95th Congress 2d Session } COMMITTEE PRINT

EXPORT STIMULATION PROGRAMS IN THE MAJOR INDUSTRIAL COUNTRIES: THE UNITED STATES AND EIGHT MAJOR COMPETITORS

PREPARED FOR THE

COMMITTEE ON
INTERNATIONAL RELATIONS
U.S. HOUSE OF REPRESENTATIVES

BY THE

FOREIGN AFFAIRS AND NATIONAL
DEFENSE AND ECONOMICS DIVISIONS,
CONGRESSIONAL RESEARCH SERVICE,
LIBRARY OF CONGRESS

OCTOBER 6, 1978

Printed for the use of the
Committee on International Relations

U.S. GOVERNMENT PRINTING OFFICE
34-201 O WASHINGTON : 1978

HOUSE COMMITTEE ON INTERNATIONAL RELATIONS

CLEMENT ZABLOCKI, Wisconsin, *Chairman*

L. H. FOUNTAIN, North Carolina
DANTE B. FASCELL, Florida
CHARLES C. DIGGS, JR., Michigan
ROBERT N. C. NIX, Pennsylvania
DONALD M. FRASER, Minnesota
BENJAMIN S. ROSENTHAL, New York
LEE H. HAMILTON, Indiana
LESTER L. WOLFF, New York
JONATHAN B. BINGHAM, New York
GUS YATRON, Pennsylvania
MICHAEL HARRINGTON, Massachusetts
LEO J. RYAN, California
CARDISS COLLINS, Illinois
STEPHEN J. SOLARZ, New York
HELEN S. MEYNER, New Jersey
DON BONKER, Washington
GERRY E. STUDDS, Massachusetts
ANDY IRELAND, Florida
DONALD J. PEASE, Ohio
ANTHONY C. BEILENSON, California
WYCHE FOWLER, JR., Georgia
E (KIKA) DE LA GARZA, Texas
GEORGE E. DANIELSON, California
JOHN J. CAVANAUGH, Nebraska

WILLIAM S. BROOMFIELD, Michigan
EDWARD J. DERWINSKI, Illinois
PAUL FINDLEY, Illinois
JOHN J. BUCHANAN, JR., Alabama
J. HERBERT BURKE, Florida
CHARLES W. WHALEN, JR., Ohio
LARRY WINN, JR., Kansas
BENJAMIN A. GILMAN, New York
TENNYSON GUYER, Ohio
ROBERT J. LAGOMARSINO, California
WILLIAM F. GOODLING, Pennsylvania
JOEL PRITCHARD, Washington

JOHN J. BRADY, Jr., *Chief of Staff*
GEORGE M. INGRAM, *Staff Consultant*

FOREWORD

HOUSE OF REPRESENTATIVES,
COMMITTEE ON INTERNATIONAL RELATIONS,
Washington, D.C., October 6, 1978.

This study, "Export Stimulation Programs in the Major Industrial Countries: The United States and Eight Major Competitors," was undertaken by the Congressional Research Service of the Library of Congress at the request of the Committee on International Relations.

Over the years there has been considerable confusion and debate over the export promotion policies of the major industrial nations and how U.S. export promotion policies and programs compare with the assistance provided by other governments to their exporters. It is hoped that this compendium of the policies of the major exporting nations will help shed light on this issue.

This study is particularly timely given the growing concern over the persistent U.S. balance-of-payments deficit and the President's export policy statement of September 26, 1978.

It is intended that this study serve as the basis for congressional consideration as to the adequacy of existing export promoting policies and programs and that it will stimulate those in the private and public sectors to review our export promotion activities and consider what an appropriate policy would entail.

This study, under the direction of Dr. Jonathan E. Sanford, is the work of the Foreign Affairs and National Defense Division and the Economics Division of the Congressional Research Service and does not necessarily reflect the views of the members of the Committee on International Relations.

CLEMENT J. ZABLOCKI, *Chairman.*

LETTER OF SUBMITTAL

THE LIBRARY OF CONGRESS,
CONGRESSIONAL RESEARCH SERVICE,
Washington, D.C.

Hon. CLEMENT J. ZABLOCKI,
Chairman, Committee on International Relations, House of Representatives, Washington, D.C.

DEAR MR. CHAIRMAN: I am happy to be able to send you the completed study you requested surveying export stimulation programs in the United States and eight major competitor countries. It was prepared jointly by the Foreign Affairs and National Defense Division and the Economics Division of CRS, under the direction of Dr. Jonathan E. Sanford of my division. The research for the study was quite extensive and involved detailed analyses of operations and policies of many governments in addition to those of the United States. At your request, it goes beyond description of the different countries' export stimulation programs to identify specific activities the United States might consider if it wished to expand its official efforts in the export stimulation area.

WILLIAM W. WHITSON,
Chief, Foreign Affairs and National Defense Division.

CONTENTS

PREFACE

This study was prepared cooperatively by the Foreign Affairs and National Defense Division and the Economics Division of the Congressional Research Service, under the direction and editorial supervision of Jonathan E. Sanford, analyst in international relations. Contributing research was provided by John Costa, analyst in international relations; Jane Gravell, specialist in taxation and fiscal policy; Kent Hughes, analyst in international economics; and George D. Holliday and Raymond J. Ahearn, economic analysts. Assistance was also provided by the following consultants: Robert Beckman, Robert Beyer, Geoffrey B. Hurwitz, Jaap Dingemans, Laura Corr, Jose Fiallo, Kenneth Durkin, and Sallie M. Hicks. The contributors for each individual chapter are identified in the text. The Congressional Research Service wishes to thank the Department of Commerce, the Department of State, and the Export-Import Bank of the United States for their cooperation in providing information on the operations and goals of the U.S. and foreign export stimulation programs.

EXPORT STIMULATION PROGRAMS IN THE MAJOR INDUSTRIAL COUNTRIES: THE UNITED STATES AND EIGHT MAJOR COMPETITORS

INTRODUCTION*

The United States has experienced a serious deterioration in its foreign trade balance in recent years. According to figures from the U.S. Commerce Department, the United States ran a $15.4 billion current account deficit in 1977, its first since devaluing the dollar twice in 1971-1973, and the shortfall in the U.S. merchandise trade balance increased to $31.2 billion in 1977 from $9.3 billion the year before. (See Table 1.) This situation has spurred interest in this country over ways the U.S. Government might encourage growth in U.S. exports. This study is an effort to respond to that interest. It analyzes export stimulation programs in the United States and eight major competitor countries and describes ways they seek to expand non-military exports through official export promotion programs, government export financing systems, and special international tax policies.

There have been expressions of doubt in the United States recently about the basic fairness of the world trading system and the competitiveness of

Table 1. U.S. Balance of Trade
(millions of dollars)

	1968	1969	1970	1971	1972	1973	1974	1975	1976	1977
Merchandise trade balance	635	607	2603	-2200	-6416	911	-5367	9045	-9320	-31,241
Services trade balance	986	395	309	1920	328	2609	7527	7119	12,916	15,827
Goods and services balance	1621	1002	2912	-340	-6088	3520	2160	16,164	3596	-15,414

Source: U.S. Commerce Department

*Prepared by Jonathan E. Sanford, Analyst in International Relations

U.S. exports. In particular, a good deal of criticism has been directed towards export stimulation practices in other countries. Some U.S. trade groups have argued that foreign government programs hamper U.S. exports by unfairly reducing the competitiveness of U.S. goods.

In response to a request from the House International Relations Committee, the Congressional Research Service has sought to determine what incentives other major countries provide and what options the United States might consider if it sought to expand in this area. The Committee asked CRS to analyze the export promotion, financing, and international tax systems of the eight major countries that compete most directly with the United States in international markets: Canada, France, Italy, Japan, the Netherlands, Switzerland, West Germany, and the United Kingdom. These countries are also the United States' main trading partners.

This study focuses on three areas of government activity: export promotion, export financing, and international tax programs. Government export promotion programs help firms increase their international sales through marketing assistance and efforts to expand foreign interest in national products. Official export financing programs offer government credits to finance export sales in certain circumstances. Tax policy gives differential treatment to money earned through international commerce.

The comparisons in this study are based on data for 1976, the last year for which comprehensive program analyses and budget information were available for the countries chosen. An effort has been made to provide more recent information on foreign operations and expenditures, though, when it was available. The study looks only at government expenditures and the ways their programs are designed to work; it does not seek to determine how effective they have been or how well they have accomplished their respective goals.

The study shows there are significant differences in emphasis among the major Western industrial countries regarding their export stimulation programs. The United Kingdom, France, Italy and Japan all place great stress on their official programs to promote and finance exports. The Netherlands, West Germany and Switzerland, on the other hand, make only slight efforts to provide official assistance to expand their international trade. Some countries, like France and Japan, provide close coordination of their official export programs, while others--West Germany, for example--make minimal coordination efforts. The study shows that the United States has one of the larger official export stimulation programs, and many of its activities compare in size and effort with activities sponsored by other governments. A number of the major industrial countries have much more vigorous specific programs, though, if one takes into consideration the relative size of their economies and their total exports. The study suggests that there may be ways for the U.S. Government to improve the coordination and focus of its official export programs, and it identifies several new programs the United States might consider if it wished to expand its activities in this area.

