food sanctions for short supply or foreign policy reasons.

#### Meeting the Economic Development Issue

In developing countries, half or more of the population lives in rural areas, where most are dependent on farming or related activities. In these countries, half or more of each additional dollar of income goes for food.

Steps that increase agricultural productivity in these countries produce a double benefit: they kick-start economic development more effectively than would reforms in any other sector; and they lower out-of-pocket food costs, which frees up income that can be spent on other goods and services.

Effective commercial diplomacy for food, therefore, becomes a tool for encouraging countries to develop their economies and increase their prosperity by instituting market-based food and agricultural systems. That linkage has been too often overlooked in the past, when governments set food self-sufficiency goals and attempted to achieve them by isolating the food and agricultural sector from the energizing effects of competition. Time after time, the result was stunted agricultural productivity and slower economic growth.

Instead, the United States should encourage and assist developing countries in adopting agricultural systems based on private enterprise and competitive markets, including improved opportunities for foreign investment. "Marketization" of domestic food systems will lower food costs, raise productivity, stimulate growth and investment, and prepare these nations for integration into open global systems.

#### Meeting the Sustainable Development Issue

A look at environmental degradation in poor countries, where subsistence farmers are forced to exploit vulnerable soils carved out of virgin wildlands, can often find poverty at the root of the problem. On the other hand, market-based food systems can be instruments for sustainable development, both economic and environmental.

Market-based systems, with their inherent risks and rewards, tend to foster the technological innovations--like precision farming or plant biotechnology--that increase output while also reducing inputs, waste, or land-endangering practices.

The same atmosphere rewards improved management practices that complement new technologies. For example, U.S. farmers have increased nitrogen efficiency by one-fifth and reduced crop protection chemical use by one-third while raising crop output by one-fourth in the last 15 years.

Finally, cost-effective, outcome-based regulatory practices can harness market incentives that reward faster introduction of resource-conserving technologies and management practices that lower costs and waste over entire product life cycles.

Effective commercial diplomacy means advocating market principles, modern technologies, and sensible regulatory practices. It also means abandoning once and for all the elitist environmental notions that tend to perpetuate poverty and peasantry by seeking to protect people in developing countries from economic reforms and technological progress.

This programmatic approach to U.S. commercial diplomacy in Asia on behalf of food and agriculture is very different from the past. It is not a self-serving front aimed at dumping surpluses or promoting dependence. It is not transaction-oriented.

Rather, this strategy for the U.S. food and agricultural sector aims at institution-building. It creates well-functioning markets and marketing institutions in Asia. It promotes market-based regulatory and environmental protection systems. It puts agriculture at the top of the foreign economic policy agenda for both trade liberalization and supply assurances.

Feeding people first in an open global food system is a worthy goal of commercial diplomacy, and U.S. agriculture will do fine in such a world.

## Beyond Manic Mercantilism

David J. Rothkopf

The first years of the post--Cold War era produced a kind of euphoria that security threats were behind us, a new world order was upon us, and the United States could return to the land where "the business of America is business." While this view allowed a greater emphasis on international economics in U.S. foreign policy than was possible during the Cold War, it also produced a period that might be labeled "manic mercantilism." Promoting U.S. exports took on disproportionate importance among international objectives.

But after a brief moment in the sun, "commercial diplomacy" is in trouble. Trade purists say it distorts the market mechanism and impedes free trade. Budget deficit hawks charge

that it's corporate welfare and a waste of taxpayer money. Political partisans claim that the Clinton administration used export promotion programs to

strong-arm campaign donors and reward corporate supporters. Finally, during the last several months, economic upheaval in Asia has seriously weakened buying power in export markets that were at the heart of commercial diplomacy efforts and made aggressive export promotion in those markets politically inappropriate, insensitive, and unlikely to be effective.

But criticism and momentary political economic phenomena threaten to lead policymakers to throw out the baby with the bathwater. It is true that a thoughtful, systematic effort to end this sort of government intervention in the marketplace would be sound economics, because any attempt to tilt the commercial playing field is bad policy. But the recent and accelerating decline of commercial diplomacy is not the result of careful policy planning. Like the circumstances that gave birth to it as a policy priority of the Clinton administration, commercial diplomacy is threatened because of extraneous factors, such as politics and personalities.

Nevertheless, commercial diplomacy should be viewed as something considerably more than the manic mercantilism that made it famous. Understanding this larger role starts with recognition that, among the levers at the disposal of the makers of U.S. foreign policy, many are economic or commercial in nature. At the same time, the two other primary levers--political suasion and military force--have undergone substantial change. In the wake of the Cold War, U.S. political influence as "leader of the Free World" has ebbed. American military technology has made the costs of warfare unacceptable except in extreme circumstances. Consequently, the need to inventory, understand, and successfully wield economic carrots and sticks has grown substantially.

This paper explores the circumstances behind the rapid rise and equally sudden decline of commercial diplomacy as a priority of the Clinton administration. It looks at both the publicly stated and concrete economic reasons behind that rise, the special circumstances that gave the effort momentum, the policy principles that shaped the Commerce Department's leadership of the administration's commercial diplomacy programs, and the situations in which Commerce and the administration delivered on their promises and those in which they indulged in fairly typical, generally necessary, exercises in hyping "programs" and "policies." The paper lays out the reasons commercial diplomacy is in trouble, who really benefited from the programs, and the particular importance of commercial diplomacy in Asia and of Asia to U.S. commercial diplomacy efforts. Finally, it discusses what institutional changes are needed to maximize the effectiveness and efficiency of ongoing U.S. commercial diplomacy efforts, what conundrums policymakers will face, and what overarching policies should influence the development of tomorrow's commercial diplomacy.

**WHAT IS COMMERCIAL DIPLOMACY? ORIGINS OF THE INITIATIVE**

Before considering the administration's commercial diplomacy initiative, we offer a word about the origins of the term "commercial diplomacy." It was proposed as an umbrella for the policies undertaken by the Commerce Department prior to one of the late secretary of commerce Ron Brown's international trade missions. The objective of introducing such a term was to place trade missions squarely at the center of U.S. international policy and not at its periphery. The terminology was meant to suggest that in addition to political/diplomatic and military levers, governments had economic/commercial levers that were becoming increasingly important to the pursuit of U.S. national interests around the world. This digression into etymology is meant to emphasize that at the time the term did not have the purely mercantile meaning it has taken on for some since--or the negative connotation ("sellout of values") that it has taken on for some, such as those in the human rights community, in the years since it was introduced.

Lastly, for the record, one of the reasons the term was "commercial" rather than "economic" diplomacy was that the Commerce Department had discovered that whenever the word "commercial" was used in regard to an initiative, "high-policy" agencies such as State, Treasury, or even the Office of the United States Trade Representative wanted to have nothing to do with it, thus allowing Commerce to go about its business unburdened by the usual internecine rivalries.

In the name of commercial diplomacy, the Clinton administration undertook a program in support of U.S. business interests that even its critics acknowledge was unprecedented and often effective. Commercial opportunities worth over \$1.5 trillion and perhaps as much as \$2 trillion were targeted in the world's emerging markets, with \$1 trillion established as a target for U.S. exports in the next several years. Ten particular emerging markets became the focus of a special program designed to reorient U.S. trade promotion efforts to account for the unprecedented growth of the largest emerging markets--markets that would within a decade surpass those of our traditional trading partners as the largest served by U.S. exporters. Over 100 U.S. government--supported trade missions, trade shows, and other events per year were scheduled for China alone. New bilateral consultative bodies were established with South Africa, Brazil, Argentina, India, the Association of Southeast Asian Nations (ASEAN), and Turkey, and existing bodies were expanded with other key emerging markets. Special programs were created to support new trade deals, such as the North American Free Trade Agreement (NAFTA), and other U.S. government initiatives, such as making the information superhighway global. Export controls were often dramatically liberalized and in many cases lifted. New financing programs were born with the specific objective of countering the aggressive efforts of our competitors. Intelligence agencies were drawn into the commercial fray, providing analysis and other forms of assistance for these efforts. Speeches were delivered. Acronyms were coined. For a couple of years, commercial diplomacy became a policy growth stock in the wonk marketplace.

## TARGETS OF COMMERCIAL DIPLOMACY

Commercial diplomacy differs in important ways from other means of influence at the disposal of the United States. Military force has a universal character that enables its

deployment against any entity at any time. It can be defended against and counteracted; outcomes are dictated by the resources and wit of the opposing nation. This is not true for economic or political diplomacy. Both require that the United States have demonstrable leverage in an area important to the target country or countries. In the wake of the Cold War, as noted, the scope of U.S. political leverage has diminished. U.S. economic leverage has been similarly diminished, although for different reasons. The rise of the global marketplace has helped and hurt the United States in this respect. As the world's largest market, most would-be global players seek access to U.S. consumers. As the world's richest nation, most would-be global players seek access to U.S. finance. Since many U.S. firms are industry or technology leaders, many counterparts from overseas seek relationships with them. Each of these realities is a source of leverage.

On the other hand, the rise of new markets of great size and promise, and the growth of international competitors to U.S. firms in almost every significant sector, has reduced U.S. leverage in substantial ways. In 1946, over 50 percent of the world's trade passed through the United States. Today it is less than 15 percent. Immediately after World War II, if a nation sought the latest consumer products or technology, the United States was often the dominant supplier. That is no longer the case. Furthermore, Pax Americana came with an implicit price tag to nations that accepted the U.S. security umbrella. If a country depended on the United States for security protection, it dealt with the United States on trade and commercial matters. Now the lesser "need" to deal with the United States hurts efforts to fashion international consensus or gain ground in bilateral trade discussions.

Nonetheless, virtually every country in the world has reasons for dealing with the United States on a commercial basis or some need for U.S. support to achieve its own commercial goals internationally. Consequently, a wide array of potential targets are available for U.S. commercial diplomacy. Several of these can be listed, but the categories of nations that follow are intended to be illustrative rather than comprehensive:

**Trading Partners.** With these, the United States has the levers of opening and closing markets, building investment, merger, and joint-venture linkages or dismantling them, exchanging technologies, adopting like standards or not, and so forth.

**"Hardball" Competitors.** With these countries, the United States can fund countermeasures to their initiatives (e.g., official export credit support) and undertake international initiatives to "level the playing field."

**Enemies and Rogues.** Against these countries, the United States can institute the most extreme sort of economic and commercial measures, such as sanctions, embargoes, and harsh unilateral and multilateral legal measures.

**Victims, the Needy, Special Situations.** With these nations, the United States can offer or withhold assistance and investment or promotion activities designed to encourage U.S. companies to enter transitional, post-crisis, and peacekeeping environments.

Targets can fall into more than one of these groups simultaneously. However, membership in only one is enough to make the economic diplomacy effective to some degree.

Yet the definition of the term, a list of the accomplishments produced in its name, or an overview of its targets does not offer the context needed to fully understand the phenomenon or the substance of this policy boomlet. To fully understand that context, it is necessary to take several steps back and examine how politics set some of the wheels in motion that led to those programs. Specifically, the politics of 1992 helped pave the way for the introduction of many of the policies and programs that are now defined under the umbrella of commercial diplomacy. Subsequently, the success of many of those programs gave them a prominence that placed them squarely in the cross-hairs during the political seasons of 1994 and 1996, when commercial diplomacy began to come under attack.

## THE REAL ECONOMICS BEHIND COMMERCIAL DIPLOMACY

In the Sally Bedell Smith biography of the late U.S. Ambassador to France Pamela Harriman, a pivotal meeting is described in which then Democratic National Committee Chairman Ronald H. Brown announced that the Democratic Party would now target and make itself home to the leaders of the business community. No reason is given for this shift in views by a key operative in the presidential campaigns of Jesse Jackson and Edward Kennedy, candidates not known for their pro-business views. But even modest scrutiny suggests Brown's shift in attitude is as much linked to the fact that corporations represent the single best source of the six-figure soft-money donations on which national political campaigns must depend as it is to any shift in party or personal ideologies. Indeed, thanks to the burgeoning costs of major campaigns and the fact that the only large group that can write the big checks is business, it was inevitable business would become the darling of both political parties and a greater force in politics than at any other time in our recent past. Viewed in terms of its economic policy consequences alone, this is not necessarily a bad thing.

The shift of the Democratic Party to centrist, more pro-business views represents at its core pragmatic politics. The Democratic Leadership Council, once led by Governor Bill Clinton, represented a break with the failed Roosevelt-era policies of former Democratic presidential candidates George McGovern and Walter Mondale. This rupture was due both to the failure of their antiquated views and to the inexorable, unignorable aging of the single largest demographic group in the American populace, the baby boomers. As these voters aged, it was inevitable that they would grow more conservative and more concerned with preserving and building their own wealth. (This is as close to a law of nature as can affect politics.) Ronald Reagan capitalized on this trend, and his successes focused the attention of his opponents.

Business meanwhile was willing to write checks to both parties, knowing that either would be beholden should it win. The cost of underwriting one sure loser was far outweighed by also underwriting a sure winner. And if the loser was still influential on

the Hill or elsewhere, all the better. Later corporations would also discover that for some very logical reasons, Democrats make better advocates for business in several respects. This was later a key to the development and success of the programs and policies that came to be known as "commercial diplomacy." At its core, this Democratic "advantage" was linked to the party's view that government can and should play an activist role in American lives. This in turn led Democrats to eschew the laissez-faire approach of Reagan disciples and naturally assume there is a role for government in the marketplace. In international markets in which the competition often materializes as public-private partnerships with foreign governments offering financing, advocacy, technical assistance, and other forms of less savory arm-twisting, American firms were at a disadvantage unless their government did the same or used equally effective tactics.

Of course, the new, symbiotic relationship developing between the political leaders within the administration and the business community went hand-in-hand with the general wisdom that elections are about pocketbooks and the oft-quoted Clinton administration "maxim" that it was "the economy, stupid." Economic growth was an administration priority from the get-go, and there was also a going-in assumption, perhaps related to the relative youth of many of the leaders within the administration, that a key to that growth would be global competitiveness. The important influence of intellectual work by incoming Secretary of Labor Robert Reich, incoming Council of Economic Advisers Chair Laura Tyson, incoming Treasury Undersecretary Larry Summers, incoming Commerce Undersecretary Jeff Garten, and others should not be discounted here. This was probably the first administration in history built around such a core of economic globalists. And they were led by a number of individuals who had important track records of accomplishment or interest in this area as well: National Economic Council (NEC) Chairman Robert Rubin, Treasury Secretary Lloyd Bentsen, and, significantly, Vice President Albert Gore, Jr. While this group did not share every view, the international focus and the focus on economic growth created the atmosphere in which commercial diplomacy could become a major thrust for the administration, for Brown, and for the trade promotion agencies individually and severally.

## THE ALIGNMENT OF THE STARS

Another reason that the policies that commercial diplomacy comprises gained traction within the Clinton administration had to do with three facts about the organization of the administration. First, during the initial year of the Clinton presidency, there was considerable disorganization, and it was possible to "lob ideas into the center from almost anywhere" (in the words of one very senior official) and "have them stick." There was a void and an earnest desire to fill it. The next key reason was the organization and introduction of the NEC as a central policymaking organ within the White House. This agency was important because it coordinated economic policymakers within the government and because it elevated these issues within the White House. But it was also important to secondary agencies such as Commerce because it gave them "a seat at the table." Furthermore, in addition to Rubin, the deputy at the NEC in charge of international issues, Bowman Cutter, was that rare combination of experienced businessman and government official who was seeking creative ways to stimulate U.S.

growth through seizing the opportunities presented by the global marketplace. His support and sponsorship of many of Commerce's ideas and his introduction of many ideas of his own within the policymaking process were absolutely essential to giving these ideas any chance of being more than the invisible output of a second-class agency.

The third organizational quirk was a vestigial mandate from Capitol Hill that Commerce chair a committee to coordinate the trade promotion activities of the complex amalgam of 19 agencies of the U.S. government that have trade promotion programs or responsibilities of one sort or another. This committee, the Trade Promotion Coordinating Committee (TPCC), was seen as a unique opportunity to give otherwise secondary issues the importance of a real interagency process. Commerce Secretary Brown saw the group as a chance to preside over an interagency effort that could be meaningful and to provide some of the status he sought for the department, which he needed if he was to play a meaningful role in the administration.

## THE FOUNDATIONS OF COMMERCIAL DIPLOMACY IN THE CLINTON ADMINISTRATION

The role the Commerce Department played in championing commercial diplomacy during the first Clinton administration had two primary components. Only one was substantive in the practical sense that it led to the actual support of real deals or had a meaningful impact on policy decisions. The other, which was also important given the state of U.S. commercial diplomacy prior to the administration, was promoting the promotion. This effort was critical to the effectiveness of these programs, but it also produced a haze of hype that distorted and obscured some aspects of those same programs.

The Export-Import Bank of the United States (Ex-Im Bank), the Overseas Private Investment Corporation (OPIC), the Trade Development Agency (TDA), the Commerce Department, and 14 other agencies have played some trade promotion role for years. They have made important contributions to U.S. economic well-being. But there was no organizing principle bringing these agencies together. There was no sense that their mission was a national priority. There was no vocabulary of commercial diplomacy that resonated with business, policymakers, and the American public.

The job for the Commerce Department was to develop the organizing principles that would shape the TPCC mission and then to make the mission a national priority by selling it to the public. The role of Commerce's International Trade Administration (ITA) was key to that effort. ITA kept Commerce focused, keeping it from getting involved in the turf battles that inevitably undermined ITA (and other similarly secondary agencies) in the past. It created a vocabulary with which to sell the core programs. It helped establish priorities for the development of those programs. And it, above all, gave the policies involved intellectual grounding, credibility, and a place within the broader foreign policy frameworks shaping administration policies. With the new administration still developing its foreign policy "vision," ITA's ideas enjoyed disproportionate



visibility. This was particularly important given the traditional uphill struggle involved with placing backwater agencies at the center of administration policies.