Until after World War II, there were no internationally accepted standards for government export stimulation programs. Prior to that time, governments often adjusted their trading rules to give local firms special advantages over their foreign rivals. The resultant trade rivalries reached a peak in the 1930s, as the world depression caused enormous economic problems everywhere. Governments sought to improve the relative position of their exporters through competitive devaluations, high tariffs, export bounties and other policies designed to shift unemployment to their trading partners. The result was a series of practices that brought losses to all participants, thereby deepening the depression and destabilizing the international economic system by discouraging international trade.

After the war, in the absence of an International Trade Organization, the major industrial countries established the General Agreement on Tariffs and Trade (GATT) to help avoid the dangers of the past and lay the foundations of a more open world trading system. The GATT rules generally prohibit countries from offering special rewards, export bonuses, "bounties," or from instituting other "beggar-thy-neighbor" economic policies. They do allow governments to provide a number of services, however, to encourage international trade.

Most of the export stimulation programs described in this study were adopted in the Bretton Woods period (1945-1971) when a fixed exchange rate system existed. Questions have been raised as to the economic justification for some of these programs, however, under the floating exchange rate system which has been in effect since 1971. Critics of stimulation programs argue that many programs are obsolete or even counterproductive, since economic theory requires the value of a currency to go down if a country runs a chronic payments deficit. This, in turn, is supposed to rectify the imbalance by making the country's exports cheaper and more attractive. Others contend that these stimulation programs are valuable because structural rigidities in the world trading system hamper the adjustments that theory would predict and also because governments interfere with the free operation of the floating exchange rate system. Export promotion and export financing programs might be justified under either the floating or fixed exchange rate system, though, if their primary goals involve the elimination of market imperfections caused by incomplete information and structural barriers that otherwise prevent trade.

Export stimulation programs are not panaceas, and they cannot solve a nation's balance-of-payments problems on their own. A country's international economic condition is affected many factors and official export stimulation programs can have only a modest impact on a country's total export volume.

Export stimulation programs can be helpful in contributing to a country's balance of trade, however, if they are applied in conjunction with other appropriate programs. The current U.S. trade deficit, for instance, has developed more as a result of growth in U.S. imports than from a drop in U.S. exports. The volume of U.S. exports was 2.8 percent higher in 1977 than in 1975, but U.S. imports were up 35.7 percent in 1977, largely because of the relatively higher U.S. growth rate (a condition that tends to attract imports) and the increasing cost and volume of U.S. petroleum imports. New U.S. export stimulation programs might succeed in righting the U.S. trade deficit if they are adopted along with energy policies to restrain petroleum imports and new programs to enhance the productivity and stability of the American economy. Ultimately, though, any decision to adopt new U.S. export programs will require a careful assessment of both the potential benefits and the probable costs of the new activities. This study takes no position on the desirability or utility of new U.S. export stimulation programs.

PART A

EXPORT STIMULATION PROGRAMS: A COMPARATIVE ANALYSIS

The first three chapters of this study (Part A) provide an overview on different aspects of export stimulation policy in the United States and eight major competitor countries. The first chapter compares and contrasts export promotion programs, while the second reviews similarities and differences among the countries' official export financing programs. The third chapter assesses the affects that national tax systems have on international trade. In each of these chapters, there is a brief analysis of initiatives the United States might consider if it wished to adopt features of those programs found in competitor countries.

The second major portion of the study (Part B) contains nine chapters, each analyzing and describing the export promotion, export financing and international tax policies of a specific country.

CHAPTER I

EXPORT PROMOTION PROGRAMS*

There is a great deal of diversity among the major Western industrial countries regarding the size and vigor of their official export promotion programs. Some countries, like Switzerland and West Germany, have rather small government programs, which rely mainly on their chambers of commerce and the private sector to promote foreign interest in their export goods. Other countries, like the United Kingdom, Italy and France, have large active government programs that work to expand their foreign sales. There are many similarities among the major industrial countries' export promotion systems, but there are also significant differences in their approaches that reflect variations in their national economic policies and their traditions. The United States has a rather large official export promotion program, and many of its activities are comparable to those of its major competitor nations. This chapter compares the U.S. export promotion program with those of the other major countries and identifies foreign practices the United States might consider if it wishes to attempt further improvements in its official export promotion system.

The first section of this chapter offers a brief country-by-country synopsis describing the export promotion programs used by the United States and eight major competitor nations. The second

*Prepared by Jonathan Sanford, Analyst in International Relations, Foreign Affairs and National Defense Division.

34-201 O - 78 - 2

section compares the structure and scope of these national programs and outlines some variations in their operations. The third reviews similarities and differences in the way these countries implement the three basic elements of a national export promotion program; i.e., export information systems, marketing assistance services, and domestic "awareness" activities. The fourth section of the chapter identifies some options or alternatives the United States might consider if it wished to adopt new programs or emphases comparable to those of its major competitor countries.

SYNOPSIS OF COUNTRY PROFILES

As Table 1 indicates, there are many similarities--but also some significant differences--in the major industrial countries' export promotion systems. Most have basic informational services, though they differ broadly in their scope and intensity. Many have significant marketing assistance programs--trade fairs, centers, missions, visitors programs--but these also vary widely in their scope. A few also have domestic stimulation programs to encourage potential new exporters to consider the advantages of international trade, and some have unique services designed to meet particular concerns. This section provides a national profile for each country, in order to show the way each assembles these different elements into its own characteristic program.

Table 1. Promotional Techniques

	CANADA	FRANCE	ITALY	JAPAN
Informational Services	Some info. services and publications, but limited extent. *Subsidies and aid to* encourage firms doing *own market research* in new areas. Overseas marketing *repts.* subsidized.	Extensive info. *facilities,* linked to marketing intelligence. Subsidized studies of firms' export potential. Overseas marketing aid, on *contract,* for new exporters. Market research to help *expand* North *American sales.* Tailored market research for *chosen firms.*	*Some data center,* supplies info on markets and *foreign* firms via terminals at regional offices. ICE subsidizes trade promotion and market *research for* joint export associations	Computer data, large library and publica*tions for subscribers.* Low-cost credit info. on *foreign firms.* Market research free to small or medium-sized firms and low-cost to larger entities.
Trade Centers	none	two: Tokyo + floating ctr.	two: London & Dusseldorf	22 trade ctrs.
Trade Fairs	Govt. coordinates planning & operation. Cost sharing formulas differ; large for *target* countries. Transport and exhibit costs often *subsidized.*	CFMEE organizes *participation* in many *fairs. "Fair insurance"* if new sales don't cover participant costs. Floating exhibits (on boats) to Arab countries.	*Major official program.* Subsidies covering most transport, display, *staff* costs. ICE coordinates and plans many fairs and solo exhibitions.	Major govt. *program.* Subsidized exhibition costs *(besides space) "image" publicity & transport.* JETRO organizes and coordinates many *fairs.*
Trade Missions	*Special trade missions* by government invitation. Report published.	No regular program. Advice and aid--but no *subsidies--for* missions by new exporters to North America and U.K.	Major official program. Old and new-to market firms eligible. Subsidies for travel and group expenses.	No regular program, but govt. does pay costs of trade assoc. group travel for market research. Reports published.
Trade Visitors Program	Subsidized *visits by* foreign leaders and training program for foreign technicians, to influence their buying attitudes. Subsidized visits by *non-US buyers.*	*No regular program.*	Increasing emphasis, esp. Middle Eastern visitors.	Pays travel and per diem for potential new buyers, and for visits by key foreign leaders.
Domestic Stimulation Activities	Active program to encourage new *firms* to export, with *incentives and advice* from 8-10 field offices.	Low-cost market research and *advice available* locally for firms requesting aid.	Weak in past, growing recent emphasis. 37 domestic offices, with education & awareness ef*forts, services to new* exporters. Links to trade groups.	29 local offices to advise potential exporters. Supplements trade assoc. and trading company efforts.
Other Major Promotion Activities	Special aid to firms entering high-risk markets. Center to *coordinate* bidding *on foreign projects.*	*Special emphasis on promoting* high technology exports, like computers, communications, and aerospace.	Subsidies for advertising and other promotional *costs* in foreign stores' "Italian weeks."	Emphasis on also stimulating *import from* LDCs. Loans and aid for small or medium firms investing in LDCs. Overseas technical training programs.