Two policy concepts were central to Commerce's commercial diplomacy initiatives. The first was an emphasis on what were called Big Emerging Markets (BEMs). This program propounded several important ideas. It provided the aforementioned focus--just ten markets would receive the bulk of the attention from the Commerce Department and affiliated agencies. This was essential given the limited resources with which those agencies were working. Furthermore, it shifted attention away from traditional trading partners. This was desirable because, from a policy standpoint, ITA analysis had determined that governmental intervention would be of more value in emerging markets than in mature ones. This is because in emerging markets local governments were still actively involved in major commercial decisions, such as those regarding the large infrastructure projects, that represented the big commercial prizes in those nations. In addition, in these markets the competition facing American businesses was often arrayed in public-private teams in which foreign export financing, aid, and other leverage would be key to winning or losing a deal. By intervening with local governments, by providing programs to counteract those of our competitors, the U.S. government could, from time to time, make a difference in the outcome of some of the big deals in these rapidly growing markets. At the same time, U.S. government intervention was decidedly less meaningful on the commercial front in traditional/developed markets. Staying away from those markets had the added virtue inside the Washington Beltway of reducing the likelihood of internal conflicts with other agencies for whom those markets were more "prized" in terms of their high-policy status for security or diplomatic reasons.

Next, focusing on the BEMs was moving into what was both terra incognita for U.S. policymakers and an area that was widely regarded as being of increasing importance. (The United States will export more to these markets by the early years of the next century than to Europe and Japan combined.) Furthermore, as those markets grow in importance, it was also clear that American commercial/economic levers will be especially important in shaping relationships with them. Finally, the BEMs effort enabled the Clinton administration to redefine U.S. relationships with these markets from the outset in terms of mutual interests rather than having those relationships defined by the diplomatic and security impediments that had been the principal concern during the past several decades.

The second "pillar" of Commerce's commercial diplomacy efforts was "advocacy." This was the concept of actively marshaling the re-sources of the U.S. government in support of specific U.S. companies in their efforts to win international projects. It entailed coordinating the efforts of multiple agencies on behalf of companies and ultimately involved the establishment of an advocacy center located in the Commerce Department. This center was created to track major deals, collect requests for advocacy from companies, vet those requests to make sure they met advocacy guidelines (that there was U.S. content in any prospective deal, that the U.S. government would not be supporting one U.S. company against another, etc.), make requests of other agencies as part of the advocacy effort, follow through on those advocacy initiatives, get advocacy letters

produced, support trade missions by identifying advocacy efforts to be conducted within them, and so forth.

These two ideas formed the core around which commercial diplomacy programs were developed. A concerted effort was made to communicate concrete achievements, deals that got signed, and progress that was made in bilateral relationships so that the value of the program in a political sense was advanced. Because the programs in place won the support of the business community, were supportive of jobs, helped bilateral relationships, and so on, they won general support from those questioned by reporters about them and consequently were viewed as successful. Momentum built from deal to deal, trip to trip, and speech to speech, and a sense that Commerce was back on the map developed. Ultimately, this produced support for the agency on Capitol Hill at budget time, when it was really needed, and a greater sense of the importance of such programs within the policy community at large. Unfortunately, it also made the Commerce Department and its secretary a more attractive target for political opponents.

In several cases, for example, in the Raytheon Company's efforts to win support for its Amazon surveillance project in Brazil, the advocacy program performed as advertised. It brought together various agencies in a room, worked with them and the company to do what was necessary to win a contract, responded to challenges with creativity and purpose, and ultimately helped win a billion-dollar victory for an American company and the American economy. In a number of other cases, such as Saudi Arabia's purchase of U.S. aircraft and telecom equipment, the Paiton power project in Indonesia, the Exxon-Natuna power project in Indonesia, and others, advocacy sometimes coupled with financing also helped produce results. The total dollar value of deals in which some advocacy was involved has been set at more than \$50 billion. While this number is defensible, it is also guilty of the same kind of hype that distinguished, enabled, and burdened these programs. For, much of the time, the U.S. government's efforts in a project were only of limited value to helping swing a deal one way or another (business issues, pricing, quality, etc., were, of course, central). In those cases, the real value was primarily through financing (although sometimes communicating that a project was a priority to the United States helped). And the advocacy effort frankly was never as systematic as it was portrayed to be. In fact, the vast majority of deals tallied in the numbers featured in Commerce press releases were projects not that were associated with systematic efforts to identify important deals or respond to corporate requests, but rather that were linked to Commerce Department trade missions. Many if not most of these came to the attention of Commerce not through the advocacy center but through the outreach efforts of the department's business liaison office, which was seeking CEOs to participate in such missions. The liaison office would find a company that had pending projects in the targeted region, and then the company would hope to get a signing ceremony of some sort done for the mission (and often Commerce, seeking "deliverables," would encourage the company to find such projects).

HOW HIGH THE HYPE?

Forms of hype, such as the type described above, can be--and were--useful. But to understand commercial diplomacy and to improve upon it, it is important to note where the hype stops and the reality begins.

One element of the hype centers on the role of the Commerce Department. Commerce was seen as the center of our commercial diplomacy efforts. Commerce had the size to employ large numbers of people in policy and program development functions. It had the prominence as a cabinet agency to make its case more forcefully within and outside the government. And it had and used well the role of being the coordinator of all trade promotion efforts through the TPCC. But except to the extent that it motivated change and provided policy leadership and coordination, it alone was unable to play a meaningful role in winning the deals that were won. As most business leaders will assert, American trade finance agencies were perhaps even more important in this regard because financing is really the primary make-or-break component of a deal in which governments can play a meaningful role. Consequently, Ex-Im Bank, OPIC, and the Trade Development Agency were where "the rubber really met the road" in U.S. international commercial efforts.

Moreover, Commerce had very little in the way of budget resources. Of ITA's \$165 million of annual budget, the vast majority (in the neighborhood of 90 percent) went to salaries and fixed costs. There was virtually no program money save for a few grant programs that had been put in place by certain senators and representatives to offer support within industry sectors of special importance to them. What is more, ITA covered the costs of most Commerce trade missions because the budget of the office of the secretary was so small and shrinking with each new congressional onslaught on the federal deficit.

Given the preceding realities, ITA specifically and Commerce in general could not introduce new programs with any reasonable expectation they would be funded. So the agency had to be about people, ideas, information, and legwork of staff that was already in place--notably, overseas commercial officers who were the infantry of the advocacy effort, on the ground, in country. When money was needed, it had to be some other agency's money that Commerce would "spend" or suggest be spent. In other words, it took real teamwork among a wide variety of separate governmental agencies to produce an effective commercial diplomacy effort--something that was often not so easy to achieve.

## NON-EXPORT PROMOTION ASPECTS OF COMMERCIAL DIPLOMACY

But export promotion is only one, fairly limited aspect of commercial diplomacy. International advocacy of U.S. interests using commercial and economic tools includes a range of other activities. While a brief paper cannot hope to cover all non-export promotion aspects of commercial diplomacy, it is possible to convey the breadth of options by highlighting techniques used in the recent past, which are currently being used or that are foreseeable in the near future.

It is important to reemphasize the broad nature of the term "commercial diplomacy," defined to cover any action whereby the United States advances its interests internationally by expanding or reducing commercial interaction with another country or entity. The brief descriptions that follow touch upon the carrots and sticks currently available to U.S. policymakers. Wherever possible, specific examples of these techniques are offered.

## Carrots

The carrots the United States can offer to induce another entity to act in a manner supportive of U.S. international interests include the following:

1. **Granting or Improving Access to U.S. Markets.** Providing greater access to the world's most attractive market is certainly a powerful diplomatic tool. The China most-favored-nation (MFN) debate is one example that illustrates how that access can be wielded in the broader context of U.S. foreign policy. The annual congressional debate over MFN has been an opportunity for the United States to send signals to China--although they have often been ignored--about U.S. concerns over China's human rights record, its foreign sales of arms, and so forth. Similarly, working with South Africa to restore post-apartheid trading privileges and ratifying the General Agreement on Trade and Tariffs (GATT) and NAFTA pacts exemplify how these tools have been used in a wide-ranging fashion. NAFTA, for example, was a means of bolstering the Mexican economy to help solidify economic and political reform in a country along the U.S. southern border. Other carrots can be quite industry-specific, such as offering landing slots at U.S. airports or negotiating zero tariffs on information technology goods.

2. **Financing Trade and Investment.** While many of our trade and investment finance programs are viewed domestically in terms of boosting U.S. exports, these programs are also a boon to foreign governments. Ex-Im Bank loans enable foreign buyers to purchase U.S. products at competitive interest rates. Moreover, the "tied-aid war chest" enables the United States to match concessionary financing offered by other governments, thus helping emerging nations to undertake major projects on very favorable terms. The war chest also provides leverage vis-...-vis other providers of concessionary financing, encouraging them to take below-market loans off the table. Because it is difficult for foreign governments--particularly those in the key emerging markets--to finance major projects with public funds, the project finance programs of both Ex-Im Bank and OPIC are extremely important. OPIC's political risk insurance programs remove impediments to U.S. investment in many emerging countries. The feasibility study programs of the Trade Development Authority are also much sought after by foreign governments in the planning stage of large projects.

Although commercial diplomacy was not foremost in the mind of Congress when it authorized (and reauthorized) these programs, the leverage they offer U.S. foreign policymakers should not be underestimated. The introduction of one or more of these programs into such places as South Africa, Haiti, the Middle East, Bosnia, or Russia suggests various ways they can be used in conjunction with broader foreign policy

initiatives. The debate about whether or not to extend such programs to places such as China or Vietnam illustrates their appeal as carrots in normalizing relations and coaxing those nations into the global economic system.

3. Transferring U.S. Technology. One thing that distinguishes U.S. companies from their foreign counterparts is a comparative willingness to share technology with partners in other markets. This is repeatedly cited as a reason American firms are sought after in deals around the world. It is also linked to a host of other U.S. corporate "best practices" that make doing business with U.S. firms an effective tool for communicating U.S. values and ideals. Programs such as Commerce Department trade missions and fairs effectively illustrate this fact. But it would be possible to be more aggressive on this front. One way is to eliminate barriers to the sale or transfer of U.S. technologies that pose no threat to our national security. Information technologies offer a variety of excellent examples as to how the United States can ease export barriers, enable technology transfer, and win favor abroad. By reforming export control standards that restrain U.S. companies from selling more powerful computers abroad, by revising limitations on encryption technologies, and by releasing individual satellites from export restrictions, the Clinton administration strengthened relations with nations around the world, notably China. The Global Information Infrastructure (GII) initiative likewise promotes U.S. industries in which technology transfers are especially important and attractive.

4. Providing Technical Assistance. The U.S.-Asia Environmental Partnership and the GII also offer examples of U.S. government programs that help countries develop specific industries through technical assistance from government and industry specialists. These technical assistance programs are often much sought after and take many forms. The National Oceanographic and Atmospheric Administration works with Bangladesh to help create early-warning systems for typhoons and flooding, and with Chile to help chart the hole in the ozone layer in the Southern Hemisphere. NASA works cooperatively with a number of foreign space agencies on satellite programs and played a helpful role in winning Brazilian support for the Raytheon Amazon surveillance project noted earlier. The Department of Transportation has a variety of programs that help foreign counterparts, as do the Department of Agriculture, the Department of Energy, and virtually every other U.S. government agency. In addition, through Department of Treasury leadership at the world's development banks, the United States plays a leadership role in funding technical assistance programs. Finally, bilateral and multilateral forums stimulate the creation of public-private technical assistance programs ranging from the Asian-Pacific Economic Cooperation's (APEC's) GII initiative to the sectoral working groups that are part of the Trans-Atlantic Business Dialogue (TABD).

5. Bilateral and Multilateral Cooperation and Institution-Building. Indeed, forums such as the TABD can effectively identify areas of cooperation in bilateral relationships that might otherwise be strained. The TABD, for example, has undertaken a project to harmonize U.S. and European Union (EU) standards in key industries (such as autos). Getting businesses to agree first on terms that are mutually acceptable not only creates goodwill, it effectively makes government-to-government negotiations a "rubber stamp" in which neither side can hide behind the reservations of domestic industry. Similarly,

bilateral commercial committees such as the U.S.-China Joint Committee on Commerce and Trade; the U.S.-India Commercial Alliance; the various business development councils that have been established with South Africa, Argentina, Brazil, and Turkey; the bilateral commissions chaired by Vice President Gore, together with Russian Prime Minister Chernomyrdin, Egyptian President Mubarak, South African Deputy President Mbeki, and others create regular opportunities to identify and advance mutual interests.

These committees and commissions institutionalize contact not only between the United States and key governments but also between leaders of business communities, and they enable the resolution of a wide range of divisive issues. A strong example of how a multilateral initiative has produced goodwill and tangible progress is the Hemispheric Trade and Commerce Forum, launched in conjunction with the series of Trade Ministerials initiated as part of the process leading to the Free Trade Area of the Americas (FTAA). These meetings have attracted literally thousands of business leaders to discuss specifically how they can advise and accelerate the process of hemispheric integration.

6. Creating the Sinews of International Markets: Deals Rather Than Treaties. This last point is significant enough to be discussed under a separate heading. More important to hemispheric integration than government-to-government trade agreements are business-to-business deals. Deals, not treaties, are what bind countries together, link companies, create capital flows, and enable infrastructure. Telecom and transportation projects rather than communiques are turning individual nations into regional markets. Initiatives like the Hemispheric Trade and Commerce Forum, the business adjuncts to APEC and the TABD, are most important when they promote real business.

It can be fairly said that highly publicized signings on Commerce Department trade missions are part of the hype, and that U.S. export advocacy programs have a mercantilistic goal. But it also cannot be denied that real business linkages between U.S. and foreign partners overseas tangibly and meaningfully affect U.S. relations with those countries, their views of America, the degree of commonality, and in all likelihood the prospects for future such deals. In short, deals tie the world together, and the U.S. government can do many things to encourage that process while leaving the business to business leaders.

7. Promoting and "Endorsing" Markets. When the U.S. secretary of commerce leads a planeload of businessmen and businesswomen to a foreign destination, he or she increases attention on that destination and lends an imprimatur that the country is important to U.S. leaders. When the U.S. government undertakes a special initiative such as the Big Emerging Markets Program or smaller programs such as "Export Mexico" or "Destination ASEAN," it does the same thing. Indeed, more than one foreign government approached the United States after the creation of the Big Emerging Markets initiative with carefully prepared presentations, arguing that they too should be cited as BEMs. More than one of the BEMs used this status in its own promotion efforts. Noteworthy was the massive program by Poland featuring videos, posters, flyers, brochures, and other

materials built around the theme that Poland was a BEM in the eyes of the U.S. government.

8. Developing Commercial Institutions. Many emerging nations are currently in the process of developing the institutions they need to compete effectively in the global environment. These include the development of an effective, transparent, fair system of commercial law, a functioning, effective system of taxation, and appropriate regulatory regimes for the environment, worker safety, product safety standards, and customs enforcement. In each of these areas, the recognized leadership of the United States has led to public, private, and public-private assistance efforts to help the foreign governments create the desired institutions. Examples include the U.S. Department of Commerce's Agency for International Development (AID)-funded Commercial Law program, which instituted projects from eastern Europe to China to help establish commercial codes, and customs harmonization and information exchange initiatives conducted by the Customs Service under the broader ambit of the FTAA process.

9. Economic Peacekeeping and Other Special Interventions. In special situations, commercial diplomacy is linked even more directly to traditional foreign policy initiatives. When a crisis occurs, and the president finds it is in the U.S. interest to intervene, he also increasingly finds that U.S. options are constrained. There is little political appetite for overseas military entanglements, and when these do take place, the objective is to get U.S. troops in and out as quickly as possible. This means that when America intervenes, the military goals are precise and the duration of military involvement is brief. Meanwhile, the political leverage that accrued to the United States as the leader of one Cold War camp has eroded.

Hence, other stabilizing forces must be found. Principal among these are economic forces, especially the prospect of jobs and prosperity that can persuade a nation that a new peace or a new political order is in its interest. As aid budgets shrink, it becomes increasingly difficult to achieve an atmosphere of progress simply by writing a check. Consequently, the United States has repeatedly found itself turning to the techniques of commercial diplomacy, such as offering OPIC insurance against political risk to attract new investment, sending Commerce trade missions into affected regions, and creating special financing or information programs to draw the private sector into these regions. Washington has done this with varying degrees of success in high-priority situations such as Bosnia, the Middle East, Haiti, South Africa, Northern Ireland, Russia, and the Commonwealth of Independent States. The United States will almost certainly be called upon to do the same in the wake of a collapse of North Korea (and Korean reunification) and following the demise of the Castro regime in Cuba. While the private sector will not invest or trade simply to support U.S. government objectives or for humanitarian reasons, it will do so if special business opportunities are created and the attendant risks have been ameliorated.

Sticks

The United States can also wield several economic sticks to induce another nation or nonstate actor to support U.S. objectives. Many of the commercial diplomacy sticks at the disposal of policymakers are simply the converse of the carrots cited above.

1. **Imposing Sanctions, Introducing Embargoes, Withdrawing Privileges.** The severest actions available include embargoes and a wide range of sanctions of varying consequence to the nation or parties targeted. Sanctions can include the withdrawal of privileges previously granted, such as most-favored-nation trading status, benefits under the Generalized System of Preferences, and the like. Recent examples of these techniques abound, from the embargoes of South Africa, Iraq, and Haiti, to the sanctions imposed under the Helms-Burton law, to the sanctions included in the drug decertification of Colombia, to the tug-of-war over MFN status for China. Threats of these actions are also used regularly with varying degrees of success. (For example, threatened sanctions are linked to the violation of nonproliferation agreements.) However, given the changed status of the United States in the post--Cold War era, unilateral sanctions are increasingly ineffective. They can actually backfire, isolating the United States, hurting its economic interests, and diminishing its influence on the targeted party.

2. **Aggressively Enforcing Trade Laws and Laws with Economic Consequences.** While all laws are to be enforced, it goes without saying that there are degrees of intensity with which enforcement takes place. The United States has the option of overlooking or downplaying transshipment violations involving military or dual-use products, other export control violations, or inadequate cooperation in the war on drugs. Indeed, the United States has done so in each area. For example, it is widely believed that the U.S. government possesses evidence of Category One violations of the missile control regulatory regime on the part of the Chinese government with respect to the transfer of missiles to Pakistan. However, the United States has repeatedly found reasons for avoiding enforcement action, because the sanctions entailed could actually be more costly than withdrawal of China's MFN status. Similarly, the United States may, from time to time, look the other way with regard to Mexico's problems with the drug trade while decertifying Colombia for similar infractions. The list of discretionary calls is long, and it covers almost every area of trade law and many regulatory spheres. Of course, the option to enforce stringently is also there, as the Colombians and others will attest. Consequently, such laws are double-edged swords, making them especially useful tools for U.S. policy officials.

3. **Withdrawing Finance and Investment Programs.** In the same vein, where the United States has the option to offer finance and investment programs, it also has the option of withdrawing them. The most famous recent example was the post-Tiananmen sanctions, which precluded OPIC and TDA from operating in China.

4. **Withdrawing or Withholding Promotion or Other Programs.** Promotion programs can be similarly withheld or curtailed. Under the BEMs initiative, the Commerce Department will participate in or sanction over 100 trade missions to China. Should these missions cease, there would be a strong message sent to China, with some economic consequence. In the same vein, while the BEMs program targets ASEAN, Vietnam has received



measured support, and Myanmar will likely receive none for a long time to come. Although withholding such programs is often only a symbolic act, sometimes such symbols can be useful. Finally, countries can be excluded from multilateral trade initiatives where they might otherwise play a role--the exclusion of Cuba from the FTAA process is notable here.

5. Competing Aggressively. An unintended consequence of the "manic mercantilism" style of commercial diplomacy is that aggressive support of U.S. business alienates many U.S. allies who also happen to be strong competitors. Sometimes, this can be avoided because other elements of the relationships take precedence over commercial interests. At other times, however, other nations know that they are pursuing unduly aggressive actions on behalf of their companies. In these circumstances, the United States can always play the "800-pound-gorilla" card. As the world's largest and richest market, the United States can simply raise the ante until the others pay attention. The Ex-Im Bank's "tied-aid war chest" is one example of this approach, although modest. Aggressive Commerce Department advocacy of U.S. business, and the creation of a visible "war room," is another.

6. Aggressively Targeting Sensitive Foreign Competitive Practices. A natural extension of the approaches already discussed is to identify practices that are both undesirable and potentially embarrassing to foreign governments, and to systematically expose them as a way of stopping them. U.S. initiatives to curtail foreign bribery and corruption, and U.S. efforts to counteract tied aid prohibited by the Organization for Economic Cooperation and Development (OECD), both fall in this category. Carrying these initiatives forward multilaterally--through the OECD, the Organization of American States (OAS), the World Bank, APEC, and other such forums--offers an additional channel. Bilateral initiatives, in which the threat of exposure can be more powerful than exposure itself, offer another source of potential leverage.

7. Undertaking Intelligence and Counterintelligence Initiatives. The most sensitive of all areas falls in the domain of intelligence. Meeting the threat posed by foreign intelligence services, countering it, and even, from time to time, exposing it can be very powerful. It can also be very dangerous, given the nature and scope of our own activities.

8. Linking Commercial and Noncommercial Issues--Imposing Conditionality. While there has been some reaction, especially in the business community, against linkage between commerce and other foreign policy objectives--such as advancement of human rights--it must be acknowledged that not all such linkages are wrong. Indeed, using commercial leverage to achieve noncommercial gains is desirable when it is effective at reasonable costs. Furthermore, it is naive to think that such linkages can or should always be avoided. Rather, conditionality should be avoided when it is likely to be ineffective, be very costly, or have unintended consequences that outweigh the gains that might be achieved.

9. Initiating and Orchestrating Bilateral and Multilateral Opposition. As the world's leading economy and the sole remaining superpower, the United States still has more

leverage in international disputes than any other country--even if it is less than before. Therefore, the United States always has the option of undertaking initiatives in multilateral forums, or in bilateral contexts with the implicit support of a group of allies that can pressure specified targets. This is completely in keeping with the long-practiced international gamesmanship of diplomacy. It is noted here only to acknowledge that such tactics have been effective commercially whether they pertained to the adoption of international health and safety standards, allowing China to enter the World Trade Organization (WTO), or forcing change in European positions on agriculture during the Uruguay Round.

## THE DECLINE?

The beginning of the decline of concerted American efforts to promote exports can be marked by the death of Commerce Secretary Ron Brown--the architect, advocate, and champion of modern U.S. commercial diplomacy. Brown's demise and the subsequent departure of key aides robbed the effort of its defenders just as criticism of the endeavor began to take shape. Allegations that Commerce Deputy Assistant Secretary John Huang used his position to raise funds for Democratic campaign coffers gave substance to growing questions about ever closer ties between a Commerce Department led by a former head of the Democratic Party and the business community. This political vulnerability gave congressional budget cutters the opening they needed to renew attacks on the Commerce budget and to cloak their charges with the rubric of rooting out corporate welfare.

To the extent that Commerce and the finance agencies are diminished through such political infighting, to the extent that the people in key positions are not or cannot be effective advocates or promoters of U.S. business interests abroad, to the extent that it is politically dangerous for Commerce to lead missions or for business people to go on them, then one of the pillars of commercial diplomacy as it has been recently practiced--advocacy--will be seriously compromised. At the same time, the other pillar of the past four years, the BEMs initiative, is also crumbling. This is due in part to the inevitable turnover at the policymaking level in Commerce and other agencies and the desire of new leadership to make their name in a way that differentiates them from their predecessors. It is also due to the fact (noted earlier) that for a variety of reasons certain key big emerging markets such as Indonesia, Korea, China, and Mexico have become even more economically vulnerable and/or politically sensitive. Finally, the failure of those of us who were the architects of the Big Emerging Markets policy to effectively institutionalize it and of other agencies to embrace it in a more meaningful way has resulted in its inexorable waning.

In addition, it should be noted that one of Commerce's great advantages within interagency and intra-Washington battles was that it was one of the few agencies with a constituency: the business community. An earlier section of this paper briefly discussed why the business community was targeted and cultivated. It should also be noted that changes in the wind could change the Commerce-business relationship substantially. Already the controversy surrounding soft money, former Commerce official Huang,

Commerce missions, and the like have made it more difficult to attract business leaders to participate in those missions that do take place. Furthermore, as the congressional investigations of these episodes take their course, this situation will deteriorate further, and many of the commercial diplomacy programs of special importance during the last term also will be negatively impacted. (Who will be willing to undertake the next special commercial diplomacy initiative with regard to Indonesia?) It is also interesting to speculate as to the consequences should campaign finance reform actually restrict the donations of soft money (which it clearly should do to prevent the further perversion of the U.S. political system). Will the influence of the business community on public policy then diminish, perhaps significantly in relation to those traditional grassroots organizations (such as labor) that can more credibly argue that they can deliver votes?

That said, it is unlikely Commerce will recede to the role played in past administrations, because the benefits that can accrue from effective commercial diplomacy have been demonstrated. As a consequence, something in the middle should be anticipated where Commerce plays an important coordinating role and the Commerce secretary remains the principal cabinet-level advocate for business, one whose practical success will depend in large part on the cooperation and support he or she gets from the key trade finance agencies, should they themselves survive the reauthorization battles they will face during the next several years.

## BENEFITS AND BATTLES

There has been much discussion by the critics of the administration's policies that they really benefited only a handful of big businesses. The administration often responded that 85 percent of those who frequent commercial service offices in the United States are from small businesses or cited the several small businesses that benefited from the most recent trade missions. While both of these responses are true, they are also inadequate. First, although 85 percent of the visitors to commercial service offices in the United States are from small businesses, the majority who visit commercial service offices overseas are from big business. Next, though a handful of small businesses have signed deals on trade missions, the big benefit from these exercises in commercial diplomacy have been the small businesses that were suppliers to big businesses. An example are the 1,700 U.S. auto supply companies that manufacture the parts used in Big 3 vehicles and stand to sell more of their products when auto exports increase. Another are the thousands of suppliers whose work goes into each Boeing aircraft that is sold thanks to a trade mission.

Because the real benefits the government can offer to business are in the area of financing and traditional export financing is primarily targeted at big businesses, big businesses are the ones current U.S. government programs can really help the most. They also generate the biggest projects/headlines. The fact that they feed into huge families of small businesses should be acknowledged and accepted even as efforts are made to do more for small businesses directly. This could be done by reinvigorating the Small Business Administration's (SBA) Small Business Export Finance program, which currently suffers not from a lack of available capital (quite the contrary) but from a lack of trained headquarters and field staff to market the program to qualified would-be borrowers (who

need it because their local banks have gone out of the trade finance business). This program also has not been helped by internecine battles in which Ex-Im Bank--whose own such program, the Commercial Service, could actually provide the field staff the program needs--and SBA frequently slug it out at the local level in pursuit of clients.

As suggested here, these interagency battles are a real problem despite the cheery rhetoric about coordination. The trade finance agencies clearly resented the attention being given to Commerce for wins that they made happen. They did not like having their leaders go to TPCC core group meetings chaired by a Commerce undersecretary. They did not like the idea of focusing on BEMs not of their choosing. Indeed, they often set different priorities. They each had their own lists for reasons of preference (Russia) and statutory limits placed on their operations (China, Vietnam, etc.). They did not work together in any meaningful way when called upon as a group to help stimulate private-sector participation in the reconstruction of Haiti, the Middle East, or Bosnia. This discord results in part because these agencies have different stated missions and different political constituencies on Capitol Hill. It is also due to their differing reads on what was important to the administration and what would fly with political godfathers each of the agency leaders would have. Conflicts went further. Beyond the obvious contradiction between Commerce's having established China as the most important of the BEMs and OPIC's and TDA's being prohibited from doing business there, there were even conflicts on policies toward individual projects within China. While the National Security Council and a supposedly independent Ex-Im Bank took the stand that it was not in the administration's interest to finance American participation in the Three Gorges dam project, Commerce Secretary Brown publicly took an opposing view. OPIC withdrew coverage for a project in Irian Jaya on environmental grounds in a move that many in Commerce and the business community felt was in conflict with the emphasis being placed on building commercial ties with Indonesia and set a precedent that would put the United States at a disadvantage with companies of competitor nations.

Old hands might argue that at least these agencies were talking to each other regularly. But sometimes the conversations were not terribly civil. These tensions were colorfully illustrated when during a TPCC meeting called in January 1996 to repair the damage caused to the institution by internal tensions, Secretary Brown went around the room asking agency heads their views. Most were constructive, if somewhat tense. Ruth Harkin, then president of

OPIC, however, said simply, "The TPCC sucks." While something of an overstatement, her view had its adherents and should be taken as a symptom of the failings of the current structure of the U.S. trade promotion apparatus.

#### THE MERITS OF CONSOLIDATION . . . BEGINNING WITH COMMON SENSE

It is absurd to have 19 different agencies working separately with limited budgets on what should be common goals. Coordination is fine, but it should also be seen as a halfway measure. For the sake of policy, effectiveness, and efficiency, all these arms of the government should be part of a single trade agency, as they are in virtually every

other country in the world. It matters little whether you call this agency the Department of Trade or the Department of Commerce. What matters is that there is a cabinet secretary leading it and that it contains all trade functions coordinated by a policy formation operation at the top.

A Department of Trade should include the United States Trade Representative's (USTR's) Office. Many argue that USTR operates well at its small size and with its independence, and that this should not be trifled with. First of all, USTR's small size should be a model for all other agencies and emulated in the Department of Trade. Second, there is no reason to assume that an agency operates more independently while located within the White House or focusing just on negotiations than it would were it located outside the White House and focusing on a wider range of trade-related questions. But another question must also be posed in response to these critics of possible consolidation of the trade functions: ". . . and independent of what?" Business interests? Labor interests? Political interests? Aren't all agencies of the U.S. government supposed to be serving U.S. interests? This is in fact the main reason that USTR should be part of this consolidated agency. It handles a functional area of trade policy implementation. It does not have sufficient analytical or research staff to serve basic policy development functions. The history of the agency also demonstrates that individuals who are primarily negotiators often confuse strategy and tactics, looking to negotiating gains rather than the full range of U.S. policy interests in our relations with any country or sector in particular. A well-conceived, consolidated agency should therefore have reporting to its secretary a policymaking apparatus that can set the agenda for the separate trade-negotiating, trade-promotion, trade-financing, and trade-enforcement (Bureau of Export Administration, Import Administration) units that would report to it. All the trade carrots and sticks of the U.S. government should be housed in the same institution, and their use should be coordinated as part of an overarching, strategic, balanced trade policy.

How big should such an agency be? Not too big. ITA has 2,400 people and could probably easily operate with half that. The trade finance agencies have around 680 and could lose 150. USTR is 170. The final agency could be smaller than ITA is currently and dramatically more effective as internecine rivalries are stamped out, real coordination introduced, and budget dollars maximized (with more money going to programs than to salaries). Will this happen in our lifetimes? "Don't bet on it," say "old Washington hands" who have seen these ideas being batted around for years, notably back to the proposals of Senator William Roth (R--Del) in the early 1980s. But that doesn't undercut the fact that it is the right thing to do or that every once in a while the bureaucratic system is actually capable of doing the right thing.

What will certainly happen is that budget cutters who have targeted OPIC and to a lesser degree Ex-Im Bank will continue to make their runs at these agencies, reducing budgets and, when grudgingly approving them, keeping authorization periods as short as possible. Their argument will be fueled by attacks on "corporate welfare." These attacks are grounded in the false logic that businesses are taking unfair advantage of the U.S. government and gaining an unfair advantage overseas, rather than in the reality that these programs only level the playing field and that without them many American workers

would be prime candidates to experience a different type of welfare program. However, Rep. John Kasich (R--Ohio) has come close to nailing OPIC several times. Another run at OPIC is likely before the next presidential election. This, in turn, could produce renewed thought about consolidation of all the trade finance agencies (Ex-Im Bank, OPIC, and TDA) into one U.S. Trade and Investment Bank and might be a sensible interim step in the direction of the single, unified Trade Department the country deserves.

## WHAT ABOUT COMMERCIAL DIPLOMACY IN ASIA?

The discussion above focuses broadly on questions of commercial diplomacy. Given the origins of this paper within a Council on Foreign Relations study group focusing on "Commercial Diplomacy in Asia," commercial diplomacy, however defined and practiced, owes its development as much to the rise of Asia's emerging economies as it does to any other factor touched on above. When the list of Big Emerging Markets on which Commerce focused was developed, the biggest and most important were certainly in Asia. China led the list whether approached simply as the People's Republic or also incorporating Taiwan and Hong Kong, as in the Commerce Department's concept of the Chinese Economic Area. Next in sheer size came India; these two countries made up 40 percent of the world's population. However, in terms of near- to medium-term economic potential, the third Asian BEM, originally Indonesia and ultimately the aggregated market of the countries of ASEAN (Indonesia, Thailand, Malaysia, Singapore, the Philippines, and Vietnam at the time ASEAN was named to the list), seemed to the architects of the plan to represent what might be the greater of the prizes within the region. ASEAN is home to 500 million people and was projected to spend \$1 trillion on infrastructure investment in the next ten years (as opposed to just over \$500 billion in the Chinese Economic Area and perhaps \$150 billion to \$200 billion in India). South Korea was the fourth Asian BEM and the one that already ranks among America's top trading partners.

The rapid rise of these markets during the decades preceding the BEMs effort, the size of the likely investment in infrastructure their growth will demand, U.S. leadership in key infrastructure industries (such as telecommunications, aerospace, automotive industries, construction and engineering, and power generation), and the fact that growth in these markets seemed likely to continue unabated all argued that it was time the United States devoted more attention to these countries. Of course, during times of crisis, China has always held our attention, as have South Korea, Southeast Asia, and the South Asian subcontinent. But now these were markets that demanded that the United States develop positive relationships if it was to maintain its economic leadership. At the same time, the need these emerging markets had for the U.S. marketplace gave the United States special leverage in helping to solve some of the problems that separate or have the potential of separating America from these prospective trading partners.

Furthermore, in each of these markets, because major infrastructure projects were on the agenda and because local governments were--as noted earlier--going to be the principal decision makers about these projects, U.S. government advocacy could be especially decisive. In addition, these markets were being heavily and systematically targeted by our

main commercial competitors: the EU and Japan. As the Clinton administration began its first term, these competitors were pulling out all the stops: leading major commercial missions to the region; offering long-term financing at concessionary rates on the major infrastructure projects; and offering rich aid packages, technical assistance programs, political incentives, and other inducements. The much-publicized trade missions to the region by German Chancellor Helmut Kohl and British Prime Minister John Major are just the most prominent examples of the high-visibility tactics employed. However, other highly effective maneuvers were less visible. On the financing side, Japan implicitly tied aid programs. Tokyo until recently has had an aid budget that is comparable to that of the World Bank, and it has been estimated that while all that aid is supposedly "untied" (with no restrictions on its use) and within OECD guidelines, fully 70 percent of it ends up back in the hands of Japanese contractors and companies. Is this a coincidence? Furthermore, the sheer amounts of aid offered are bound to be persuasive. Japan provides over \$2 billion per year in aid to Indonesia. The United States offers less than \$90 million. In addition, a Commerce study of foreign competitive practices in Asia showed a willingness on the part of foreign governments to explicitly link aid to promises of market share in many Asian markets. Also, many Japanese companies were gaining an advantage over U.S. firms because of Tokyo's relatively lax views toward bribery and other business practices. Consequently, when U.S. businesses spoke about an uneven playing field, they were talking above all else about Asia.