Table 1 (cont.) Promotional Techniques

NETHERLANDS	SWITZERLAND	UNITED KINGDOM	WEST GERMANY	UNITED STATES
Basic info services on marketing opportunities and economic conditions abroad. Some publications, references, and answers to inquiries.	Basic info services on foreign markets and economic conditions. Publications on opportunities and references to local suppliers. Limited program.	Subsidized computer data system on export opportunities, for subscribers. Subsidies for some market research and consultants. Emphasis on foreign project contracts and subsidies to help weak firms bid.	Basic info services on foreign opportunities and markets. Publications, daily reports.	Computerized Trade Opportunities Program, with data published weekly for subscribers. Studies and publications on market opportunities. Counseling services, esp. for small and medium firms. Trade Contracts Info. Service. Subsidized fees for new exporters.
none	none	one: Tokyo	none	16: eleven large & five minor ctrs.
Chamber of Commerce function. No subsidies from government to participants.	Small govt. program. Apparently no subsidies.	Large govt. program, subsidizing space and transport costs. Govt. organizes and coordinates many fairs and exhibitions.	Managed by private contractors, with some govt. subsidies for construction, advertising, and other costs.	Major government program, coordinating trade fairs. Subsidized rates for new exporters.
No regular program.	No regular program.	Growing govt. program, subsidizing trade association group travel.	No regular program.	Commerce schedules trips by industry, product or area.
No regular program.	No regular program.	Aid for visits by key leaders, to influence purchasing decisions. Emphasis esp. on LDCs.	No regular program.	Foreign Buyers Program to match visitors with appropriate U.S. suppliers, esp. small and medium firms.
No government program.	Some seminars, but no regular national government program.	No major awareness campaign, but market research services do focus on new-to-market firms requesting help through some local offices.	No government program.	Major program to encourage export awareness. 43 field offices offering incentives and services to potential exporters.
Subsidies to overseas Dutch Chambers of Commerce and to Trade Promotion Council.	Some occasional efforts to expand imports from LDCs and East Europe	Trade drives, emphasizing exports to target markets over extended period. Overseas Project Group to coordinate bidding. Committee on Invisible Exports, to expand sales UK Services to target markets. Overseas technical seminars and domestic college courses on overseas trade methods.	Subsidies to overseas German Chambers of Commerce.	Experimental task force on project opportunities in Venezuela. Target industries keyed to promotional efforts in specific markets.

Italy

Though less costly in an absolute sense, the Italian official export promotion program is one of the most intensive of those found in major Western industrialized nations. An autonomous government agency, the National Institute for Foreign Trade (ICE), operates the official export promotion program, under the general policy direction of the Ministry of Foreign Trade. ICE maintains its own independent overseas and domestic offices, providing commercial intelligence, export information, and support for Italian participation in trade fairs and overseas marketing activities. Though weak in the past, ICE's links with domestic Italian trade and commercial organizations have been improved and its export awareness program strengthened. The ICE offers a wide range of services in addition to basic market data, and its active program is supplemented by aid from the Trade Ministry to private associations that conduct approved promotional activities. The government programs place special stress on small or medium-sized businesses and new-to-export firms.

France

The French Government also maintains a large, intensive export promotion program, but one that, organizationally, is in interesting contrast to the British system. A unit of the Finance Ministry, the Directorate for Foreign Economic Relations (DREE), retains close policy control over the country's export promotion programs but they are administered through autonomous semi-public or mixed corporations rather than through government bureaucracies. The French Committee for Foreign Economic Shows (CFMEE) is a government corporation which uses its government subsidy and operating fees to support French participation in foreign trade fairs. The French Center for Foreign Commerce (CFCE) is another government company which provides commercial intelligence, market information, and aid for French participation in trade fairs and other promotional activities. A joint public-private organization, SOPEXA, promotes international sales of French agricultural products through trade fairs, publicity, and other means. The large official export promotion program offers a substantial range of services and appears to be concentrated mainly on creating new exports through aid to small or medium-sized firms and new-to-export companies.

Japan

The Japanese also have an active government export promotion program roughly half way between those of France and the United States in terms of its relative emphasis on promotional activities. A semi-autonomous government agency with broad private sector business membership, the Japan External Trade Organization (JETRO), conducts most of the official promotion programs, under the general policy direction of the Ministry of International Trade and Industry (MITI). The Foreign Ministry, too, provides supplemental market data and services through the commercial officers at its overseas embassies. JETRO maintains its own extensive network of foreign and domestic posts to gather market information and help Japanese firms, and offers a full range of services which include both basic informational and marketing programs and a number of innovative services. JETRO concentrates especially on aid to smaller companies and new-to-export firms and has strong ties to many trade and commercial organizations. There is a strong subsidy element in some of its programs. While the official Japanese export promotion system is quite large, it is dwarfed by the substantial export promotion programs conducted by private Japanese firms. Each of the top ten Japanese general trading companies has more personnel overseas than does JETRO, for instance, and most private companies maintain substantial overseas trade establishments. The government's export promotion program is intended to complement the activities of these private organizations by concentrating mainly on the initial stages of export marketing.

United States

Responsibility for managing the U.S. trade promotion is divided among three government departments. The State and Commerce Departments share the task of coordinating most activities, with the foreign service commercial officers providing overseas market data and the Commerce Department's Bureau of Export Development (Industry and Trade Administration) handling basic information and marketing assistance programs. The Agriculture Department's Foreign Agricultural Service promotes overseas sales of American farm products. Though relatively modest in proportion to the total volume of U.S exports, the total U.S. export promotion program is one of the largest in terms of costs and expenditures and one whose services are comparable to those of competitor nations. The United States probably has a smaller subsidy element in its promotion programs, however, since it usually prices its government services closer to cost than do some countries. The U.S. program gives particular emphasis to marketing intelligence and overseas promotion activities through trade fairs and trade centers. Its domestic effort for promoting export awareness and interest among potential new exporters appears to be one of the strongest in the world. The U.S. export promotion program concentrates particularly on aid to small and medium-sized firms and new-to-export companies, though any business is eligible to use the U.S. service.

Canada

The Canadian Government maintains a modest export promotion system The official program is managed by the Department of Industry, Trade and Commerce (ITC), and supplemented by major promotional activities conducted independently by the different Canadian provinces. The ITC has an active export awareness program through its local offices and a modest overseas network in its Trade Commissioner Service to provide market information and services to exporters. The rather small Canadian national program concentrates mainly on domestic awareness, basic export information, and trade fairs, but it also includes a few special subsidy programs to encourage exports and facilitate entry into high-risk markets. Its Program for Export Market Development offers aid--repaid only if new business results--to defray over half a company's costs for exploring new markets, bidding on major foreign contracts, or participating in new international trade exhibitions. The overall size of these special programs seems limited, however.

West Germany and the Netherlands

The West German and Dutch governments have very modest export promotion programs directed mainly at providing basic economic intelligence to their national exporters. The German Federal Office for Foreign Trade Information (BfA) and the Dutch Export Information Service (EIS) are units of their Ministries of Economic Affairs which take foreign market data gathered by commercial officers at their diplomatic posts and give it to local firms. Most other export promotion activities in these countries are handled by the private sector, though the German and Dutch Governments provide subsidies to their overseas private chambers of commerce to help them expand their export promotion services. The Dutch Government also provides major subsidies to its Council for Trade Promotion, an organization of businessmen which provides basic export data and coordinates Dutch commercial participation in trade fairs and private economic missions to foreign countries. The German Government has a small office that oversees, and makes annual contributions to support, the private association coordinating German commercial participation in international trade exhibitions. German and Dutch businesses also sponsor large private export promotion programs in addition to these activities encouraged by "no strings" government subsidies to private groups.

Switzerland

The Swiss Federal Government makes a small annual payment to the Swiss Office for the Development of Trade (SODT), a semi-official, mixed public-private organization to promote Swiss exports. The SODT coordinates Swiss participation in some international trade fairs and provides basic marketing information to local exporters. It has no overseas staff, though, and limited resources. The private sector plays the predominant role in the promotion of Swiss exports.

THE DIVERSITY IN NATIONAL SYSTEMS

Program Expenditure

Perhaps the most dramatic difference among the export promotion programs of the major industrial countries is the wide variation in their levels of spending for these activities. 1/ The United Kingdom had the largest government program for the year 1976, as Table 2 indicates, with $95.7 million in gross expenditures in 1976, and France followed only slightly behind with 1976 gross outlays of $80.7 million. Japan, Italy and the United States maintained somewhat smaller programs, in the $60 million range, while the Netherlands, West Germany and Canada ran programs that were barely one-quarter that size and the Swiss Government spent very little for official promotion programs that year.

1/ The computation of export promotion spending covers direct government expenditures and subsidies to encourage exports and foreign purchases of national goods, and services. It includes outlays through the foreign ministry for gathering export intelligence, but does not include foreign economic, military, or food assistance, foreign military sales programs, official export financing activities or indirect assistance through the national tax system to create incentives for export trade. Export finance and international tax issues are addressed in subsequent chapters of this study.

Table 2. Export Promotion Intensity,
Major Industrial Countries

	Total Value, 1976 Exports ($ = U.S. millions)	Govt. Promotion Spending, 1976* ($ = U.S. millions)	Relative Promotional Intensity (spending per $1,000 of exports)
United Kingdom	$46,042	$95.7	$2.08
Italy	36,170	59.8	1.65
France	56,607	80.7	1.43
Japan	67,710	60.7	.90
United States	114,887	64.4	.56
Netherlands	40,592	18.7	.46
Canada	39,028	14.5	.37
West Germany	103,560	15.5	.15
Switzerland	14,938	1.8	.12

* computed from data contained in this study

The actual dimensions of each country's official export promotion program is clearer, though, if the total for official spending is adjusted to compensate for the country's size and the role exports play in its economy. Several adjustment factors might be used--gross national product, the country's balance of trade situation, or the total volume of its exports--and each would yield a somewhat different ranking for the nine countries' export promotion programs. For purposes of this paper, we only use export volume. This measure emphasizes the relation between promotional spending and actual exports. It does not reflect the extent of need for export promotion and certainly should not be taken as a measure of how much export volume promotional a dollar buys in each country since export promotion plays a limited role in determining export levels. We see in Table 2 that the United Kingdom has the most "intense" national export promotion program, with over two dollars in government outlays for every $1,000 in exports. Italy and France are also very intensive, with official expenditures in the $1.50 range, while Japan comes fourth, with government outlays of 90 cents for every $1,000 in foreign sales.

	CANADA	FRANCE	ITALY	JAPAN
Type of Administering Agency	Department of Industry, Trade and Commerce (ITC), a regular government line agency.	Finance Ministry's Directorate for Foreign Economic Relations (DREE) exercises general policy control on two semi-independent govt. corporations: French Center of Foreign Commerce (CFCE) and Committee for Foreign Economic Shows (CFMEE)	National Institute for Foreign Trade (ICE), an independent govt. agency with formal links to private sector groups.	Japan External Trade Organization (JETRO), semi-autonomous official membership organization.
Focus of Promotion Program	Most programs priority to new-to-market or new-to export firms. Some open to all Canadian firms.	Available to any firm, but priority emphasis on small and medium-sized firms, especially new exporters.	Emphasis on new-to-export and new-to-market and small firms or medium-size firms.	Former priority on small or medium-size firms. Now more emphasis on services to all Japanese exporters.
Overseas staff of Promotion Agency	Modest network of about 54 trade commissioners (plus clerical staff) at 27 foreign posts.	About 190 Foreign Ministry commercial officers and 1100 other overseas French staff, plus some 500 local employees, at 229 foreign posts.	Major network of 183 diplomatic commercial officers (plus staff) at 96 posts, and ICE trade staff at 59 posts.	About 275 Foreign Ministry commercial officers at 146 foreign posts and 275 JETRO professionals at 76 foreign posts.
Cost of Export Promotion Program	$14.5 million, including $6.9 million through ITC and $0.8 million through Canadian Wheat Board for agricultural exports, an estimated $0.5 million for foreign service overseas clerical staff to ITC trade commissioners, and another $6.3 million by ITC for non-agricultural exports.	$80.72 million, including $30.76 million for overseas commercial officers, $2.49 million by CFCE and $12.24 million by SOPEXA for agricultural exports, and another $35.23 by CFCE for non-agricultural exports.	$59.8 million, including $1.8 by ICE and $1.5 million by the Agriculture Ministry for agricultural exports, an estimated $11.8 million for foreign service commercial officers and staff, and another $44.7 by ICE or Foreign Trade Ministry for non-agricultural exports.	$60.7 million, including an estimated $16.2 million for salaries of foreign service commerical officers and local staff, and $44.5 for JETRO and other promotion programs.

NETHERLANDS	SWITZERLAND	UNITED KINGDOM	WEST GERMANY	UNITED STATES
Ministry of Economic Affairs, Economic Information Service, a regular government line agency.	Swiss Office for the Development of Trade, an autonomous semi-official entity.	British Overseas Trade Board (BOTB), an official body composed of businessmen, directs policies *of Department of Trade* (DOT), a regular government line agency.	Federal Office for Trade Information (BfA), semi-autonomous subunit of Economics Ministry.	Commerce Dept.'s Bureau of Export Development (BED), State Dept.'s Bureau of Economic and Business Affairs, and Agriculture Dept.'s Foreign Agricultural Service (FAS), all regular line agencies.
No special focus to very small government program.	No special focus to very small government program.	Emphasis on large, established exporters. No special priority for smaller firms or new exporters.	No special focus to limited government program.	Emphasis on new-to-market, new-to-export and small or medium size firms. Services generally available to most exporters.
Modest network of 73 embassy commercial officers (plus clerical staff) at 53 foreign posts.	Negligible.	Extensive network of about 396 commercial officers plus over 1100 support staff at 196 foreign posts.	Modest network of 120 commerical offices at 65 foreign posts.	
$18.66 million, including about $12 (est.) *million for Foreign* commerical officers, $1.7 million through the Ministry of Agriculture or related programs, and $4.96 million for Export Information and related promotional services.	$1.88 million, (subsidy to SODT).	$95.7 million, incluing expenditures through Foreign Office for overseas commercial officers.		$64.42 million, including $13.8 million for State Dept. commercial officers, $19.08 million for Foreign Agricultural Service programs, and $31.54 for Commerce Dept. Programs.

The United States, Netherlands, and Canada are somewhat comparable, with total official programs costing roughly 40-50 cents for every $1,000 in exports. West Germany and Switzerland have the least intensive government programs among the nine major industrial countries, since they spend 15 cents or less for every $1,000 in their foreign sales. Except for the United States, most of the countries with relatively modest programs have currently been running balance of trade surpluses, while those with relatively large programs (the United Kingdom, Italy, France and Japan) are countries that have been very concerned historically about their export situation.1/

Organizational Format

Reflecting the differences in their history and traditions, there is also a great deal of variation among the major industrial countries in the way they organize their official promotion programs. As Table 3 indicates, the United States, the Netherlands, and Canada make clear distinctions between public and private sectors and employ regular government line agencies--such as the U.S. Department of Commerce and the Dutch Economics Ministry--to administer their official program. Many of the other countries mix the sectors by using autonomous agencies, public corporations or even combined public-private institutions with joint government and business participation. In Britain, leading businessmen comprise a majority of the British Overseas Trade Board, the official body which directs policy and operations in the government's

---

1/ No causal relationship is implied regarding government outlays and total exports or the relative efficiency of the national programs.

export promotion program. In Italy and France, government corporations or autonomous public agencies exist, managed by mixed public-private boards having business, labor and government members. These operate almost as though they were private trade organizations. In Japan, the government export promotion agency is closely controlled by the Ministry of International Trade and Investment (MITI), but it operates more like a trade association than a bureaucracy and it maintains close links with the 4800 private firms and associations holding paid memberships in the organization. In Germany and the Netherlands, the government supplies large unrestricted subsidies to its private overseas chambers of commerce to support their export promotion activities. The German Government works through private organizations which handle participation in trade fairs. In Switzerland, the government grants a modest annual subsidy to a semi-public institution whose board consists almost entirely of business and trade association delegates.

A few countries put their export promotion program under the administrative control of one organization, but most have the different segments of their export promotion program handled by different agencies. The foreign trade ministry has duties which are separate from those of the special export promotion agency. The foreign office provides supplemental or primary market information. The agriculture ministry has its own system for encouraging agricultural exports. In Japan and France, though, the separate government agencies are subordinate to a central entity--Japan's MITI or the French Finance Ministry's Directorate for Foreign Economic Relations (DREE)--which coordinates and directs overall policy for their programs.

As the different levels of funding for these programs might suggest, the major countries differ significantly in the number and type of services they include in their official export promotion programs. All the countries surveyed in this study offer basic export information services--of varying extent--to help their exporters identify new trade opportunities, and most provide direct or indirect assistance to subsidize or encourage participation in international trade exhibitions. The large national programs are usually very thorough in providing these basic services. They also provide many additional incentives or aids, like special travel and visitors programs, tailored market research, and counseling services to help companies respond more easily to new international marketing opportunities. Most countries charge fees to recover some of their governments' cost in providing the services, though several have fee structures that provide for a significant subsidy element in their official promotion program. The figures in this study show gross outlays, since the reimbursement data are often unavailable and it is necessary to show the actual dimensions of the different governments' operations.

The major countries also differ in terms of the dominant targets of their national programs. Most concentrate on aid to new-to-export, new-to-market, or small and medium-sized businesses--the companies which usually have the most difficulty breaking into international markets and those often with the greatest need for profitable new sales opportunities. Some of the smallest national programs--Switzerland, the Netherlands and West Germany--have no special focus, however, and the country with the largest program--the United Kingdom--emphasizes aid to large exporters who wish to expand their overseas markets.

COMPARISONS OF SPECIFIC OFFICIAL EXPORT PROMOTION PROGRAMS

Information Services

Most of the major industrial countries have some type of official export intelligence system to alert their exporters to foreign commercial opportunities. The United Kingdom, France, Italy, Japan and the United States have the largest such programs, with large overseas staffs reporting on international trade opportunities, computerized retrieval systems, detailed libraries, and publications to advise companies about specific export markets. The British Export Intelligence Service was reportedly the pioneer in this area, but the United States and most other major countries now use automated systems to analyze and disseminate data from their overseas reporting networks. The U.S. Trade Opportunities Program, for instance, offers a weekly bulletin to its 8000 subscribers identifying trade leads in different product groups. The Italians are installing video terminals to link the 37 domestic and 59 overseas ICE offices to the ICE electronic data center in Rome. The Japanese JETAC system also provides computerized credit data on potential foreign customers. Most competitor countries and the United States also offer agent/distributor services and foreign trade reference services to place exporters in contact with foreign sales markets.