The BEMs program targeted these major markets for scores of trade missions every year, including regular high-level missions. There were special education programs for U.S. businesspeople about these markets (domestic seminars, the Destination ASEAN program, etc.), the establishment of U.S. commercial centers (in Jakarta and Shanghai), and the establishment or expansion of bilateral government-to-government entities designed to institutionalize dialogue (the U.S.-China Joint Commission for Commerce and Trade, the U.S.-India Commercial Alliance, a similar ASEAN group). And there were more aggressive efforts on the part of our trade finance agencies in each of these countries in which they were permitted to operate and a greater focus of those finance agencies on products, such as project finance, which were especially important in the Asian/emerging markets environment. Ex-Im Bank went to great lengths in China to actually train Chinese officials in making their programs more acceptable to project finance. Furthermore, after having been badly burned in a first effort to match foreign "tied" aid (when the U.S. matching bid on the Shanghai Metro project was offered the day the project was awarded to the Germans), the Ex-Im Bank tied-aid war chest was tapped a number of times to effectively counter foreign offers of concessionary financing. Advocacy efforts also targeted these markets from Washington through on-the-ground advocacy of local embassies and commercial missions.

Very effective ambassadors such as Stapleton Roy in China, Frank Wisner in India, Bob Barry (and later Stapleton Roy) in Indonesia, and John Wolf in Malaysia were particularly aggressive. Indeed, wherever ambassadors actively made the support of U.S. business a top priority, brought their commercial and economic teams more closely together, showed a particular willingness to work with the advocacy support of Commerce and the other TPCC agencies, and promoted a real open-door policy at their

embassies welcoming in U.S. businesses rather than hiding behind layers of marine guards and embassy walls, they made perhaps the decisive difference among all U.S. advocacy efforts.

In addition, commercial issues were closely linked to a broad range of our other policy concerns with these countries. The linkage between MFN renewal for China and human rights in that country was perhaps the most prominent among these. But there were many others, including the continuing consequences of Tiananmen sanctions prohibiting OPIC and TDA operation in China; environmental opposition to the Three Gorges dam; the desire to continue to promote "marketization" and general reform within China; human rights, labor rights, and environmental concerns in Indonesia and other ASEAN nations; promoting reform and battling resurgent economic nationalism in India; combating proliferation of weapons of mass destruction while promoting U.S. technological advantages in key industries; addressing the planned development of North Korean nuclear capacity; restarting relations with Vietnam; attempting to isolate Myanmar; attempting to maintain a strong, stabilizing U.S. presence in Asia even as Washington withdrew military forces from the region; balancing relations and interests between China and Taiwan, and between China and Hong Kong; promoting the viability of the one country, two systems approach in the wake of Hong Kong's return to China; and so on. In each of these areas, the broader concept of commercial diplomacy as articulated earlier could have, should have, and often did come into play. Sometimes it was very conscious and planned. Sometimes the connections were realized after the fact or not taken full advantage of. But nowhere does the need to add commercial levers to those in the political/diplomatic and military areas present itself more clearly than in Asia.

President Clinton recognized the importance of these issues in his historic decision to make his first foreign trip to Asia, to offer to host the first APEC leaders meeting in Seattle, in his decision to attend the next such meeting in Indonesia, in the administration's unstinting efforts to find a strategic framework for the U.S.-China relationship, and to achieve a proper balance within that relationship. (One key to successful commercial diplomacy is not to fall victim to the hype that has economics displacing security concerns at the center of our foreign policy. In the post--Cold War era, economics has ascended in importance, but it will never supplant the central concern--America's basic security--nor should it supplant or in any way undermine those requirements of leadership that ensure that security.)

Of course, the recent economic crisis in Asia has thrown into turmoil many of the assumptions that led to these policies. It now seems likely that a number of the Asian markets that the BEMs program targeted will face several years of recession or worse before growth resumes. While the long-term potential of these markets remains unchanged, the implications of the Asian economic crisis for U.S. commercial diplomacy in the next several years are several:

1. The demands of economic recovery will force austerity measures into place that will lead to significant cutbacks in the infrastructure projects that were the "biggest



commercial prize in the world" during the heyday of the BEMs program and aggressive U.S. commercial diplomacy.

2. Continuing economic turmoil, sharp drop-offs in some national gross domestic product growth rates, and declines in others will reduce import demand in these markets and make it much tougher to sell U.S. products in virtually all of them.

3. A decline in the value of local currencies will exacerbate the problem described in point two by reducing local buying power substantially and increasing the comparative price of U.S.-produced exports with prices denominated in dollars.

4. Local economic turmoil will therefore make aggressive promotion of U.S. exports both futile and, more important, completely inappropriate--especially with the United States at the forefront of nations arguing for regional austerity and improved national balance sheets.

5. Cheaper exports from the region will lead to worsening U.S. trade deficits, and this will in turn be a source of increasing friction with the countries of the region. This will be complicated further by growing U.S. economic nationalism, opposition from the extreme right and left wings to both further trade liberalization and regional "economic bailouts," and a consequent strong impulse among some political officials to shift the focus of U.S. trade and commercial policy from market opening and liberalization to trade law enforcement and confrontation.

6. On the more positive side, the crisis is likely to lead ultimately to great reform in Asian markets that have resisted liberalization, foreign investment, deregulation, and efforts to improve transparency. What trade negotiators could not do, markets likely will do, and the long-term commercial consequences for U.S. companies could be quite good in this regard.

7. In addition, falling asset prices in these markets (in dollar and real terms) and a greater willingness to accept foreign investment are likely to create important opportunities for U.S. companies seeking to invest, make acquisitions, launch joint ventures, and establish strategic relationships in these markets. Given the comparative robustness of the U.S. economy at the present time, this could lead over the longer term to a great U.S. presence in these markets, greater market share, and closer ties between the U.S. and these countries. As a caveat, aggressive efforts in this regard could be seen as opportunism and generate resentment and simmering anti-U.S. and anti-Western feelings in these stunted economies. Consequently, while there is ample room and indeed a demand for the United States to develop a new and very different kind of commercial diplomacy in the region, it is important that for the near term, the emphasis be on "diplomacy" rather than on "commercial."

8. In addition, to the extent that the United States is seen as a friend in this time of trouble, as a result of either economic or diplomatic intervention, it could lead to enhanced relations and opportunities in this region in the future.

## CONUNDRUMS

As with any area of foreign policy, the practice of commercial diplomacy presents a wide array of challenges beyond devising, coordinating, and executing the policy--although those are often difficult tasks, given the number of concerned agencies within the U.S. government. Several of the most thorny additional challenges are briefly highlighted here, to fairly present the complexity of the matter.

### Unilateral Action, Extraterritoriality, and Other Slippery Slopes

Hidden beneath the surface of the array of policy choices are conditions and techniques affecting the implementation of those choices in fundamental ways. When seeking to penalize another nation, the changed nature of the world market must be taken into consideration. The United States is no longer the sole or dominant supplier of many products and services. The United States no longer leads a bloc of nations that follow wherever its policies may go. Consequently, unilateral U.S. action is often much less effective than it might once have been. This does not mean that unilateral action should never be taken. Sometimes, even when no one follows, leaders must lead. Business firms may argue that, in these circumstances, the United States is sacrificing markets to others who are less scrupulous--a frequent complaint about U.S. sanctions against rogue states such as Libya, Iran, and Iraq. But principle and morality play an important role in maintaining global leadership, and the world's largest economy can still make life less comfortable for its adversaries.

Nonetheless, the United States must understand the changed circumstances and restrain its actions accordingly. There is also no use in engaging in inflated expectations of the likely consequences of unilateral sanctions. These should be applied sparingly and only when benefits are likely to accrue. At the same time, the United States must recognize that, in the new environment for commercial diplomacy, just as in traditional diplomatic and military matters, a premium is placed on successful multilateral initiatives. If the United States could motivate all its G-8 partners to act together in threatening commercial sanctions for human rights violations, it would make progress rather than shooting itself in the foot. The same holds true for nuclear nonproliferation, labor rights, the environment, corruption, and other areas in which the temptation to link commercial and noncommercial issues is greatest. The United States is not very good at building multilateral coalitions. It is accustomed to the privileges of being the biggest kid on the block. But the coalition skills practiced on Capitol Hill from time to time must now be brought to international forums.

A corollary is the importance of multinational institutions. The United States will not be an effective multilateral leader if it supports institutions only when they suit it. Empowering these institutions--whether they be commercial organizations such as the WTO or security forums such as parts of the United Nations--requires a willingness to cede some degree of sovereignty. This investment of political capital is even more important than the investment of financial capital (which is also treated arbitrarily). The transfer of measured amounts of sovereignty is hard to sell within the United States. But

it is as important to the future of international stability, akin to the ceding of some measure of states' rights to the Union during the formative years of U.S. history. Given U.S. history and U.S. leadership in shaping international institutions, Americans should understand these realities better than most. But the fact is, the United States often abuses these institutions, sometimes out of frustration, sometimes out of undistilled capitulation to domestic political pressures (the Helms-Burton law comes to mind).

## WHERE TRADE POLICY ENDS AND COMMERCIAL POLICY BEGINS

Another conundrum posed by nonmercantile aspects of commercial policy is an inside-the-Washington-Beltway debate. It is the question "Where does trade policy end and commercial policy begin?" This is a polite way of asking "Isn't commercial policy what the Commerce Department and the Ex-Im Bank do, trade policy what USTR does, and international economic policy the province of Treasury, State, and the White House?"

This is a question for policy wonks. At some high bureaucratic level, all international levers--economic, political, and military--ought to be considered together, presumably in or near the White House. At some lower level, the international economic policy levers ought to be considered together. And at some still lower bureaucratic level, trade-related levers ought to be considered by those agencies with the primary responsibility for their use. It is a ridiculous peculiarity of the U.S. government that 19 separate agencies have responsibility for trade promotion, and only in the United States do the functions of trade policy development, trade promotion, trade negotiation, trade law enforcement, and trade finance reside in so many unrelated, uncoordinated government departments.

The point here is that commercial diplomacy as described in this essay is a policy discipline offering a set of options that are increasingly important to the United States, have been underestimated for a long time, and should be thoughtfully added to the U.S. international policy mix. If this recognition leads to a rationalization of the U.S. government structure, so much the better.

Asking for the Order:

### Commercial Quids for Political or Military Quos?

As the United States has become more sophisticated in assessing the commercial diplomacy of other nations, it has come to note surprising differences in values. Most other countries feel that government has a much bigger role to play in winning deals for their companies--be it in financing, advocacy, or using political muscle. Many permit activities that are illegal or unacceptable in the United States. These differences require some thought.

For example, while many nations seek commercial concessions in exchange for noncommercial actions--support for entrance to the EU, support against terrorism, support in a military sense, aid flows--the United States seldom acts so explicitly. In both Kuwait and Korea, to name but two of many cases, countries that would not exist were it

not for U.S. military intervention repeatedly close the United States out of deals or entire markets in ways that are inconsistent with international trade law or standards. Are U.S. firms being taken advantage of? What kind of message does acquiescence send to other competitors and trading partners? What would be the economic consequences if the United States were seen to take action more protective of its self-interests? It may well be that the political or moral consequences would require the United States to be less heavy-handed than some of its friends. It may also be that equivalent actions would threaten important alliances or make future diplomatic initiatives more difficult. It may also be that the United States is missing opportunities that virtually every other nation in the world would take. Whatever these answers, these questions deserve asking.

### Is Economic Intelligence Worth the Risk?

Foreign governments are directing their intelligence services against U.S. economic assets, spying on U.S. companies. In addition, foreign governments and companies are regularly engaging in a wide variety of competitive practices from bribery to intimidation that are undetectable, except with the assistance of U.S. intelligence resources. Indeed, in the case of foreign use of tied aid, since it is prohibited and since the United States as a matter of policy can respond only via the tied-aid war chest when it is identified, the intelligence community has served from time to time as the first "loan officer"--its imprimatur is needed before the financing wheels can begin to turn.

At the same time, the use of intelligence assets carries great risks, whether those assets are used to address commercial or military threats. A debate has raged over whether those risks warrant continued involvement of the intelligence community in commercial matters--heightened during the past two years as a consequence of press assertions that the CIA spied on Japanese trade negotiators and on French business firms competing with a U.S. company for the Amazon Surveillance project in Brazil.

Given the diplomatic fallout from such allegations, the use of intelligence reveals yet another dimension to the pursuit of effective commercial diplomacy. The answer lies in a careful weighing of risks, resources, and rewards. However, that process is still in its early stages, and, to date, there may have been as many stumbles as successes.

### Allies or Competitors? Realities of a Zero-Sum World

A fundamental question of commercial diplomacy is whether any nation can correctly be characterized as a "competitor." Economists such as Paul Krugman argue compellingly that the talk of competition is usually misguided and demagogic. Nations do not compete with one another in a meaningful economic sense; instead, they compete with their own individual past, seeking to improve living standards by better education, higher savings, sensible regulations, fiscal prudence, and low inflation. In this view, the world market is an expanding pie, each country's share of the pie will ultimately be determined by its own attributes, and a deal lost here will be offset by a deal gained there. Unfortunately, while offering much to the debate about the values of mercantilism, these observers miss one critical fact. While the world market may not be a zero-sum game, every deal is. And if

your town has one big employer and it loses that deal, your town suffers. And if that firm loses because a foreign government intervened on behalf of one of its companies, and the U.S. government sat idly by, a legitimate question can be raised about what the appropriate role of government should have been. From time to time, such issues force the United States to cast allies in the role of competitors. Such pressures pose the danger of undermining alliances. Nevertheless, when a security threat arises, allies will still depend on the United States more than vice versa. Consequently, no matter how intense commercial disputes may be, they will surely seem secondary in the face of a serious security problem and will fade into the background.

Unfortunately for this sanguine view, day-to-day commercial problems arise not with regard to major threats where security imperatives are clear but in managing midlevel problems like Bosnia, where the glue of big threats does not hold and the friction of commercial competition wears away. Herein lies the principal balancing challenge of commercial diplomacy.

#### CONCLUSION: THE NEED FOR BALANCE

Commercial diplomacy is a useful tool of American foreign policy. Export promotion efforts can be helpful, but they must be placed in context--seen for both unintended and intended consequences; seen for how they succeed and where they fall short; seen for how they utilize resources and how they deplete them; and seen for how they interact with other aspects of diplomacy. With such understanding American policymakers can wield with sophistication and understanding those elements of power that accrue as a consequence of being the world's undisputed economic leader.

#### In Praise of Sunset Mercantilism

Even the most jingoistic members of the "Buy American" chorus must acknowledge that every thoughtful analyst and economic theorist believes that government intervention in the marketplace through the basic techniques of commercial diplomacy (financing, technical assistance, high-level advocacy, etc.) is distorting. Further-more, even the best-intentioned government intervention is likely to be sometimes misguided or badly executed or both. In addition, active international advocacy for U.S. business interests implies that government officials actually understand what U.S. business interests are. At the beginning of the decade, Robert Reich posed the question "Who is us?" We are still a long way from answering it. The interests of multinational corporations very often are not congruent with--or are at odds with--U.S. national interests. Indeed, not only is it problematic from a policy perspective to pick winners, it is increasingly difficult to tell who is even on America's side. The composition of the team changes with every new foreign investment in the United States and every closure of an American plant to shift production overseas. For example, should the U.S. government spend its limited export promotion resources to promote the overseas sales of the telecommunications products of an American firm based in France? Or should it promote the exports of products made by a Swedish firm based in New Jersey? What matters--nationality or the location of

production? Faced with such conundrums, in the best of all possible worlds, commercial diplomacy programs should eventually be discontinued.

Unfortunately, America's primary competitors show no signs of letting up. Indeed, they spend more than the United States does in these pursuits and afford their companies much greater latitude of action. They also are willing to undertake actions on behalf of their companies that the United States would never do in terms of trading political favors/actions for market share. Consequently, were Americans to "do the right thing" and withdraw from the commercial diplomacy game, U.S. companies would be at an enormous disadvantage. Moreover, by remaining weak or contemplating unilaterally withdrawing programs or reducing them, the United States creates greater opportunities for its competitors to succeed and greater incentives for them to continue their programs. In addition, the United States should not and politically could not remove certain of the constraints placed on American companies, such as the Foreign Corrupt Practices Act.

In addition to the above, the evidence of the past several years is that concerted efforts at supporting U.S. businesses overseas, particularly through the types of programs described in this paper, have greatly discomfited America's competitors. The decision to create a tied-aid war chest to match the (OECD-prohibited) tied-aid efforts of foreign competitors or the decision to challenge certain of their competitive practices, including bribery and inappropriate use of political leverage and intimidation, not only got their attention but actually got them back to the negotiating table to eliminate some of these problems.

Consequently, there can be only one sound export promotion policy for the U.S. government: sunset mercantilism. We must aggressively support U.S. businesses for as long as it takes to get competitors to agree to take these programs off the table and keep them off. We should spend more now so we can spend less in the future. We should let the world know that the biggest guy on the block is going to make it painful for them to continue their policies, but that we are ready at any time to talk seriously about changing them. We should maintain and build on the efforts described in this paper so that ultimately we can eliminate many of them. At the same time, we must find effective multilateral means of combating corruption and ensuring transparency in procurement processes worldwide. This will certainly involve cooperation and enforcement by our multilateral development banks but also requires that we cut into the problem from the "supply side" of the bribery transaction--getting our closest allies to realize that bribery is an unnecessary cost for them and an unfair "tax" on those nations that can afford it the least. (The Clinton administration, through the World Bank, the OECD, the OAS, and APEC, has begun to make some modest progress in this regard.)