Some of the major countries also provide comprehensive market studies in addition to their regular market research studies on specific products in specific markets. The Dutch Economic Information Service prints a comprehensive study every two or three years, for instance, on potential export markets and practices in countries around the world. The U.S. Commerce Department publishes its Global Market Surveys every nine months describing market opportunities and conditions in specific sectors and foreign areas, and reportedly plans to reduce the preparation time considerably on its future surveys.

Domestic Awareness Program

Besides providing data on export opportunities to firms already active in the international market, many governments also try to encourage potential exporters to be more aware of opportunities available to them through foreign trade. The U.S. domestic awareness campaign uses 43 local Commerce Department district offices to seek out companies that have export potential and persuade them that they have real export prospects. Special publications, awards, seminars and counseling services are available--particularly for minority and small businesses--to encourage entry into the export market.

The Canadian and Italian Governments also have substantial programs that stimulate and encourage export awareness among their local firms. The Canadians have ten domestic ITC offices and the Italians thirty-seven ICE field offices that actively seek out potential new exporters and provide the services most small and medium-sized firms need in order to break into foreign markets. Both reportedly have close ties with local chambers of commerce or other export trade groups and give many seminars and conferences to acquaint local firms with new export possibilities.

The French and Japanese reportedly have no formal awareness programs--though it would hardly seem necessary to emphasize the benefits of foreign trade in an export-oriented country like Japan --but both have numerous field offices and special programs to help firms enter the export market. The British have no particular new-to-export emphasis in their program, but the government has developed a special "Foundation Course in Overseas Trade," which is offered in colleges and polytechnical schools in conjunction with the Institutes of Export Freight Forwarders and Marketing.

Direct Marketing Assistance Programs

In addition to these general information and awareness programs, many governments also have specific programs designed to give direct marketing assistance to their exporting firms. Three types of activities are of particular relevance in this category: trade centers and trade fairs, which display sample goods abroad to potential purchasers; trade missions and visitors programs, which transport sellers and buyers to visit potential markets or suppliers; and specialized market research programs, which help firms target their approach to specific foreign markets. Though some of these foreign programs are more extensive or generous than those run by the U.S. Government, most major competitor countries have marketing assistance programs roughly comparable to those provided by the United States.

Trade centers and trade fairs. Trade centers are permanent installations in foreign cities which provide exhibition space for different organized shows and single exhibits, temporary office facilities, and resident staff experts to advise exporters who wish to conduct business in their city. Trade fairs are temporary exhibitions which display products in a city for a specific period and then close or move to another locale. The United States and Japan are the major countries that use many trade centers in their marketing assistance programs. Most of the other major industrial countries primarily use trade fairs to promote their exports in foreign market centers. France, Italy and the United Kingdom, however, do have a few centers each and France has a floating exhibit, run by the government's maritime company, which displays industrial products in Arab ports.

The major countries generally put a great deal of emphasis on foreign trade exhibitions in their export promotion programs, though there are minor differences in the various services and techniques employed. Most have agencies that plan and coordinate fifteen to twenty overseas trade fairs a year, charging participants fees which cover most of the costs of those events. The British Overseas Trade Board, on the other hand, underwrites the bulk of the operating costs and charges participants only nominal fees and the Italian ICE pays up to 80 percent of the expenses--including all indirect and most direct costs--for fairs it sponsors. The Italians also reportedly provide 30-35 percent subsidies (100 percent for firms from the South) to cover costs of participating in other international trade exhibitions. Other countries also offer subsidies to defray some of the costs for participants in their official shows: the British, Canadians, Italians and Japanese pay half or all the return shipping costs for unsold display items, while the British and Italians provide half the air fare for company representatives at their fairs. The Canadians offer a per diem and subsidies for half the travel and display costs, and forgive the company this expense if it gets no new export business from the fair, while the French spent over FF 38 million ($8.4 million) in 1975 on "fair insurance" to partly reimburse participants who failed to get incremental sales from the official shows. The U.S. Government provides few such benefits, although it does offer new exporters (usually two-thirds of the participants) a 43 percent discount off the standard $3500 participation fee for U.S. fairs. Commerce Department spokesmen claim, however, that the United States is the only country to mount a systematic customer identification campaign before a show--to visit potential customers and call attention to particular products--and that this more than compensates for the lack of direct subsidies in their program.

Trade missions and visitors programs. The United States and some of its major competitor countries also have major trade missions and trade visitors programs which encourage personal contacts between potential exporters and foreign customers. Trade missions are group excursions conducted by the government which take potential exporters to foreign areas to familiarize them with markets and sales opportunities. Trade visitors programs bring individual foreign agents or customers to the exporting country in order to explore new products and suppliers.

The U.S., British, and Italian Governments all organize frequent overseas trade missions--19 by the U.S. Commerce Department in 1977--to expose their new and old exporters to new marketing opportunities abroad. The U.S. and British Governments seek to cover the full cost of the service, though they still underwrite most of the basic organizational expenses and new U.S. exporters are given discounts to encourage participation. The Italian Government usually pays much of the air travel and general group costs for its trade missions. Canadian missions are organized by special invitation of the ministry and sent abroad with a specific task, like negotiating a new trade agreement or introducing a new technology in a potential market. The government pays most of the cost and the members are obliged to prepare a report which will be available to industry generally. The Japanese do not organize trade missions per se, but they do underwrite many of the overseas travel costs for trade association and some company representatives doing market research abroad, providing the findings are published in association with JETRO. Some overseas travel for associations and smaller firms will also be supported if deemed beneficial to the country or particular industry.

The Japanese and British trade visitors--or reverse trade missions--programs seem to be designed mainly to bring high level foreign officials and businessmen to the selling country in order to familiarize them with its economy and influence their purchasing decisions. The Italian and Canadian programs seem more like trade missions, with the foreign visitors coming to see particular domestic facilities or local exhibits. The Canadian Government will also help finance individual visits by potential foreign buyers and the local firm must only repay the aid if it gets new business from the visit. Additionally, the

Canadians also offer special export-related training programs which bring foreign technicians to Canada in order to help influence their employers purchasing decisions.

The U.S. Foreign Buyers Program is similar to those of the Canadians and Italians. The Commerce Department selects 15-20 major U.S. domestic trade shows which it wishes to promote overseas--generally those dealing with high technology products--and U.S. foreign service posts promote the shows among the local businessmen and organize visits for those desiring to attend. The participants pay their own costs. The Commerce Department makes sure the show operators provide translators, and it puts the visitors and exhibitors in touch with one another in advance in order to facilitate business talks. When possible, similar arrangements are made for individual buyers coming to visit specific U.S. plants. The United States has no general program to bring high level businessmen to this country for familiarization purposes.

Market research. The United States has no service comparable to those of other countries which offer special government market research to help particular exporters or official subsidies to underwrite research programs run by private firms. The British Export Market Research Scheme offers special advice and subsidies designed to encourage firms to do more overseas market research, and it pays one-third of the cost of new research by individual firms, half the cost of joint research for several firms, and two-thirds of the cost for trade association sponsored research. As noted earlier, the Japanese pay the full cost in certain instances for overseas market research by trade groups and small or medium-sized firms, and JETRO's own overseas staff undertakes an annual market research program--for publication--based on suggestions by exporters and trade associations and funded jointly by JETRO and the affected firms. The French CFCE's Market Research Division (PROMEX) offers no subsidies for private research. It does conduct its own special research program, however, to help firms not sufficiently established in North American and British markets, and tailored market research--and consulting or operating assistance--to diagnose a new firm's export potential in promising areas. The Italian ICE pays for all the market research done in conjunction with its special trade promotion activities, while the Canadian Government can provide per diem and a 50 percent subsidy--which a company repays only if it gets new business--to help underwrite a firm's costs in studying potential foreign markets or unfamiliar marketing practices. The Canadian Trade Commissioner Service also prepares free short market reports for Canadian firms interested in a particular foreign market, with a summary published in the departmental foreign trade magazine and copies distributed to interested parties. The United States provides reports from its overseas post on market conditions and trade opportunities in specific countries, but it rarely conducts major market studies to benefit individual firms.

Other Export Aid Programs

In addition to these basic information, awareness, and marketing assistance programs, a number of countries also offer additional specialized aids to help promote their national exports. In West

Germany, the Netherlands, France and Italy, for instance, each government provides substantial subsidies to underwrite the country's overseas chambers of commerce, which often perform major export promotion services for national firms. The Dutch Council for Trade Promotion also receives government aid to finance its informational program and its work coordinating Dutch participation in trade fairs and trade missions, while the Italian Foreign Trade Ministry provides subsidies for private trade associations that manage certain promotional events. These private organizations reportedly retain their organizational autonomy in all cases in spite of the sometimes heavy government support for their "private" operations. The United States has no comparable program.

The Italian and Canadian Governments also work to encourage consortia among small and medium-sized firms, in order to increase their export potential. The Italian ICE has been pushing Joint Export Associations, where it shares the overseas promotional, research, and operating costs with the participating firms, while the Canadian ITC offers subsidies (repayable only if successful consortium ensues) to defray the organizational and initial costs of new consortia entering high-risk markets. The Japanese Overseas Development Corporation gives small and medium-sized firms long-term, no interest loans to finance joint ventures in many developing countries, and JETRO provides advice and market surveys to help developing countries increase their exports to Japan. These programs tend to expand Japanese export opportunities in developing countries. The U.S. Government has a modest insurance and guarantee program administered by the Overseas Private Investment

Corporation (OPIC) to encourage more private investment in developing nations.[1/] It provides no subsidies to help firms offset the costs of entering new foreign markets, though, and its antitrust laws usually restrict companies from combining their operations in export situations.

The British and Canadian Governments also have special regional groups charged with helping their local firms compete for major foriegn contracts. The British Overseas Project Group works to interest British firms in specific overseas projects and coordinate bidding. It can provide up to half the precontract expenses for certain companies which might be competitive but lack the resources to make independent bids. The Canadian Center for Joint Ventures and Turnkey Projects also helps companies identify opportunities and bid on major projects, and it offers subsidies to defray half the costs (repayable only if the contract is secured) of preparing the exploratory studies, proposals, and bids. The British also have a special Committee on Invisible Exports to encourage and promote overseas British sales in insurance, finance, and engineering and other consulting services. The U.S. Commerce Department has a special experimental program to help companies bid on major projects in Venezuela, but no subsidies seem to be involved, and the U.S. Government has no other special programs of this sort.

1/ Many other countries also have OPIC-type programs. See the description and comparison of these to the U.S. program in U.S. Congress. House. Committee on Foreign Affairs. The Overseas Private Investment Corporation: A Critical Analysis. (Committee Print) 93d Cong., 1st sess. September 4, 1973, pp. 114-29.

EXPORT PROMOTION PROGRAM:
OPTIONS FOR THE UNITED STATES

As this study has shown, there are a number of policy alternatives the United States might consider if it wished to adopt programs similar to those of its major competitor countries. These can be grouped into three main areas: changes in the organizational structure of the U.S. system, increased support for private activities, and expansion in official programs to support new export activities.

Government Reorganization

This study of foreign programs suggests that there are several ways the U.S. Government could reorganize its export promotion program if it wished to make structural changes in the U.S. system. One category involves the formation of a new umbrella organization to coordinate policy in this area. One option might be a new U.S. foreign trade agency that combines into one organization all the present functions of the Foreign Agricultural Service, the Eximbank, the Commerce Bureau of Export Development, and the State Bureau of Economic and Business Affairs. Another option might be a central U.S. office like the Japanese MITI or the French DREE to coordinate policy in the various specialized agencies while leaving them administratively separate. A third option might be a new coordinating council--chaired, perhaps, by Commerce or a White House specialist--to expand contracts among the different agencies while retaining their administrative and policy autonomy. Several issues might be involved in one's choice among these options. Consolidation could improve the way the agencies work together, but it also might impose the special norms and goals of one agency on others whose needs and constituencies are different.

Centralization could give the new entity enough authority to have some impact on U.S. trade, but it could also require careful regulation because it would put a good deal of economic power in one place.

A second kind of reorganization--compatible with any of those in the first--would be formation of a semi-autonomous public corporation comparable to the French CFCE, the Italian ICE, or the Japanese JETRO, to replace the present Commerce Department offices. This alternative might allow for better coöperation between the domestic and international wings of the U.S. promotion program and more flexibility in its operations. The executive branch now has the President's Export Council to give insights from the private sector on the workings of the U.S. promotion system. Should a closer association be desired, the United States might consider the idea of broad business and labor membership in a new U.S. official trade organization or perhaps even designated business and labor seats on its administrative board.

These concepts may not be as appropriate for the U.S. setting, however, as they are for other countries where the traditions of government and industry cooperation or state direction in the economy is more common and accepted. Centralization of policy and an autonomous official export trade corporation remain options which are available to the United States, though, if it wishes to emulate elements of its competitor countries' export promotion programs.

<u>Support to Private Activities</u>

A second group of options concerns additional government assistance for private activities related to exports. One possibility would involve increased cooperation between the existing U.S. export promotion agencies and private export organizations in the U.S. The U.S. Government might consider activities which link its promotional activities more directly to the needs and concerns of regional and national bodies like chambers of commerce or trade associations, as in Britain or France, giving them a broader advisory role in the development of new programs. Alternatively, the United States might consider providing operating subsidies for some overseas U.S. chambers of commerce, as the Germans, Dutch, French, and Italians do for theirs, in order to help these organizations expand their promotional services for U.S. exports. The U.S. Government would not have direct control on the use of these funds, but it could have indirect control (through guidelines and the annual appropriation process) and its support might draw additional private money into the export promotion process.

A second possibility would involve the expansion of U.S. official efforts to coordinate American private trade activity in certain areas. The United States might form a Committee on Invisible Exports (emulating the British) to give special emphasis and direction to overseas sales of U.S. financial, professional, and technical services. This could be a major source of new exports for the United States, as the U.S. economy becomes more and more oriented towards services and advanced technologies. The United States might also copy the Canadians and British by increasing its facilities for coodinating U.S. private bidding on major foreign contracts. The existing U.S. program for U.S. project opportunities in Venezuela might be expanded to include major projects in other high-potential target countries, and ultimately, all major foreign markets.

A third possibility would involve additional efforts to stimulate domestic U.S. interest in international trade. The U.S. Government already has a program designed to make small and medium-sized business more aware of new export opportunities. More advertizing might be used, as in Canada, to publicize the existing program and encourage companies to seek out government services in this area. The Federal Government might also consider developing a curriculum like the British "Foundation Course on Overseas Trade" to teach export techniques in American colleges and trade schools. An expansion in the total stock of U.S. export marketing skills would almost certainly increase the American business community's interest in and awareness of export opportunities. The United States might also consider possible changes in its tax or antitrust law to allow U.S. firms--or perhaps just smaller U.S. firms--to cooperate with one another in foreign markets through joint export associations, consortia, or joint subsidiaries that will give them the size and resources needed to break into foreign markets. Some of the major countries have found this a useful tool for encouraging their smaller companies to develop their international trade potential.

New Official Export Services

One area of initiative the United States might consider would be special tailored official market research designed to help firms explore new markets, as is done in France and Japan, or subsidies to encourage private firms and trade associations to do more such research on their own, as is done in Britain, Italy, Japan and Canada. The United States now offers Global Market Surveys, to assess economic opportunities for individual firms and industries in particular areas. That service could be offered either on a subsidized or a fully-reimbursable basis. Subsidies for new private overseas research would be more costly, but would free the government from the task of conducting the work itself.

Another new possibility might be an expansion of the existing foreign buyers program, in order to help finance U.S. training seminars for foreign technicians, visits to U.S. firms by prospective foreign buyers, or even trips by high officials or businessmen from developing markets to familiarize them with the possibilities of the American economy. Canada, Japan, Italy, and Britain all have some version of this program. These services would probably need to be offered on a subsidy basis, though, and the question of whether adequate direct benefits could be found to justify some of these activities would have to be addressed. The other countries do claim, however, that their visitors programs produce real indirect benefits by influencing general overseas purchasing patterns.

With respect to new subsidies to encourage broader private participation in existing official U.S. programs, the United States might consider a number of possibilities. It could emulate Italy, Britain, Japan, and West Germany, for instance, by financing part of the display, transportation, or even personnel costs for participants in its international trade fairs. Or, it might copy France by offering "fair insurance" to guarantee firms against losses from participation in those shows. It might impose only a nominal charge, as in Italy and Britain, on companies who benefit from its outward trade missions and inbound foreign buyers program. Expansion of the subsidy element in the U.S. promotion program would go against the recent trend, however, in which the Office of Management and Budget has been seeking to get the Commerce Department to set fees that would recoup a larger share of the cost of mounting some of the major U.S. promotion operations. It might also raise questions about whether subsidies are necessary or desirable, from an economic perspective, in order to encourage sound firms to explore their real international export opportunities. Some type of activity in this area does remain an option, however. The alternative--persuading those countries to drop their subsidy levels down to those of the United States--would not seem particularly fruitful at this time, but it also might be an option which the United States could explore if it wished to influence competitive factors in the international marketplace.