Such an approach will not, of course, mean the end of commercial diplomacy. Access to America's markets, U.S. trade policies, U.S. support for multilateral development efforts, domestic policies that help shape the development of U.S. industry, decisions to impose or eliminate sanctions or introduce or withdraw aid programs--all give the United States economic/commercial levers that will be extremely important in the execution of broader foreign policy. As such, they will remain the core elements of commercial diplomacy as

it should be practiced, once governments are finally off a field that should ideally be left to the world's businesses.

## How Much Bang for the Buck? Japan's Commercial Diplomacy in Asia

Christopher B. Johnstone

On the surface, Japan's commercial diplomacy in Asia presents much for an American observer to envy. Government programs aimed at promoting trade and investment are extraordinarily well funded. The Export-Import Bank of Japan (JEx-Im) alone extended nearly \$14 billion in loans and guarantees during FY 1996--with about 40 percent of the total targeted for projects and transactions in Asia. The Ministry of International Trade and Industry (MITI) operates the largest government trade and investment insurance program in the world. Bilateral official development assistance (ODA)--a significant portion of which, in fairness, should not be considered commercial in nature--currently exceeds \$8 billion annually, the world's largest aid program. And a host of other, smaller programs and organizations provide support for Japanese business abroad as well.

Japan's commercial diplomacy is also strikingly comprehensive. Initiatives that fall under the rubric of "economic cooperation" (keizai kyoryoku) range from traditional tools--such as financing and insurance schemes--to less direct means of advocacy and influence building--personnel exchanges, for example, as well as government-funded educational and training programs. Further, the institutions responsible for implementing these programs arguably profit from an embedded, societywide view that national security interests are consonant with aggressive support for Japanese business overseas; while criticism of ODA policy emerges from time to time in the national media, public debate on the merits of commercial diplomacy is virtually nonexistent. Broad support for economic cooperation arguably is also linked to the unique arrangement that provides for Japan's defense. In part as a result of the protection afforded by the U.S. military presence, policymakers in Tokyo and the broader public appear largely unburdened by the American tendency to see national security and economic interests as distinct--and at times even in conflict. Put crudely, making the world safe for Japanese business is seen as a perfectly worthy goal of national policy.

Big bucks and a plethora of programs are no guarantee of effectiveness, however. Arguments that government initiatives have played a key role in facilitating--and strategically configuring--Japan's massive investment thrust into Asia paint an incomplete picture of Japanese commercial diplomacy. These programs unquestionably provide important support for private-sector activity overseas, but evidence of waste, inefficiency, and duplication abounds. Bureaucratic turf wars impair many government programs, despite the widely held view in the United States that Japan's commercial diplomacy efforts are centrally controlled and well coordinated. Japanese ODA is only the most obvious example of this problem: four ministries vie for control over the size, uses, and objectives of foreign aid, often leading to poor quality standards and questionable project selection. Such rivalries extend to other programs as well. The activities of JEx-Im and the Overseas Economic Cooperation Fund (OECF) often appear to be in competition, for

example, and turf battles between the two massive financing agencies well may increase after their scheduled merger in early 1999.

Interagency rivalry is not the only form of inefficiency. In many cases, implementing agencies offer programs, and impose terms, that could better be provided by the private sector. Export credit organizations in particular provide services that have been privatized in many other industrial economies--implying that a certain percentage of Japanese government support serves only to displace private activity. The large number of smaller organizations that support Japanese commercial interests overseas (often through direct subsidies from MITI or other government agencies) appear to offer strikingly similar programs as well, a fact that suggests the need for consolidation. Corruption and waste remain central challenges to the foreign aid program, although reforms appear to have eliminated some of the most egregious forms of abuse.

That Japanese trade and investment promotion programs are plagued by serious deficiencies will become clear; that fact should not be taken to imply, however, that these programs represent an abject waste of taxpayer money. The various initiatives clearly provide important support for corporate Japan, in ways both tangible and intangible. Indeed, Japanese commercial diplomacy may best be visualized as the advertising budget of a major corporation: a certain amount is surely wasted, but quantifying that sum is nearly impossible--and therefore the activities assume a life of their own. American policymakers attempting to draw lessons from the Japanese experience therefore would do well to view the scope of Tokyo's programs with a healthy dose of skepticism. The large budget outlays, and MITI's grand schemes for molding East Asia into a playground for Japanese companies, certainly are impressive and offer insights into the philosophical underpinnings of Tokyo's support programs. The rhetoric, however, often masks a reality that is much less threatening to other competitors in these markets.

What follows first is a broad overview of the programs and policies that form Japan's economic cooperation with the developing world, with particular emphasis placed on activity in Asia. The paper then turns to the question of effectiveness and attempts to look behind the numbers in assessing the strengths and weaknesses of Tokyo's programs. Finally, the paper describes recent initiatives that represent Japan's attempt to adapt these programs to the needs of the future--while still maintaining the comprehensive approach that has characterized economic cooperation from the beginning.

#### KEIZAI KYORYOKU: PROGRAMS AND COMPONENTS

Japan's economic cooperation policies are an outgrowth of the early postwar need to achieve stable and secure access to raw materials imports--essentially paid for with exports of machinery and other capital goods. The strategy was seen from the outset as fundamental to the nation's survival; as Shigeru Yoshida, Japan's first postwar prime minister, wrote in 1957, "A maritime nation, Japan has no choice but to engage in overseas trade if she is to support her ninety million inhabitants."<sup>1</sup> Even the war reparations payments to Asian countries victimized by Japanese aggression during World



War II assumed an overtly commercial character. Funds were disbursed for projects in targeted industries

often heavily capital-intensive in nature

and tied to the procurement of goods and services produced in Japan. As Tokyo's economic cooperation programs expanded and the country achieved the status of an advanced industrial economy, Western pressure forced Japan in the 1970s to begin separating its ODA and commercial support programs

a process that has occurred only grudgingly.<sup>2</sup>

Despite the nominal separation of the two programs, however, the institutional mind-set continued to envisage economic cooperation as a comprehensive package of public and private programs, all acting in concert to support Japan's economic interests.<sup>3</sup> The philosophy underpinning MITI's so-called New Asian Industrial Development plan of 1987--which represented an attempt to help Japanese manufacturers undercut by the yen's dramatic post--1985 appreciation relocate to Asian production sites--reveals the continuing strength of this tradition. MITI officials spoke of a "holy trinity" (san mi-ittai) that would link foreign aid, investment, and trade in a comprehensive effort to promote Asia's industrialization--and in turn assist corporate Japan; government and business would cooperate in supporting each component. Even today MITI publishes an annual volume describing Japan's economic cooperation in terms of this trinity; the agencies responsible for disbursing ODA are included with export and investment promotion programs in a list of the organizations that implement keizai kyoryoku.<sup>4</sup> The programs outlined below follow this model.

### Export-Import Bank of Japan

JEx-Im's lending programs are massive: the bank extended some \_1.5 trillion (\$13.6 billion at \$1.00 = \_110) in financing during FY 1996, including \_57 billion (\$518 million) in guarantee commitments (see Table 1). As of March 1997, the bank had more than \_9 trillion (\$82 billion) in loans outstanding. Cumulative JEx-Im commitments worldwide total some \_33 trillion (\$330 billion); approximately one-third of this volume was extended for transactions in Asia.

The large figures in part reflect that JEx-Im's services are more wide-ranging than those offered by most other official export credit agencies. In addition to traditional export financing--in the form of supplier and buyer credits--the bank provides loans and guarantees to support investment overseas, as well as imports into Japan. About half of JEx-Im financing is extended directly to Japanese companies and consortia--often in conjunction with financing from private Japanese financial institutions--or to borrowers in foreign markets for the purpose of purchasing equipment and goods produced in Japan. Since 1987, the bank has also extended nominally untied loans to foreign governments, financial institutions--including the various multilateral development banks--and corporations. Commitments of untied loans made to multilateral development banks are

subject to the competitive bidding practices of those institutions and therefore appear genuinely open to contractors of any nationality; loans extended on a bilateral basis, however, suffer from frequent complaints of opaque bidding procedures and face repeated allegations that access to the funds is de facto limited to Japanese contractors. After a major untied commitment to the International Monetary Fund in FY 1994, JEx-Im provided no loans to international organizations in FY 1995; in FY 1996,

JEx-Im extended \_25 billion (\$218 million) in untied loans to international organizations. Bilateral untied loans amounted to \_302 (\$2.7 billion) in FY 1996, about 20 percent of total JEx-Im lending; import loans--which include credits to support imports of natural resources, another form of untied JEx-Im financing--totaled \_66 billion (\$600 million).

A look at JEx-Im lending by region and purpose illustrates an important characteristic: the bank is substantially focused on supporting Japanese commercial interests in Asia (see Tables 2 and 3), particularly participation in large-scale industrial and infrastructure projects. Investment loans and untied loans, the two primary avenues for such financing, together accounted for about 70 percent of the bank's commitments in FY 1996; loans for these purposes in Asia alone consumed about 36 percent of JEx-Im's lending. When loans for exports and imports are included, the share rises to 47 percent.<sup>5</sup> Examples of recent projects include support for the construction of a build-own-operate power plant in China, expansion of natural gas liquefaction facilities in Indonesia, and expansion of the telecommunications network in the Philippines. These projects, it is worth noting, support both Japanese exports and imports--a pattern that illustrates the strategic underpinnings of JEx-Im lending. Japanese firms will construct the gas liquefaction facility in Indonesia; the plant in turn will supply Japan with liquefied natural gas, a commodity for which Japan completely depends on imports.

#### MITI's Trade Insurance

The Export-Import Insurance division of MITI administers the largest government trade and investment insurance program in the world--in part because there are virtually no private-sector providers of such products in Japan. Through a number of different services, MITI insured more than 550,000 transactions during FY 1994, a figure that represented in excess of \_19 trillion (about \$190 billion at that time) in commitments during that year, including nearly \_7 trillion (\$70 billion) in Asia (see Table 4). Asia accounts for more than 60 percent of the system's outstanding liabilities. Claims against MITI's insurance programs in FY 1994 totaled about \_81 billion (\$810 million).

Premiums, in principle, are determined on the basis of the length of the contract and the political risk present in the recipient country. To further hedge risks, however--and to boost its premium revenue--MITI has actively steered exporters into arrangements known as comprehensive insurance policies. Under these schemes (which include both company-based and product-based packages) member firms are obligated to pay premiums based on all of their export transactions, regardless of conditions in an individual recipient country. As a result, exporters in effect receive discounted premiums for transactions in risky countries, while being forced to pay higher premiums for less

risky transactions--including deals in developed markets for which insurance may not be necessary at all.

Although the distortionary effects of comprehensive insurance policies occasionally become the subject of criticism in Japan, in recent years MITI has, if anything, moved to strengthen the system. As a number of developing countries reached international agreements during the 1980s to reschedule or write off their external debt obligations, claims against MITI's trade insurance programs increased dramatically, causing a rapid erosion of the system's reserves. The ministry responded by raising premiums, securing an annual subsidy from the general account budget (about 25 billion [\$250 million] in FY 1994), and pressuring yet more customers into comprehensive insurance arrangements. MITI officials estimate that 80 to 90 percent of the transactions supported by trade insurance are covered by comprehensive packages; some 15 exporters' organizations and virtually all trading companies participate in these schemes.<sup>6</sup>

### OECF's Private-Sector Investment Finance

OECF's primary function is to serve as the loan arm of Japan's official foreign aid program, which follows international norms in lending only to other government entities (see below). In addition to this ODA function, OECF provides a relatively small volume of loans to, and equity investments in, Japanese corporations and joint ventures operating in the developing world. In principle, these OECF functions are clearly separated from those of JEx-Im. The fund's private arm is officially sanctioned to provide financing only for projects concerning agriculture, forestry, and fisheries; exploratory mining; preparatory surveys for development projects; and development projects for which JEx-Im would be unlikely to offer its own financing. In fact, however, the delineation of roles between the two lending organs is often fuzzy, particularly in the final category of lending.

In FY 1996, OECF made four commitments to Japanese corporations totaling 6.6 billion (\$60 million). Since 1961, the fund's private arm has extended a total of 510 billion in commitments (\$4.6 billion at current exchange rates), nearly half for Asian projects.<sup>7</sup> While some of this financing clearly falls within the fund's officially mandated role--such as a recent loan for a pulp project in Indonesia--other commitments appear remarkably similar to the large-scale industrial and infrastructure projects generally financed by JEx-Im or ODA loans. In FY 1994, for example, OECF took an equity stake in a power plant project in Pakistan; in FY 1995, the fund provided a loan to support an industrial water project in Chang Chung, China; in FY 1996, OECF provided funds for a study of a toll road project in the Philippines, a private-sector infrastructure initiative. Although formally the roles of the two institutions have been separate since OECF was created, jurisdictional overlap with JEx-Im at times appears to produce activity that competes rather than complements--a phenomenon that may worsen after the two financing organizations merge in March 1999.

### Other Commercial Programs

In addition to the major financing arms described above, Tokyo manages or subsidizes a host of other, smaller programs designed to support Japanese business interests overseas. While an exhaustive list of such organizations is impossible, a few examples follow.

**Japan External Trade Organization.** Although JETRO's functions (which are heavily subsidized by MITI) now include public relations and import-promotion programs, a substantial portion of the organization's activities remains focused on supporting Japanese exports. JETRO performs surveys and collects information concerning conditions in overseas markets, for example, and offers an array of educational programs for Japan's small- and medium-sized companies. Among a number of initiatives focused on promoting trade with developing countries, a JETRO-sponsored program aims to introduce Japanese environmental and energy technology into China and Southeast Asia. JETRO's FY 1995 budget for promoting trade with developing countries was 4.4 billion (\$44 million).<sup>8</sup>

**Japan International Development Organization Ltd. JAIDO** was established in 1989 by the Japanese government and the Japan Federation of Economic Organizations (Keidanren)--an industry group whose members include many of Japan's largest companies--to provide equity support, loan guaranties, and consulting services for "commercially viable" projects in the developing world. As of 1995, about 60 percent of JAIDO's 16 billion (\$160 million) capitalization came from contributions by the organization's 132 member companies; the remainder was supplied by OECF. While Japanese companies invariably are participants in JAIDO-supported projects, other international financing organizations--such as the World Bank's International Finance Corporation or the Asian Development Bank--frequently supply funds as well. Projects targeted for JAIDO support tend to be relatively small in scale and appear evenly scattered across Asia, Latin America, and eastern Europe--with a handful under way in Africa as well. Among the dozens of JAIDO projects approved to date are \$1.6 million (out of a total cost of \$22.7 million) for a cotton-spinning factory in Java; \$2.1 million (out of \$5 million total) for a computer software company in Shanghai to develop software engineering technology and Japanese-language software programs; and \$8.7 million (out of \$267 million) for the construction and management of a building complex in Bangkok.

**Japan Overseas Development Corporation.** JODC was founded under MITI's auspices in 1970 to support the industrial development of, and expand trade with, the developing world.<sup>9</sup> The corporation's financing programs are focused on facilitating the overseas investments of Japan's small and midsized companies, as well as on promoting imports of primary products. These financing programs are small: in FY 1994, JODC provided 846 million (\$8.5 million) in investment support funds and 1.1 billion (\$11 million) in funds to promote imports. Perhaps of more significance are JODC's personnel exchange programs. In response to requests from host country companies and other private organizations, JODC dispatches technical and management experts to function as consultants in developing countries for periods of up to two years. In FY 1993, nearly 400 experts were sent overseas through JODC's programs; about 95 percent were bound for countries in Asia.

Association for Overseas Technical Scholarship. AOTS, supported in part by MITI's foreign aid budget, was created in 1959 to provide technical training in developing countries. The organization offers a number of educational programs, ranging from correspondence courses to seminars conducted by lecturers dispatched from Japan. Most well known, however, are AOTS's personnel exchange programs. Trainees--more than 70 percent of whom come from

Asia--are brought to Japan for periods averaging about six months. During the initial phase of their stay, participants undergo Japanese language training, visit factories, and attend other educational programs designed to deepen their knowledge of Japan. Participants then move to a Japanese company for experience more specifically related to their backgrounds and skills; training traditionally has focused on such industries as transport machinery, electronics, and chemicals. Follow-up efforts ensure that the impact of these exchanges continues long after trainees return to their home countries. Offices across Asia allow for regular visits with former participants; AOTS representatives collect information on trainees' current activities, survey common workplace problems, and offer advice on improving management and productivity. AOTS "alumni" organizations also serve to maintain contact among former participants, further solidifying the network of human ties with Japan. More than 60,000 people have participated on AOTS training programs since their inception, including about 4,000 in FY 1993 alone.

#### Official Development Assistance

Despite recent budget cuts, Japan's ODA program continues to be the largest in the world: net outlays in 1996 totaled nearly \$9.5 billion, including about \$8.2 billion in bilateral disbursements; the United States, the world's second-largest donor, provided \$9.1 billion (although this figure was inflated by budgetary flukes in Washington).<sup>10</sup> Although fiscal constraints in Japan are likely to force reductions in the aid budget, Japanese officials have indicated that bilateral programs are likely to escape significant cuts. Foreign aid will continue to be a major component of Japan's international strategy.

Japan's foreign aid program began in the 1950s with openly mercantilistic intentions, and most disbursements were tied to the purchase of Japanese goods and services. Foreign aid, despite its nominally altruistic intentions, traditionally has been viewed as an integral part of keizai kyoryoku. Although outside pressure and internal reforms have brought much of Japanese ODA formally into line with international standards, suspicion as to the program's true intentions continues. These doubts emanate from several patterns that characterize Japanese aid practices. First, although recent years have brought some movement toward diversification, Japanese ODA remains heavily concentrated in Asia--a region of obvious strategic importance to Tokyo. Despite Asia's relative prosperity, the region received nearly 55 percent of Japan's bilateral aid disbursements in 1995. Second, the share of loans in Tokyo's total giving is much higher than the Organization for Economic Cooperation and Development (OECD) average; less than 50 percent of Japanese ODA in 1993--94 came in the form of grants, a level that placed Japan close to the bottom among the world's major donors--although grant aid has increased

significantly in recent years.<sup>11</sup> Finally, Japanese ODA has long emphasized the financing of large-scale infrastructure projects--roads, power plants, telecommunications networks, and hydroelectric dams, for example--as opposed to providing support for basic human needs. Infrastructure projects obviously carry a significant profit potential for Japanese suppliers and improve the business environment for other investors. In 1995, about 45 percent of Tokyo's foreign aid was extended for economic infrastructure projects. Although Japanese foreign aid officials vigorously defend these practices as consistent with an underlying philosophy, criticism in the West continues unabated.<sup>12</sup>

No single ministry is in charge of formulating Japanese foreign aid policy. In fact, four agencies--the ministries of Finance, Foreign Affairs, and International Trade and Industry, as well as the Economic Planning Agency (which plays the least important role of the four)--vie for influence over the ODA program. Two smaller agencies--OECF and the Japan International Cooperation Agency (JICA)--are primarily responsible for disbursing ODA funds.

OECF. As noted above, OECF's primary function is to serve as the loan arm of Japan's ODA program. The fund's lending is the primary avenue through which Tokyo finances the economic infrastructure projects described above; some 70 percent of OECF's new commitments in FY 1996<sup>13</sup>--which totaled \_1.3 trillion (\$12 billion)--were intended for projects in sectors related to transportation, electric power and gas, irrigation, mining, and telecommunications. These financing programs carry an overwhelming focus on Asia: about 77 percent of the new loans were extended to Japan's closest neighbors--with about 55 percent to northeast and Southeast Asia alone.

In principle, OECF loans are almost completely untied; companies from any country are free to bid on contracts associated with OECF financing. According to official statistics, Japanese firms won just 33 percent of the contracts linked to ODA loans in FY 1996; firms from other OECD countries secured about 14 percent of such contracts, with enterprises in developing countries winning the remainder. These figures are the subject of considerable controversy, however. Critics assert that many firms considered to be developing country concerns for the purpose of calculating procurement statistics in fact are disguised Japanese subsidiaries or joint ventures--and that therefore the Japanese share of ODA contracts is much higher than official figures suggest.<sup>14</sup> Further, some elements of OECF financing are more transparent than others; while bids on construction contracts are formally open to all bidders, the fund's project design and implementation contracts are less transparent.

JICA. The less prominent of Tokyo's two aid-dispensing agencies, JICA is primarily responsible for implementing Japan's grant and technical assistance programs. As in similar programs in other donor countries, procurement contracts from grant assistance generally are limited to Japanese companies; while these contracts rarely are large in and of themselves, they arguably facilitate access to other, more lucrative projects associated with Japanese ODA. The agency plays an active role in identifying development projects by performing feasibility studies, for example. In many cases, these studies lead to the major capital projects financed by OECF; while these larger contracts nominally are

untied, critics charge that the consultants and engineering firms involved at the feasibility stage design projects with specifications that favor Japanese companies.

Also important are JICA's personnel exchange programs. The agency brings thousands of people in the developing world--again largely from Asia--to Japan every year for technical training in fields as diverse as agriculture, telecommunications, energy, and health. Since the inception of these programs in 1954, more than 130,000 people have participated in them; in 1994, Japan accepted some 5,600 trainees from Asia--more than half the overall total. JICA also dispatches "experts" to serve as advisers in government, educational, and research institutions in developing countries; these consultants (whose numbers since 1954 have exceeded 40,000) often make substantive policy recommendations and play an active role in formulating comprehensive development plans in the host country. About 2,600 short- and long-term experts were dispatched to Asia for these purposes in 1994; that figure again accounted for more than half the overall total.<sup>15</sup>

## BANG OR WHIMPER?

### Impact Unquestioned

As the scale and scope of the above programs suggests, Tokyo clearly has sought to support Japanese commercial interests in Asia in a well-funded, systematic, and comprehensive way. By any reasonable measure these efforts have proven beneficial, both to the companies involved and to Japan's strategic interest in a regional environment conducive to trade and investment. Japanese trade and investment with Asia has expanded dramatically over the last decade: Japan's exports to the region have more than doubled since 1990, and the country runs large and rapidly growing trade surpluses with most Asian economies--with the notable exceptions of China and Indonesia, which export to Japan large volumes of raw materials. Annual flows of Japanese foreign direct investment (FDI) to the region rose to \$8 billion in 1989, before slumping during the early 1990s; since then, Japanese FDI to Asia has grown rapidly again, reaching \$12 billion in FY 1995, nearly double the level of three years ago. Cumulative Japanese FDI in Asia now totals in excess of \$88 billion.

Even assuming that much of this trade and investment would occur without government support, JEx-Im and MITI unquestionably have played an important role in amplifying the trends. Japanese trading company executives suggest, for example, that the value of these programs is far greater than the loans and guarantees themselves; indeed, for most projects a range of financing options is available--in some cases more cheaply--through either private financial institutions or multilateral entities, such as the International Finance Corporation and the Multilateral Investment Guarantee Agency. Arguably more important is the role JEx-Im and MITI fulfill as a signaling device, both to other financial institutions and to the host country. The backing of the Japanese government serves as powerful leverage against attempts by local authorities to "change the rules" governing a particular project.<sup>16</sup>

Japanese ODA, too, has had an immeasurable impact on the regional economy. OECF estimates, for example, that its loans have financed the construction of 46 percent of Indonesia's hydroelectric power capacity and 12 percent of the country's railroads; 24 percent of peninsular Malaysia's total power capacity--and 15 percent of Thailand's--is said to have been paid for through Japanese ODA loans.<sup>17</sup> More subtly, JICA's technical cooperation programs have given Japanese officials a role in formulating development strategies in Asia that improve the business environment for Japanese investors. Exchange programs run by JICA, AOTS, and other organizations familiarize Asians with Japanese business practices--and improve Japan's public image in a region that is naturally predisposed to view its northern neighbor with suspicion. Although the effect of these "people-centered" initiatives on Japanese commercial interests is impossible to quantify, their significance should not be underestimated--particularly in a region where personal ties are an important element in conducting business.

The lasting importance of the keizai kyoryoku framework to the Japanese business and policy communities is perhaps most dramatically demonstrated by MITI's 1987 New Asian Industrial Development plan. The initiative represented a strikingly explicit attempt to construct an "Asian division of labor" by assisting low-end Japanese industries--undercut at home by the yen's appreciation--to move overseas. As envisioned by MITI, the new Asian Industrial Development (AID) plan consisted of three phases. First, Japanese officials (for example, through JICA exchange programs) work with their counterparts in Asia to develop comprehensive economic development strategies. In the process, particular export industries are targeted for Japanese direct investment and other forms of support, and structural barriers that might impede development are identified. Second, Japanese government officials and private consultants recommend specific policies and projects to support the targeted industries; ODA funds are used, for example, to perform feasibility studies for, and design, infrastructure projects. Implementation occurs in the final phase: ODA loans are used to finance the infrastructure projects; technical experts in the targeted industries are dispatched through the programs described above; and JEx-Im and MITI financing schemes are used to promote Japanese investment in designated sectors. The new AID plan was never formally endorsed by the government--and its importance has almost certainly been exaggerated in the West. Nevertheless, elements of the scheme are under way across China and Southeast Asia--and its very existence provides insight into the mind-set and philosophical framework that guide keizai kyoryoku.<sup>18</sup>

### Problems Profound

Impressive numbers and MITI's expansive schemes may not be the best measure of Japanese commercial diplomacy's effectiveness, however. Indeed, an undue focus on budgets and rhetoric can cloud understanding of the serious problems that characterize virtually all the programs described here.

**Inefficiency and Waste.** Many of the institutions and initiatives that make up Japan's commercial diplomacy appear to crowd out private activity and expose taxpayer money to unnecessary risk--and in some cases appear to suffer from corruption and



mismanagement. JEx-Im and MITI programs, for example, support a surprisingly high share--36 percent--of total Japanese exports; in contrast, 15 percent of French exports receive some form of official support, and only 2 percent of U.S. exports benefit from similar programs.<sup>19</sup> These numbers are inflated, however, by the fact that Japanese support programs supply short-term credits to borrowers--a function that is fulfilled by private institutions in many other industrialized countries; the percentage of Japanese medium- and long-term exports receiving government support is much closer to G-7 norms.<sup>20</sup> MITI's trade insurance programs similarly displace services the private sector easily could provide; virtually no private trade insurers exist in Japan to compete with government programs. The cross-subsidization resulting from the comprehensive insurance packages described above also in effect imposes a tax on Japanese exporters for their sales in the world's least risky markets (i.e., the advanced industrial economies), which continue to buy the overwhelming share of Japanese exports. MITI's trade insurance programs therefore have assumed an exaggerated size: a far larger percentage of the nation's exports is covered by insurance than would be the case under a more competitive system,<sup>21</sup> a fact that clearly irritates many Japanese business representatives.

Japan's foreign aid program is subject to frequent charges of waste and corruption. Revelations in 1986 that a portion of OECF loans to the Philippines had been kicked back to the coffers of President Ferdinand Marcos and other government officials sparked the first real domestic debate in Japan over ODA policy.<sup>22</sup> Since that time reforms have improved the transparency of Tokyo's aid program--particularly in concessional lending procedures--but evidence persists of continuing irregularity. In October 1995, for example, Japan's Fair Trade Commission imposed fines on 37 domestic trading companies and department stores for widespread bid rigging on contracts linked to Japanese grant and technical assistance; investigators determined that the firms had colluded on some 631 projects--worth a total of about \$170 million--in 82 countries. Similarly, in November 1995, a prominent weekly magazine in Japan charged that waste and poor management plague a number of ODA-financed projects across Southeast Asia; the article further asserted that Japanese commercial interests were the driving force behind many of the projects in question.<sup>23</sup> The large number of apparently indistinguishable personnel exchange programs also raises questions about the overall efficiency of these initiatives--and the possible need for consolidation.

**Bureaucratic Rivalry.** Interagency turf battles encumber the implementation of keizai kyoryoku. The foreign aid program provides the clearest example of the problem: as noted above, four ministries, each with distinct institutional interests, struggle for control over the program. While MITI, of course, would love to use foreign aid as a tool to support commercial interests, other institutional actors hamper that goal. The Ministry of Finance, for example, views foreign aid primarily as a budget issue and as a tool for recycling Japan's large current account surplus. As concern over the nation's finances has grown, the ministry has applied steadily increasing pressure on ODA outlays. Budgetary constraints have contributed to, for example, a dramatic understaffing in the aid program, particularly in the field; the OECD estimates that Japanese ODA is among the most thinly staffed in the world--a fact that in turn undermines efforts to manage and implement projects effectively.<sup>24</sup> The Foreign Ministry (MOFA) has interests that occasionally

conflict with MITI's goals as well. MOFA generally is more sensitive to outside pressure and criticism--particularly from the United States--than other agencies, and has at times sought to use ODA as a broader foreign policy tool. The ministry has played an important role in diversifying the recipients of Japanese ODA, as well as in slowly boosting the share of funds allocated to purposes other than building economic infrastructure--such as basic human needs.<sup>25</sup> Although the Diet traditionally has not played a major role in formulating aid policy, lawmakers in the future also may demand a larger voice in the process--as is discussed below. ODA's utility as a component of keizai kyoryoku therefore may be in decline; the frustration many Japanese corporations express over the increasing difficulty they face in winning ODA contracts is perhaps evidence for the trend.

JEx-Im and OECF also engage in regular turf wars, a trend that shows signs of escalating as the March 1999 merger of the two institutions approaches.<sup>26</sup> Officials from both financing arms insist that the roles of the two institutions are distinct--and assert that even after the merger their respective lending functions will be separated by a "firewall." Nevertheless, JEx-Im's untied loans and project finance programs often appear remarkably similar in purpose--and even financial terms--to lending provided by OECF. This is particularly true in the current interest rate environment in Japan, where long-term rates hover at around 3 percent. JEx-Im's generally "semi-concessional" lending terms--which are determined relative to Japan's long-term prime--in many cases approach the fixed interest rates carried by OECF loans, which were established at a time when domestic rates were much higher.<sup>27</sup> Open competition between the two institutions particularly emerges in projects involving cofinancing with the World Bank. Procedures for handling bilateral requests for loans provide for the interagency dialogue and horse-trading that prevent these turf battles from spilling into the open; a similar process allowing for *nemawashi* (consensus-building) is absent in many multilateral financing projects.

Evidence abounds that JEx-Im and OECF are jockeying for expanded turf and influence in the postmerger financing organization. Both are extremely active in China in strikingly similar ways; indeed, China is the single largest recipient of lending from both agencies, and much of that financing is extended for large-scale industrial and infrastructure projects. OECF also has recently upgraded several countries to the status of "annual borrowers"--Turkey, for example, as well as Morocco and Tunisia--that in the past fell primarily under JEx-Im's lending purview. Turkey in particular has a per capita GNP that qualifies it as a middle-income economy and therefore soon will likely "graduate" from the list of countries eligible under international norms to receive ODA; that fact raises questions about the true motives behind OECF's decision to extend funds to Ankara on a regular basis.

OECF's recent foray into non-ODA support for private-sector infrastructure projects--a function that ostensibly competes directly with JEx-Im financing programs--also clearly represents in part an attempt to carve out a role in this rapidly growing field. The broader movement toward using private capital to support the construction of large-scale infrastructure in the developing world is likely to further complicate efforts to clearly

demarcate the respective roles of ODA and other government financing programs. This trend has particularly strong implications for Japan's foreign aid program, with its heavy focus on economic infrastructure. JEx-Im and OECF therefore probably would be locked in an escalating interagency rivalry even in the absence of the upcoming merger; the fusing of the two institutions only serves to undermine prospects for efficient, coherent keizai kyoryoku.

**Effectiveness Questions.** The massive expansion in Japan's trade with, and investment in, Asia already has been noted--and the role of commercial diplomacy in supporting and intensifying these trends should not be underestimated. Nevertheless, a variety of anecdotal evidence suggests that keizai kyoryoku is somewhat less effective than might otherwise be assumed. Small and medium-sized companies in particular appear to benefit little from Tokyo's commercial support efforts. Few programs appear specifically aimed at the needs of these firms, with the exception of the small JODC and JETRO initiatives noted above. This lack of focus on smaller firms arguably carries a cost; a recent MITI survey suggests that the overseas subsidiaries of small Japanese companies on balance are withdrawing from production sites abroad.<sup>28</sup> Similarly, for all the support offered by Tokyo, Japanese subsidiaries have found overseas investment to be an intensely competitive enterprise. Although Asia continues to be easily the most profitable site for Japanese investors, MITI estimates that American subsidiaries are more profitable than their Japanese counterparts in virtually every region of the world, including the markets of Association of Southeast Asian Nations (ASEAN), China, and Asia's four newly industrialized economies.<sup>29</sup>

**A Changing Policy Environment?** As noted above, commercial diplomacy in Japan has been supported at least in part by the widespread belief that the nation's security depends on its ability to trade with the outside world. Trade and national security therefore do not represent competing interests in the minds of most Japanese policymakers--the two are one and the same. In this context, government programs in support of exports and investment can be seen as clearly consonant with the national interest. Not surprisingly, the Japanese public appears to accept the wisdom of these programs. In contrast to discussions of "corporate welfare" in the United States, the financing offered by JEx-Im and MITI is uncontroversial to the extreme; despite their massive size--and the implicit risk to taxpayer money--the programs receive virtually no public or political attention. This tendency is arguably amplified by the American military presence in Japan. In essence, because the ultimate national interest--the defense of one's borders--has been in large measure provided by an outside power, the notion of a "trade-off" between economic and security interests has never emerged as a centerpiece of Japanese discourse.

The rise of China as a major world power may force a change of thinking in Tokyo. The consensus in Japan behind a policy of engagement with Beijing is far more solid than in the United States; policymakers in virtually all government institutions agree that policies aimed at integrating China into the world economy represent the most effective means of encouraging the Asian giant's peaceful and stable development. Nevertheless, events over the past few years suggest that that consensus may be weakening. After China conducted

a nuclear test in August 1995--its second that year--Tokyo suspended most grant and technical assistance to Beijing. Although these forms of ODA represent only a small portion of total Japanese aid to China, the action nevertheless constituted an unusually strong statement of disapproval. As events continued to rock Sino-Japanese relations in 1996--additional nuclear tests, China's military exercises off the coast of Taiwan, and the reemergence of a territorial dispute surrounding the Senkaku/Diaoyu Islands in the East China Sea--political pressure grew to limit government lending in China. A research group of Japan's ruling Liberal Democratic Party called for a review of yen loans to China; a collection of lawmakers from across the political spectrum opposed JEx-Im's decision to provide loans for the Three Gorges project.

The impact of these voices should not be overblown; with the recent warming in Sino-Japanese ties, public and official opinion remains squarely in favor of engagement with Beijing, and the opposition to aid and JEx-Im financing still amounts to little more than a voice in the wilderness. Nevertheless, the increasing political sensitivity of relations with China is clear. Grant aid was only recently restored; political pressure delayed completion of a large OECF loan package to China for FY 1996 until late November 1996. The emergence of a major world power in Asia therefore may slowly erode the long-standing consensus in Japan behind the perceived unity of economic and security interests--and in turn undermine the coherence of economic cooperation.