34-201 O - 78 - 4

CHAPTER II

EXPORT FINANCING PROGRAMS*

Most of the advanced industrial countries have some system of government assistance to help their private sector finance some export sales to foreign markets. The governments sometimes find it expedient to act as the lender of last resort, to supplement the private credit market when it is unwilling or unable to provide loans at sufficiently long terms and low rates to allow a sale to occur. In addition, they often offer guarantees or insurance which have the effect of lowering risk and thereby facilitating the availability of private export credits. Sometimes, the governments of the advanced industrial countries simply offer the credits and guarantees that their exporters need in order to meet the competition from other countries. Also the growing commercial rivalry among the developed countries and the increasing similarities in the price, quality and availability of their goods has meant that, in many cases, government financing arrangements have become a determining factor in some trade transactions. In the capital goods sector and the market for "big ticket" items in particular, it now often appears that contracts may go to the exporter who is able to arrange the most attractive financing for his sale. The United States and the other major industrial countries have been working through the OECD since 1976 to limit competition in this area and develop acceptable international standards governing official export financing programs.

---

* Prepared by Jonathan Sanford, Analyst in International Relations, Foreign Affairs and National Defense Division.

The range of national emphasis

This chapter provides a comparative analysis of the major industrial countries' official export financing systems. There are major differences in the scope and terms of these countries' programs, though they all have a subsidy element since they offer credits and guarantees that may not be available at comparable terms in the private market. Some —Japan, France and the United Kingdom, for instance—have major export credit operations that benefit a large share of their export trade. Others—Switzerland, Canada and the Netherlands—rely mainly on the private sector and have only a small government program designed to deal with certain limited situations. The countries usually try to encourage new export sales by means of their official credit programs without undercutting the private market. They differ considerably in the terms and services they offer their customers. Some emphasize private participation in their financing programs, while others maintain autonomous governmental operations. Some deal mainly with long-term credits for developing lands, while others offer medium term financing for all foreign sales. Most provide their credit and insurance at near-commercial rates, ...some mix subsidies with their regular program to encourage trade with certain countries. The wide variations in these national programs complicate any effort to compare their operations.

Most of the major industrial countries have some mechanism for providing official credits for their exports, either directly through a government

Table 1. Official Export Financing Techniques, Major Industrial Nations

Technique	CANADA	FRANCE	ITALY	JAPAN
Direct Suppliers' Credits		85% long-term (7+ year); earlier maturities funded by refinancing facility (below)		50% contract, 15-20% down, rest financed privately.
Direct Buyer's Credits	60% contract, end maturities. Long-term only. 15-20% down, rest private financing earlier maturities.	Same as direct suppliers creidts		Same as direct suppliers credits
Refinancing Facilities		Gov't refinances 60-72% private low-interest credits, with guarantee, at rates attractive to private banks.	Rare; some interest rate subsidies for 85% private buy or seller credits. Limited.	Refinancing short-term available at normal rates, central bank
Govt' Loans to Private Banks				
Export Insurance	90% contract for short-term; 90-100% contract for medium-term; rates based on risk; tailored policies	90-95% contract; all goods, short-term; capital goods medium term; LDC capital goods, long-term; risk related rates.	75-90% or less of contract on limited bases; for medium and long-term, risk related terms.	60-90% contract, risk related but generally low rates.
Export Loan Guarantees	Rare	80-85% loan; heavy capital goods for long-term; light capital goods for medium term guar.		80% commercial risk on private bank loans.
Mixed Credits	Rare	For LDCs, 50% contract lent at low interest, long-term (25 yr) discount rate.		For LDCs, mix aid credits with export credits to yield low (4-6-1/2% rate, long term (25 yr) loan
Special Insurance Programs		Exchange rate flux insurance; inflation indemnity insurance. Heavy subsidized rates.	Exchange rate flux insurance planned.	Exchange rate flux insurance; performance bond insurance

Table 1 (cont.) Official Export Financing Techniques, Major Industrial Nations

NETHERLANDS	SWITZERLAND	UNITED KINGDOM	WEST GERMANY	UNITED STATES
			45% of long-term low-cost credits, mostly to LDCs; late maturities, private banks take earlier maturities	
		Foreign govts if competition merits, for medium & long-term credits. Rare.	Same as for suppliers credits.	Av. 42% long-term credits, capital goods, end maturities; private banks-early dates USDA ag credits.
Central bank refinancing for certain bank credits, discount rates; limited		85% of special rate bank credits refin. or subsidized at rates attractive to private banks; now emphasis on supporting foreign currency-demon. loans	80% of certain low rate, medium-term suppliers' credits discountable at central bank at attrative rate	Rediscount some medium-term bank loans to foreign buyers; lines of credit to facilitate private export lending
Central bank loans, medium-term, using private credits as security				Medium-term CFF loans to foreign banks for 1/2 their loans for U.S. exports
Some official reinsurance of private export insurance, at commercial rate	80-90% contract insurable, short and medium term, risk-related market terms.	90-95% comprehensive insurance short-term; 90-100% some medium-term, capital goods; risk related rates.	Govt reinsurance for some private insurance covering 85-90% of the export contract.	Reinsures some private FCIA insurance, for 90-95% contract Market terms.
		90-95% some cases; 100% for medium-term loans for capital goods, lines-of-credit, subsidized credits (above).		Guarantees bank loans associated with long-term 100% medium-term credits.
			See direct export credits	
		Inflation indemnity insurance; performance bond guarantees; both limited.	Exchange rate flux insurance, commercially-related rates.	

agency or indirectly through facilities that refinance private loans. Also most provide some official export insurance or guarantees that diminish the risk and encourage private lenders to use their own resources to finance overseas trade. As Table 1 indicates, though, the major countries employ a number of different techniques for accomplishing these two basic goals. Most offer direct government credits to buyers and sellers, refinancing facilities for private loans, government loans or guarantees to banks to expand their export lending, and export insurance and guarantee programs to underwrite private credit. In addition, some of the countries also provide mixed credits which subsidize their export loans to developing nations and specialized insurance programs that help limit the impact inflation and exchange rate fluctuations might have on their export prices. Some also offer special government-to-government loans, special preliminary commitments that authorize a line of credit for future export sales, and prefinancing that underwrites the local production costs of goods covered by an export contract. There is very little good information available, however, on the size or extent of these latter programs.

Country Summaries

France. The French probably have the broadest and most concessional export financing system among the major industrial countries. The government assists a major share of French exporters by encouraging private banks to make special medium-term fixed-rate export loans with attractive refinancing arrangements at the central bank. It also provides direct credits to finance up to 85 percent of the value of the contract on long-term loans (over seven years), the largest portion borne by any major country reviewed in this study. French exporters are also able to use foreign aid credits for up to half the value of some exports to developing countries as well as some other nations, enabling the exporter to offer low-interest (3 percent minimum) and long-range (25-years maximum) loans for exports the government deems valuable to the national interest. To supplement the private insurance market, the French also offer short-term export insurance for all exports and medium and long-term insurance for light and heavy capital goods exports, covering a rather large share of the contract for a modest charge. The government also provides an extraordinary—and highly subsidized—insurance program to help protect exporters from the effects that inflation or exchange rate fluctuations might have on their export costs. Roughly 39 percent of all French exports benefitted in 1976 from these official credit and insurance programs.

Japan. The Japanese also have an extensive export financing system with some concessional features. Their Export-Import Bank offers direct credits for about half the contract value for medium and long-term export loans, at rates that vary between 6-9 percent depending on the product, the foreign market, and the competitive situation. Though available only at near-commercial rates, the sheer volume of Japanese official credit encourages trade and foreign sales. The Japanese also mix foreign aid credits with their export loans on occasion, mostly for resource development projects in developing countries, to provide low-interest credits (4 to 6 - 3/4 percent) over periods of up to 25 years. The Ministry of of International Trade and Industry also offers export credit insurance and guarantees for private bank loans at rates which are relatively attractive compared to the fees charged by government agencies in the other major industrial nations. It also provides exchange risk insurance for Japanese exporters and a new service—performance bond insurance—that encourages complete plant exports by covering 70-90 percent of any losses attributable to unfair calling of performance bonds by the foreign buyer. Approximately 49 percent of all Japanese exports benefited in 1976 from these export credit and insurance programs, the highest percentage for all countries reviewed in this survey.