#### KEIZAI KYORYOKU: THE LATEST PHASE

Despite the obvious problems noted above, the theoretical framework of keizai kyoryoku continues to guide the thinking of many Japanese policymakers. A rapidly changing international environment, however, has begun to undermine several components of the traditional strategy--particularly the role of ODA. East Asia's rapid economic growth, ironically, has given rise to the most central challenge: that of meeting the region's massive infrastructure needs over the next decade. The World Bank estimates that between 1995 and 2004, East Asian economies will have to invest as much as \$1.5 trillion in infrastructure--including power generation, telecommunications, transportation, and water and sanitation facilities. China's estimated requirements account for about half this total, with South Korea, Indonesia, and Thailand accounting for another 40 percent. To meet these needs, according to the World Bank, the economies of East Asia will be forced to spend about 7 percent of GDP on physical infrastructure--considerably more than the estimated current levels of 5 percent.<sup>30</sup>

On the surface, the infrastructure focus of Japanese ODA, and of keizai kyoryoku more broadly, would appear to position the programs perfectly to continue their contribution to East Asian development, and to the overseas expansion of Japanese corporations. In fact, a number of factors suggest a different interpretation. Despite the size of Tokyo's official support programs, traditional financing approaches will prove inadequate to meeting East Asia's future development needs. At current levels, OECF loans--currently the primary tool for financing many public works projects--would support less than 3 percent of China's overall infrastructure requirements through 2004. The broader shortage of public resources available to finance infrastructure development has forced many developing

countries to turn to private funds; one World Bank adviser has estimated, for example, that 12 to 15 percent of East Asia's infrastructure projects are being carried out by the private sector--a share that could increase to about 30 percent by the year 2000.<sup>31</sup> This tendency away from utilizing foreign aid and other public funds to finance infrastructure is exacerbated by long-standing criticism of OECF lending policies. Given the relatively high payback burden of yen loans, which has been amplified by secular appreciation of the yen, many developing countries in Asia prefer that private investors perform work previously limited to the public sector.

These developments represent both a challenge to existing keizai kyoryoku policy and an opportunity for private Japanese infrastructure providers to expand their activities in Asia. In response, the Foreign Ministry and MITI informally announced in 1996 the outlines of a new element to Japan's overall economic cooperation strategies in Asia. In essence, the approach calls for combining foreign aid with JEx-Im and MITI financing programs to supplement the use of private capital in specific infrastructure projects. Targets for the initiative--which thus far is limited to a few pilot projects--will be primarily those ODA recipients with relatively high per capita incomes that already receive large private capital flows from overseas. The plan by no means should be interpreted as a fundamental restructuring of Japanese aid policy; Tokyo also plans to continue meeting requests for more traditional assistance projects and to continue diversifying the forms and recipients of Japanese ODA. Nevertheless, the new strategy recognizes that in the coming decades private capital will play a central role in financing East Asia's economic development. Tokyo clearly is attempting to alter foreign assistance and government financing strategies to reflect this new environment--and, not coincidentally, position Japanese business to compete more effectively.

#### Supporting the private sector

In February 1996 the Economic Cooperation Committee--a division of the Industrial Structure Council (Sangyo Kozo Shingikai), an advisory body to MITI<sup>32</sup>--issued a report arguing that Japanese government assistance should be used primarily to mitigate the risks for private investors associated with infrastructure investment.<sup>33</sup> The document advocates using a combination of loans, insurance, and guaranties from JEx-Im and MITI; the OECF's private-sector investment finance arm; and OECF's foreign aid loans to support private infrastructure projects in developing countries. As with any commercial project, trade and investment insurance, as well as JEx-Im loans, would go directly to private interests (presumably Japanese corporations) involved in targeted infrastructure projects. ODA loans, in turn, would be used to underwrite components of a given project that are of a "public nature" and that are not likely to attract private financing. Examples cited in the report include developing environmental conservation measures for a power generation project, constructing dams for hydroelectric power initiatives, or building access roads for an industrial park.

In general, according to the committee's report, Japan should develop assistance policies that "utilize the vitality of the private-sector" by emphasizing approaches in which "public funds effectively function as priming water for private funds." In this way, the

committee notes, Japan's limited public resources might be put to more effective use in promoting economic development. Criteria that the report suggests for determining which projects are deserving of Japanese government support include initiatives of an "unmistakable public character" that are consistent with the host country's overall development strategy, and that demonstrate "appropriate" levels of risk sharing between the host government and private investors.

Foreign Ministry statements on the proposed policy echo many similar themes. One memo on the subject states that "the Government of Japan believes that some supplementary measures should be taken . . . to facilitate private-sector initiatives in infrastructure development in developing countries." ODA again is seen as playing an important role in this regard. The Foreign Ministry suggests that foreign aid funds could be used to finance "portions of the infrastructure project where concessional public funding is regarded as more appropriate than private capital," to support the environmental conservation components on a given project, and to finance feasibility studies on projects initiated by the private sector.

The first demonstration of the new component to keizai kyoryoku appeared in April 1996, when Tokyo indicated that it would provide a total of more than \_100 billion (\$1 billion) in loans to help finance the construction of a new 20-kilometer subway system in Bangkok, Thailand. The project--which is slated for completion in 2002--reportedly will cost a total of about \_315 billion (\$3.15 billion). Private firms will assume responsibility for the procurement of subway cars and other equipment, as well as for the system's operation and maintenance; ODA loans will be used to dig the system's tunnels--a "public" component of the project for which private financing is more difficult to attract.<sup>34</sup> A similar strategy is underwriting the construction of a power plant in Indonesia. Private capital will construct and operate the plant itself; ODA loans will be used to build the network of power lines necessary to convey electricity produced by the plant.

### Seeds of Controversy

Japanese aid officials indicate that for now ODA loans extended under the rubric of this new strategy will continue to flow through host country governments. Foreign Ministry representatives have indicated, however, that over the long term concessional loans may be extended directly to companies involved in infrastructure projects, provided that repayment is guaranteed by the host country's government. Regardless of the form that the new approach eventually takes, the prospect of Japanese ODA being used to directly support private-sector projects has sparked concern that Tokyo's foreign aid policies could return to the overtly mercantilistic patterns of the past. Given the large number and the massive scale of the infrastructure projects involved--and the potential for equally large profits--Tokyo's new strategy appears to represent a means of helping Japanese corporations secure a greater piece of the action.<sup>35</sup>

Japanese aid officials vigorously deny that such ulterior motives lurk behind the new strategy. They insist that any ODA loans extended to private infrastructure projects will

remain open to contractors of any nationality and will be implemented in ways consistent with international norms. Foreign Ministry representatives downplay the possible negative perceptions of the new strategy, maintaining that East Asia's development needs demand innovative solutions; these officials note that "sometimes you have to take a risk to do the right thing." An informal MOFA statement, for example, asserts that support for privately financed infrastructure projects "will strictly follow all applicable international rules and procedures. . . . ODA loans to be extended [for such projects] will be provided under general untied procurement conditions like most of our ODA loans." The statement further invites "other members of the donor community including [the] U.S. and [the] World Bank to jointly support such private-sector initiatives."

The MITI report described above also appears to have bowed to this concern, suggesting that infrastructure projects involving "enterprises from more than one advanced country" are likely to be more effective and less risky. Nevertheless, it is no secret that Japanese companies are expressing dissatisfaction with their ability to win procurement contracts linked to Tokyo's foreign aid loans--a frustration that by some accounts has intensified in recent years as Japan's economy remains mired in little or no growth.<sup>36</sup> MOFA officials acknowledge that Japanese corporate interests have stepped up pressure on Tokyo to guarantee greater access to ODA contracts.

This context adds weight to suspicions that Tokyo's new aid paradigm is intended primarily to benefit corporate Japan. Such worries are compounded by language in the Industrial Structure Council report cited above, which appears to openly express the hope that the new approach will result in increased business opportunities for Japanese firms. The committee document states, for example:

. . . the Government of Japan should consolidate the business environment required to encourage the commitment of Japanese infrastructure service providers to private-sector-led infrastructure development in developing countries.

. . . While adopting the preconditions of respecting international rules and of not disrupting the efficiency of aid projects, the Government of Japan should try to achieve "visible economic cooperation" which unifies Japanese technologies, know-how and financial resources and which makes Japan's presence as a positive donor felt by the international community.

Further contributing to the perception of continued mercantilism in Tokyo's economic cooperation programs is Japan's leading role in spurring greater cooperation among Asian export financing organizations. At a March 1997 gathering sponsored by JEx-Im, for example, representatives from seven institutions--including the export-import banks of China, Korea, Malaysia, and Thailand--discussed ways to promote "cooperation" between Japanese companies and the respective agencies. Of particular interest to the participants were infrastructure projects in Asia.<sup>37</sup>

Although still in its embryonic stages, this innovative direction in Japanese aid policy amply illustrates the continuing relevance of the keizai kyoryoku framework--and the

attending holy trinity of trade, aid, and investment. Nevertheless, the rhetoric of intentions is likely to exceed the reality of accomplishment. Both internal and external constraints undoubtedly will limit the effectiveness of the new strategy. Bureaucratic wrangling will affect implementation: despite MITI's intentions, the Foreign Ministry--while broadly supportive of the approach--is certain to be sensitive to international opinion; MOFA likely will strive to ensure at least a modicum of openness to outside participation in projects targeted under the new strategy. Further, a policy of extending foreign aid loans directly to corporations would no doubt exacerbate OECF's competition with JEx-Im by further blurring the line between the two lending programs. Continued pressure on Tokyo to diversify the recipients and purposes of Japanese aid will likely also ensure that the strategy remains but one component of a broader policy.

Ironically, the initiative also may provide less benefit to

Japanese corporate interests than was intended. American and European infrastructure providers in many ways already are more competitive than their Japanese counterparts. Japanese telecommunications firms and electric power companies--Nippon Telephone and Telegraph Corp. and Tokyo Electric Power Co., for example--face regulatory environments that restrict their overseas activities. Japanese infrastructure providers in general also are less experienced in the build-operate-and-transfer or build-own-and-operate patterns of infrastructure development increasingly prevalent in East Asia; in many cases they look to American firms for leadership and work with them to secure infrastructure deals in emerging markets. In this context, American and European firms may be able to secure access to a considerable portion of the loans for infrastructure projects extended by Japanese government authorities--particularly untied ODA and JEx-Im loans. As with initiatives in the past, the latest component to keizai kyoryoku almost certainly will achieve less than its stated intentions.

## BEYOND BUDGET LINES

For all the size of its budgets and the ambitions of its rhetoric, keizai kyoryoku presents a record of mixed success. From the perspective of the American policymaker, the lessons of the Japanese experience are therefore limited. In striving to assist American companies competing in Asia, Washington clearly can never hope to rival the resources Tokyo offers its own corporate customers. America's more limited war chest for commercial diplomacy should not necessarily be a cause for concern, however. As this paper has tried to illustrate, a significant percentage of Japanese official support for business represents a questionable exposure of taxpayer funds hardly worthy of emulation.

The most noteworthy aspect of Japan's economic cooperation may be the attitude that forms its foundation. Japanese commercial diplomacy is not limited to a large volume of loans and guaranties--although these certainly are valuable components to the endeavor. Policymakers in Tokyo define their task far more broadly than a series of individual transactions completed over a finite period of time. Indeed, the most important contributions of keizai kyoryoku to Japanese commercial interests may be the least direct and the most difficult to measure: the long-term investment--through training programs



and personnel exchanges--in building a network of human ties across Asia knowledgeable about Japan, versed in Japanese management techniques, and comfortable with Japanese technology. The importance of the financial resources underpinning keizai kyoryoku should not be underestimated; nevertheless, programmatic diversity is the defining characteristic of Japanese commercial diplomacy. This feature may offer the most important lessons to outsiders. That Tokyo views commercial diplomacy as a worthy--and even paramount--enterprise is demonstrated by the range of tools employed in its execution.

## JAPAN AND THE ASIAN ECONOMIC CRISIS

This paper has argued that a central goal of postwar Japanese foreign policy has been to strengthen and strategically configure the nation's economic ties with East Asia. During the years of the region's economic "miracle," Japan's massive expansion of trade and investment links with its neighbors made the strategy appear wildly successful--and to outsiders, threatening. As Japanese companies began to carve out dominant positions in many industries across Asia, some analysts began to warn that Japan was slowly "embracing" the region in a hold that could exclude outsiders from the world's most dynamic economies.<sup>38</sup>

If Japan's major stake in the East Asian economy was a source of strength and envy during the boom years, that stake became a major vulnerability when events took a turn for the worse. The scope of Japan's exposure in Asia is immense. At the end of 1996, Japanese banks had some \$114 billion in outstanding loans to the major economies of East Asia--including nearly half of Thailand's outstanding debt. Japanese companies have committed about \$90 billion in direct investment and send about 40 percent of their exports to the region. At best, a sustained downturn in Asia will weaken the outlook for corporate Japan.<sup>39</sup> At worst, the crisis could threaten the collapse of a financial system already staggering under the weight of massive non and underperforming loans.

Given the stakes involved, Japan's attempts to play a leading role in the early stages of the crisis are hardly surprising. Events during the second half of 1997 exemplify Japan's leadership style, the continuing prominence of the keizai kyoryoku framework, and the constraints--domestic as well as international--on Japanese action. Tokyo clearly sought to lead the international response to the crisis, though not without help. Japanese policymakers continued a long tradition of acting first in concert with other governments or through international institutions, followed by quiet, largely symbolic initiatives to curry favor and influence with regional governments. However, budgetary pressures and Japan's own economic difficulties placed limits on Tokyo's ability to lead--a fact that may have important implications for the future of keizai kyoryoku. Indeed, as the crisis continued to unfold, Japan began to face harsh criticism that it had not done enough to assist its neighbors. What follows is an analysis of Tokyo's response to the unfolding crisis up to its spread to South Korea.

Thailand

Tokyo had indicated that it stood ready to offer assistance to the Thai economy even before Bangkok turned to the international community for help in defending its currency. At a hastily arranged August 11 meeting--held, not coincidentally, in Tokyo--Japan emerged as the single largest donor to a \$17 billion bailout structured and conditioned by the IMF. Early reports had suggested that Japan might offer as much as \$7 billion to the effort; in the end the Japanese contribution--channeled through JEx-Im--totaled \$4 billion, the same amount offered by the IMF.<sup>40</sup> The desire to avoid appearing to dominate the package almost certainly played a role in Tokyo's decision to reduce its contribution.

Japan subsequently undertook initiatives toward Thailand at the bilateral level. In late September the OECF announced a new package of ODA loans for Thailand, totaling some \$1.06 billion (\$993 million). Although the aid announcement was not unexpected, the size of the new disbursements--which represented the second-largest package ever offered to Bangkok--was striking. The loans have been earmarked for a mix of infrastructure and environmental projects, and bring the cumulative total of OECF lending to Thailand to \$1.5 trillion (\$136 billion).<sup>41</sup> Furthermore, when then Thai Prime Minister Chavalit Yongchaiyudh visited Tokyo in early October, he was welcomed with new pledges of trade insurance worth more than \$8 billion to encourage new Japanese investment in the Thai economy. Prime Minister Ryutaro Hashimoto also announced plans to send 1,000 technical experts to Thailand over the next three years to assist in the country's restructuring efforts. Although the impact of these steps on the Thai economy will be felt only over the long term--and is likely to be marginal at best--Tokyo's actions carry important symbolic value. The generosity of his Japanese hosts prompted the Thai prime minister to comment, "Japan will stand by Thailand during our time of need."<sup>42</sup>

## Indonesia

When Jakarta became the second Southeast Asian capital to request IMF assistance in early October, Tokyo was equally quick to react. On the surface, corporate Japan's stake in the Indonesian economy would appear to be smaller than that in Thailand; Japanese banks have fewer outstanding loans in Indonesia (\$22 billion), for example, than in Thailand (\$37.5 billion).<sup>43</sup> Nevertheless, Tokyo played a key role in the Indonesian rescue effort, ultimately extending more funds to Jakarta than to Bangkok. As before, international authorities played the most prominent role in assembling the package: the IMF, World Bank, and Asian Development Bank extended lines of credit worth a combined \$18 billion. Japan assumed a lead role in extending supplemental assistance, contributing \$5 billion--matched by Singapore--to a \$15 billion package of "second-line" credits available to Jakarta. The United States, which was noticeably absent from the Thai bailout, promised \$3 billion, while Australia and Malaysia each pledged an additional \$1 billion.

Officials in Tokyo hoped that decisive action in Indonesia would prevent the crisis from spreading across Southeast Asia--and perhaps Asia as a whole. In early November, the Bank of Japan joined counterparts in Singapore and Indonesia in a coordinated effort to support the rupiah; monetary authorities from the three countries purchased some \$500 million of the Indonesian currency on the Singapore foreign exchange market, at the time

driving the value of the rupiah up 10 percent against the dollar.<sup>44</sup> Japanese policymakers clearly hoped the action would set a precedent for further regional monetary coordination in the future.

### Regional Initiatives and the Asian Monetary Fund

In addition to supporting IMF actions and offering supplemental assistance at the bilateral level, Tokyo sought to organize a regional response to the Asian crisis. During a regular meeting in October between MITI minister Horiuchi Mitsuo and his ASEAN counterparts, for example, Japan proposed a number of measures to strengthen Southeast Asia's "competitiveness." Among the somewhat vague initiatives--which received only a lukewarm reception in Kuala Lumpur--were proposals to increase private-sector involvement in infrastructure development and to improve the region's investment climate. The MITI minister also encouraged ASEAN to further reduce the region's tariffs--particularly for automobile components, a major strength for corporate Japan in Asia.<sup>45</sup> As the Japanese contribution to these initiatives, Mr. Horiuchi promised expanded trade and investment insurance along the lines offered to Thailand.

The most prominent Japanese initiative, however, was a proposal for an independent Asian monetary fund to respond to future regional economic crises. Tokyo's proposal, tabled at a meeting of G-7 central bankers and finance ministers in Hong Kong in September, would have created a pool of up to \$100 billion to defend Asian currencies from speculative attack. The plan envisioned Japan as the primary donor to the fund, but all regional economies would contribute to the effort. Several Southeast Asian leaders lent immediate support to the idea, partly out of a desire to sidestep the strict conditions imposed on IMF lending.

The plan drew immediate criticism from American and IMF officials, who feared that the new facility would usurp the IMF's authority as the international lender of last resort. Western monetary authorities were particularly concerned that the Asian fund could produce a serious moral hazard in the region. The existence of a large bailout pool, lacking the same disciplines applied to IMF lending, could serve as a disincentive to undertake complex and politically difficult economic reforms. At worst, the easy availability of emergency funds could actually encourage reckless lending and investment--although Asian officials denounced this charge as "patronizing."

The Asian fund proposal raised another concern for U.S. officials: a Japan-centered facility could seriously undermine American influence in the region. A number of Southeast Asian countries were nonplussed by Washington's sermons on the virtue of economic reform--even as it refused to contribute to the Thai bailout package. Many in the region also blamed the United States for the harsh conditions attached to IMF lending.<sup>46</sup> The appeal of the Japanese proposal thus stemmed in part from a tide of anti-American sentiment sweeping across the region; a separate funding facility could serve as a way around Washington's grating pontification.

The debate surrounding the merits of the Asian monetary fund left Washington in a difficult position. On the one hand, American officials openly expressed the hope that Japan would play a central role in resolving the currency crisis. After the highly unpopular Mexican bailout in the spring of 1995, Washington was in no position to lead an international rescue effort for a handful of obscure Southeast Asian economies. American officials therefore appeared to subscribe to the financial equivalent of the nineteenth-century "sphere of influence" condominium among the great powers: if Mexico was a U.S. problem, Asia is Japan's. At the same time, Washington desperately sought to avoid the obvious implications of that construct, as few could stomach the prospect of ceding influence in Asia to Japan. The United States therefore pursued a naked "have your cake and eat it, too" strategy: the IMF would dictate the terms of the package, and Japan would supply a significant percentage of the funds.

That strategy proved to be an astonishing success. Even as Tokyo continued to contribute generously to the IMF's rescue packages in Asia--as of this writing Japan has offered \$10 billion in "second-line" financial support to South Korea as well--Japanese officials faced intense pressure to withdraw their proposal and reaffirm the central role of the IMF in addressing the crisis. Ultimately Tokyo backed away from its Asian fund proposal; indeed, its capitulation to Western pressure was complete. Japan initially sought a compromise in a regional facility that would supplement IMF lending. Member economies would make formal, prior commitments to the fund, but any lending would be subject to the same conditions as IMF funds. Even this proposal was watered down substantially, however. At a November meeting in Manila, deputy finance ministers from 14 Asia-Pacific countries endorsed the creation of a regional "cooperative financing arrangement," but the details of the plan remain vague. Indeed, the so-called "Manila framework"--later endorsed by regional leaders at the Asian-Pacific Economic Cooperation (APEC) summit in Vancouver--contained no details about how the supplemental facility would operate, which countries would participate, or how much they would contribute.<sup>47</sup> To date the plan appears to represent little more than a ratification of the voluntary, ad hoc approach that Asia has pursued throughout the crisis--although Tokyo will host a meeting early next year to "carry forward the initiatives under this framework."

Western criticism was clearly not the only factor behind the demise of the Asia fund initiative, however. Domestic fiscal constraints and financial turmoil tempered Japanese enthusiasm for grand schemes requiring massive new commitments of resources. As a number of Japanese financial institutions closed their doors in the face of scandal and bad debt--most prominently Yamaichi Securities, which folded in November just as officials were gathering in Manila--Tokyo came down with a severe case of cold feet. The realization that Japan might have to deploy public funds at home to protect depositors at risk from the bank failures proved to be the final nail in the coffin for the Asia fund initiative. In mid-November a Japanese government official was quoted as saying, "A permanent monetary fund would be financially burdensome even to economically strong countries. We did not think from the start the idea really feasible."<sup>48</sup> At a press conference during the Vancouver APEC meetings just a few days later, Mr. Hashimoto stated, "In the Asia-Pacific region, we are ready to take on roles that are appropriate [to

help the region through the crisis.] But that does not mean that Japan . . . can pull ahead of other economies in the Asia Pacific region as a locomotive. . . . Each of us recognizes each other's freedom, philosophy and methods, and none of us are in a position to impose our own ways on others." The prime minister's effort to downplay Japan's role as a regional leader is a striking departure from earlier action and rhetoric. In the months following Mr. Hashimoto's remarks, complaints that Japan was doing too much to address the crisis would give way to complaints that it had not done enough.

## THE EFFECT OF THE CRISIS ON JAPANESE COMMERCIAL DIPLOMACY

The severity of Japan's own economic troubles may have important implications for the future of keizai kyoryoku. The economic cooperation programs of the future are not likely to be what they once were: ODA programs already face significant budget cuts over the near term, and government agencies across Kasumigaseki will be under constant pressure to reduce expenditures as Japan works to trim its fiscal deficit. Additional financial crises--a not unlikely prospect, given the scale of bad debts in the banking system--would only tighten these constraints and place further limits on the funds available for commercial diplomacy.

Nevertheless, the keizai kyoryoku framework will continue to guide much of Tokyo's foreign policy establishment. Budgetary pressures will impede and erode--but not destroy. In Japan's current interest rate environment, for example, JEx-Im and OECF require only a minimal subsidy from the central government to support the "concessional" terms on their loans. At least over the short term, the lending programs of the two institutions--the vital organs of Japan's commercial diplomacy--may go largely unaffected by the turmoil around them. Both organizations will therefore continue to pursue new roles and missions with the full support of corporate Japan.

Keizai kyoryoku will survive because in Japan commercial diplomacy has always been synonymous with foreign policy. Economic cooperation programs have played a central role in Japan's postwar global strategy--to a large extent, these initiatives have defined Japan's relationship with the outside world since 1945. As long as Tokyo continues to view the international economic environment--and the free flow of trade and investment--as vital to the nation's security, the keizai kyoryoku framework will continue to shape the activity of businessmen and diplomats alike.

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#### NOTES

Ex-Im Bank and OPIC:



## 1. Trade Promoters or Welfare Pariahs?

1. "Corporate welfare" is defined by the CATO Institute as "the use of government authority to confer specific benefits or privileges to specific firms or industries where there is no corresponding societal benefit."

2. "Toward the Next American Century: A U.S. Strategic Response to Foreign Competitive Practices," Fourth Annual Report to Congress, Trade Promotion Coordinating Committee, Department of Commerce, Washington, D.C., October 1996.

3. U.S. Ex-Im Bank Fact Sheet 1997.

4. U.S. Ex-Im Bank Annual Report to Congress, 1995, and 1996.

5. OPIC Annual Report to Congress, 1996.

6. J. David Richardson and Karin Rindal, "Why Exports Really Matter!" (Washington, D.C.: The Institute for International Economics and The Manufacturing Institute, July 1995). How Much Bang for the Buck?

1. Quoted in David Arase, *Buying Power: The Political Economy of Japan's Foreign Aid* (Boulder, Colo.: Lynne Rienner Publishers, 1995), p. 16. The book provides a detailed and comprehensive overview of the history of Japan's economic cooperation policies-- and describes how ODA has been an integral part of strategies to support Japanese corporate interests.

2. To satisfy the current OECD definition of ODA, official grants and loans to a specified list of developing countries and territories must have promotion of economic development and welfare as their main objective and carry concessional financial terms, i.e., a grant element of at least 25 percent.

3. As Arase notes, "[T]he problem of having to meet Western foreign aid norms became one of altering formal appearances while preserving the substance of the economic cooperation system." Arase, *Buying Power*, p. 51.

4. MITI, *Keizai Kyoryoku no Genjo to Mondaiten* (The Current Status and Problems of Economic Cooperation) (Tokyo: MITI, 1995).

5. The Export Import Bank of Japan, Annual Report 1996, pp. 13-20.

6. Tadashi Saito, "Japan's Trade Insurance Program: Responding to the Third World Debt Crisis," JEI Report No. 14A, April 12, 1991.

7. OECF, Annual Report, 1997, p. 24.

8. MITI, Tsushou Hakusho 1996 (1996 Trade White Paper) (Tokyo: Ministry of Finance Printing Office, 1996), p. 707.

9. Interestingly, JODC was known as the Asia Trade and Development Association until 1972.

10. The Hashimoto government has indicated that foreign aid expenditures will be slashed 10 percent in FY 1998.

11. In contrast, about 98 percent of American foreign aid is in grant form.

12. Much of Tokyo's defense of its aid practices deserves consideration. Japanese aid officials argue that the focus on Asia is natural and represents Japan's comparative advantage. Other donors also focus on regions with which they have historical ties; France's aid program is concentrated in northern Africa, for example. Tokyo also asserts that the emphasis on loans stems from a belief that developing countries should be helped to help themselves; the payback burden gives the recipient a stake in any given project's success. Finally, many Japanese aid officials argue that support for economic infrastructure represents the most effective way to raise standards of living in the developing world. All these arguments may be true; none necessarily refutes the claim that Japanese ODA retains an element of mercantilist intent.

13. New commitments are to be distinguished from net disbursements, which subtract the repayments received from prior borrowers. Japan's focus on loans in its ODA program presents Tokyo with a dilemma: the volume of new loan commitments must expand annually just to hold net disbursements at a stable level. The problem was brought home in FY 1996, when a significant increase in repayments more than matched the above-noted increase in new commitments.

14. An OECF survey of ODA contractors released in 1994 attempted to refute these claims, purportedly demonstrating that the vast majority of contractors designated as host country firms had no ties to Japanese affiliates or subsidiaries. The survey relied on voluntary responses from 211 contractors in India, Indonesia, Thailand, the Philippines, and Malaysia; only 115 companies responded, however, suggesting a sample bias that undermines the survey's credibility.

15. Japan International Cooperation Agency, 1995 Annual Report, p. 183.

16. The imperative of increasing leverage against a potentially unstable political environment has led some Japanese business representatives to call for greater cooperation among JEx-Im and the export credit and insurance agencies of the United States and Europe. For at least one major Japanese trading firm, a precondition for involvement in large-scale capital projects in the developing world is the involvement of an American partner--preferably backed by U.S. Ex-Im Bank as well as multilateral financing institutions.

17. OECF, Annual Report,, p. 218.
18. Arase, *Buying Power*, pp. 129-34; Walter Hatch and Kozo Yamamura, *Asia in Japan's Embrace: Building a Regional Production Alliance* (New York: Cambridge University Press, 1996), pp. 138-40; Danny Unger, "Japan's Capital Exports: Molding East Asia," in Danny Unger and Paul Blackburn, eds., *Japan's Emerging Global Role* (Boulder, Colo.: Lynne Rienner Publishers, 1993), pp. 160--62; and Edith Terry, "The East Asian Miracle: One Paradigm Too Many?," *Atlanta Economic Journal*, September 1996. Hatch and Yamamura argue provocatively that Japanese business and government are working together to construct integrated production networks in a number of key industries across Asia that both preserve Japan's technological leadership and exclude other investors.
19. Export-Import Bank of the United States, *Report to the Congress on Export Credit Competition and the Export-Import Bank of the United States: For the Period January 1, 1995 through December 31, 1995, 1996*. See tables in the summary.
20. Dick Nanto, "Japan's Official Support of Trade and Foreign Investments," CRS Report for Congress, December 6, 1996, p. 2.
21. Saito, "Japan's Trade Insurance Program," p. 4.
22. Arase, *Buying Power*, p. 114.
23. The article, entitled "A Spectacular Waste of 1.25 Trillion Yen," appeared in the November 4, 1995, issue of *Shukan Gendai*. Excerpts from the article appear in OECF Newsletter, January 1996, pp. 9-12.
24. OECD, *Development Cooperation Review Series: Japan* (Paris: OECD), 1996, p.28.
25. For a comprehensive--if somewhat dated--overview of the role of bureaucratic politics and foreign pressure in Japanese aid policy, see Robert Orr, *The Emergence of Japan's Foreign Aid Power* (New York: Columbia University Press, 1990).
26. The impending JEx-Im--OECF merger is the outcome of a March 1995 cabinet decision. The announcement sparked international criticism from observers concerned that the move represented an overt return to mercantilism in Japan's aid program. In this case, however, the decision appears entirely political; despite opposition from officials in both institutions, legislators imposed the merger in a fig-leaf quest for "smaller government."
27. OECF loans generally carry a 25- to 30-year payback period, including a ten-year grace period. Currently loans are set at 4 percent for upper-middle-income countries, 2.3 percent for low- to middle-income countries, and 1 percent for the world's poorest countries. These rates were cut modestly in 1995 after escalating complaints in the

developing world about the onerous payback burden--which has been magnified by the yen's dramatic appreciation over the last ten years.

28. MITI, Dai 25-kai kaigai jigyo katusudo doko chosa gaiyo (Outline of the 25th Survey on the Overseas Business Activities of Japanese Firms), March 1996, p. 8.

29. MITI, 1996 Tsusho hakusho (Soron) (1996 Trade White Paper: Introduction) (Tokyo: Ministry of Finance Printing Office, 1996), pp. 227-29.

30. Economist, "Building the New Asia," May 25, 1996, pp. 65-66.

31. Ibid., p. 66.

32. The Industrial Structure Council has a long history of involvement in formulating Japan's economic cooperation policies. The group issued a report in 1972, for example, that discussed the use of keizai kyoryoku as a tool for upgrading Japan's industrial structure; the current account surplus would be used to finance foreign direct investment, in the process boosting the competitiveness of Japanese firms and improving the nation's economic security. See Arase, *Buying Power*, pp. 64-65.

33. The February 5, 1996, English-language version of the report by MITI's Economic Cooperation Committee is entitled "Towards New Trends Concerning Development of Economic Infrastructure in Asia." Copies are available from MITI's Web page at <http://www.miti.go.jp>.

34. Hisane Masaki, "New ODA Strategy Debuts in Thailand," *Japan Times*, April 23, 1996, p. 1.

35. See, for example, Hijiri Inose, "Aid Plan Makes Room for Private Firms," *Nikkei Weekly*, March 11, 1996, p. 2.

36. Ibid. See also *Asahi Shimbun*, "Minkatsu Infura, enshakkan de shien" (Yen Loans to Support Private Infrastructure Projects), February 20, 1996.

37. Export-Import Bank of Japan, "Promoting Economic Interactions within the Asian Region: JEx-Im-Sponsored 'Tokyo Meeting of Export-Financing Institutions in Asia,'" News Release, March 10, 1996.

38. See, for example, Walter Hatch and Kozo Yamamura, *Asia in Japan's Embrace: Building a Regional Production Alliance* (Cambridge: Cambridge University Press, 1996). Also of note is the authors' follow-on piece, "A Looming Entry Barrier: Japan's Production Networks in Asia," *NBR Analysis* 8, No. 1, February 1997.

39. One analyst has estimated that the problems in Asia could shave between 0.4 and 0.8 percentage points off Japan's GDP growth rate in FY 1998--a serious hit for an economy

already mired in recession. See Eric Altbach, "Japan, United States Back Up IMF Indonesian Bailout Plan," JEI Report No. 42B, November 7, 1997, p.4.

40. Australia, China, Hong Kong, Malaysia, and Singapore each pledged \$1 billion to the effort; South Korea and Indonesia each added \$500 million. The Asian Development Bank and the World Bank will contribute the balance of the funds.

41. As part of a new component to Tokyo's foreign aid policy, the funds extended to Bangkok for environmental purposes carry particularly generous terms--0.75 percent interest over 40 years with a 10-year grace period--and in essence differ little from outright grants. Tokyo has further indicated that because environmental loans carry such soft conditions, disbursements in the future may be explicitly tied to procurement from Japanese contractors. Here, again, is a classic example of keizai kyoryoku: MITI has already taken a number of steps to promote sales of Japanese environmental technologies overseas, particularly in Asia; the "new" direction in ODA policy provides a perfect complement to this goal. Despite this obvious step backward in the openness of the Japanese aid program, however, the international community has voiced little protest. At a time when foreign aid programs around the world are encountering increasingly tight fiscal constraints, other OECD countries are hardly in a position to criticize the world's largest ODA program.

42. Kwan Weng Kin, "Chavalit Assured of Japan's Continued Help," Singapore Straits Times, October 11, 1997.

43. Eric Altbach, "Japan, United States Back Up IMF Indonesian Bailout Plan," p. 4.

44. Ibid., p. 4.

45. Achara Ashayagachat, "ASEAN: Japan to Push for an Integrated Market of 500 Million People," Bangkok Post, October 16, 1997, p. 2.

46. See, for example, Michael Vatikiotis, "Pacific Divide," Far Eastern Economic Review, November 6, 1997, p. 14; and Henny Sender et al., "Not a Happy Bunch," Far Eastern Economic Review, October 2, 1997, p. 69.

47. David Holley and Evelyn Iritani, "Finance Officials Bank IMF Bailout Role," Los Angeles Times, November 20, 1997, p. D3.

48. Barry Porter, "Split over Nature of Regional Entity Eases as Common Ground on Currency Crisis Develops," South China Morning Post, November 16, 1997, p. 3.