United Kingdom. The United Kingdom also provides an export financing system with some concessional features. While it offers no direct credits, the British government usually helps most medium and long-term U.K. exports indirectly through refinancing and interest subsidies from its Export Credit Guarantee Department (ECGD). Private commercial banks are encouraged to make low-cost export loans and the government will pay either a subsidy or refinance a portion of the bank's portfolio to bring its return up to an agreed level. The British have recently been emphasizing refinancing and subsidies for loans denominated in currencies other than sterling, in order to help protect their balance of payments. This should lead to a sharp reduction in future govern-

Table 2. Comparative Official Expenditures,
Major Country Export Financing Programs, 1976*
(Millions of U.S. dollars)

Item	CANADA	FRANCE	ITALY	JAPAN	NETHERLANDS	SWITZERLAND	UNITED KINGDOM	WEST GERMANY	UNITED STATES
Annual budget ceiling, disbursements on credits	none	none	none				none	AKA: none KfW: none	3000 direct 1000 refin
Total outstanding (net 1976 increase)	3077 (550)	1799 (-114)	1862 (-711)	656 (NA)			6393 (-24)	KfW: 1334 (AKA: NA) KfW: 54)	15 415 e (091 direct) (-93 refin)
credit authorizations (disbursements)	718 (504)	7595 (NA)e/	1451 (264)e/	3266 (2263)	(NA)		1152 e/ d/ 2256)	AKA: 409 (NA) KfW: 1135 (392)	2285 direct (2098) 1204 refin (101)
credit disbursements as share capital goods exports	4.2%	NA	3.3%	9.8%	(NA)		15.8%	AKA: NA KfW: 1.3%	5.7% direct 0.3% refin
insurance budget ceiling	none	none	3600	none			none	none	8850
Total outstanding insurance (net 1976 increase)	886 (70)	24,477 (8987)	9376 (371)	51,949 (13,849)	5000 (est.) (2000 (est.))	4080 (695)	31,556 (2529)	27,762 (7882)	10,100 (330)
Insurance authorizations	1339	21,920	3306	32,034	(NA)		10,519	10,387	4800
Share of exports benefitting from official program	5%	39%	9%	49%	(NA)	9%	45%	10%	8%
Total value national exports	38,500	55,400	35,300	68,000	43,100		43,800	106,600	114,900

a Comparative figures for 1975 were $7326 authorized and $1799 disbursed
b. plus $60 interest rate subsidy payments
c. plus $876 refinancing authorizations

* Computed from data supplied in this study.

d. plus $382 interest rate subsidy payments
e. includes $246 refinancing

ment outlays for this program. The ECGD also offers comprehensive export insurance and loan guarantees covering most short-term contracts and medium and long-term contracts that involve capital goods and construction services. An unusually high portion of the contract may be covered by these insurance policies and their cost is relatively modest by international comparative standards. The British government also offers inflation indemnity insurance and performance bond guarantees to protect their exporters. The former covers for the most part large capital goods contracts which may be undercut by rapid cost increases attributable to British domestic inflation. Only two policies had been approved as of the end of 1976, however, as the government administered the program in a very conservative fashion. More coverage has been authorized under the performance bond guarantee program, which helps British contractors compete for international construction projects in the Middle East and elsewhere. Approximately 45 percentof all British exports benefited in 1976 from some aspect of the government's export credit and insurance system.

Italy. On paper, the Italians have a highly concessional export financing system, but in practice the actual level of governmental support is limited by budget shortages in the administering agencies. There is no official agency for issuing direct export credits, but the government encourages private banks to provide some medium and long-term loans at lower than international rates for up to 85 percent of the contract value by offering large interest subsidies and attractive refinancing from Mediocredito Central to cover the difference between foreign and domestic interest rates. The government usually prefers to pay interest subsidies, so as to support as many Italian exports as possible with its limited funds. Another government agency offers (INA) restricted insurance coverage for some short-term political (but not commercial) export risks and limited coverage for comprehensive risks on medium and long-term loans. Its rates are tied to the relative risk on the policy and coverage is rarely available for larger credits on the full 75 to 90 percent of the contract value authorized under provisions of the law. The Italian government has authorized a new program of exchange rate fluctuation insurance. Its former program of inflation indemnity insurance was dropped in 1974 because of the heavy cost of claims against the system. Only about 9 percent of Italian exports benefited in 1976 from any aspect of the government's export credit or insurance operations.

West Germany. While the West German export financing system relies mainly on private institutions to provide export credits and insurance at commercial rates, the government does offer some assistance on concessional terms, mostly for exports to developing nations. A consortium of private banks, the AKA, provides most of the country's export credits. It also manages a modest line of low-cost credit, though, which the government provides for 80 percent medium-term loans to be refinanced through the central bank. An official agency, the KfW, also offers a limited amount of direct credit at rather modest rates for up to 45 percent of the latter part of long-term credits (i.e., late maturities) for export loans to developing countries. Private banks provide the funds for the earlier period of the loan. On occasion, AKA and KfW financing may be combined for some medium-sized projects in poorer lands. Most German export insurance and guarantees are handled by Hermes, a private company that operates under government supervision. The government finances some policies (for 85 percent of contract) on its own account when they would be otherwise unavailable--short-term for most consumer goods and medium-term (2 to 5 years) for capital goods. Long-term coverage is also available for some capital exports to state-trading nations (8 1/2 years) and developing countries (10 years). The insurance premiums are rather low by international standards and set on a flat-rate basis--with half-off for public-sector buyers--rather than on a risk-assessment basis, but buyers must still meet mandatory credit-worthiness criteria before receiving coverage. Hermes also offers insurance for exchange rate fluctuations affecting the U.S. dollar, British pound, and Swiss franc, at commercial rates. Only about 10 percent of all German exports benefited in 1976 from these official credit and insurance programs.

Canada. The official export financing systems of Canada are more oriented to market terms than are most of the government programs in competing nations. The Canadians have no facilities for direct or indirect medium-term official credit, but they do offer some long-term credits from the Export Development Corporation for up to 60 percent--usually for the latter part of the loan-on some capital equipment and service exports. Exports to the United States are normally not eligible. The agency also provides a limited amount of export insurance for short and medium-term contracts. Most medium-term coverage is tailored to the needs of the purchaser at rates based on risk calculations, though by international standards. These rates are still relatively low. Only about five percent of Canada's exports benefited in 1976 from these official programs, the lowest proportion for any of the major industrial countries (excluding Switzerland and the Netherlands) surveyed in this study.

United States. The United States has a much more extensive official export financing system but it is also based mainly on commercial principles in most of its operations. Its Export-Import Bank (Eximbank) offers direct long-term credits at near-commercial rates for an average of 42 percent of the contract value of some large capital equipment and services ("big-ticket") exports. A consortium of private banks, the Private Export Funding Corporation (PEFCO), often takes the middle maturities while the Eximbank takes the later dates on these long-term loans and offers guarantees for the private creditors that participate in its package deals. The Eximbank can chose whether to loan against a promissory note from the foreign buyer or to purchase the obligation. It also provides direct loans from its Cooperative Financing Facility (CFF) to participating foreign banks at attractive rates for half the cost of their own credits when they finance local imports of American goods, and it stands ready to guarantee repayment of such local loans in the currency which the lender makes available. The Eximbank will also provide guarantees to private U.S. banks for up to 80 percent of the contract value on their medium-term export loans, at a guaranteed interest rate 1 percent above the U.S. Treasury rate for similar maturities. It also works with the Foreign Credit Insurance Association (FCIA), a consortium of private insurance companies, to offer short and medium-term export insurance. The Eximbank will normally reinsure most of FCIA's political risk insurance and some of its commercial risk insurance, for up to 90-95 percent of the contract. Premium rates vary with the risk and coverage and seem roughly comparable to the market-oriented rates of other national insurance programs. Roughly 8 percent U.S. exports in 1976 benefited in some way from these official credit and insurance programs. The United States also offered approximately $621 million in credit through the Department of Agriculture's Commodity Credit Corporation in 1976 to finance medium-term (3-year) loans at near-commercial rates to foreign buyers of American agricultural products. It also provided some $650 million in concessional food aid through the P.L. 480 Food-for-Peace Title I program for long-term, low-cost to buyer agricultural sales to poor countries. The CCC and P.L. 480 Title I programs financed roughly 5.6 percent of U.S. agricultural exports in FY 1976, over one percent of total U.S exports for the year.

Netherlands and Switzerland. The Netherlands and Switzerland have rather limited government programs in the export financing area. Neither has an official agency for government export credits, and the Swiss leave this activity entirely to their private sector. The Dutch have a small refinancing facility in their central bank which offers discount loans, sometimes as much as 2 percent below market rates, for certain types of exports--with the benefits being passed along to the exporters rather than the banks. They also rely mainly on their private banks for most export loans. The Swiss have a longstanding government program for export insurance which benefitted roughly 9 percent of their exports in 1976 with some type of coverage. The rates are set on a commercial basis, however, reflecting risk. The Dutch have no official agency for export insurance, but their Finance Ministry does reinsure a substantial part of the private export insurance written by NCM, the dominant company in the field. Its premiums are also determined by market conditions and estimated risk. NCM has a number of rather innovative programs, such as guarantees to foreign banks for lines of credit offered for possible future imports of Dutch goods, and it offers exchange rate fluctuation insurance at commercial rates for medium-term exports of capital goods.

Comparisons and Issues

While there are obvious problems in making overall comparisons among the export financing systems of the nine major countries reviewed in this study--their economies differ widely and their programs serve different needs in different systems--it is possible to make some general across the board observations about their financing activities. Separate attention will be given to the export insurance and the export lending programs of these countries.

Export insurance. Most of the major countries offer programs to insure firms against commercial or political risks which might block payment on their export sales. Export insurance traditionally has not been a major area of competition for the major countries. They all run their insurance programs more or less on a commercial basis, with some regard for the creditworthiness and risk-potential of individual contracts, and they usually refrain from using their export insurance programs as incentives for stimulating exports. Most of their programs cover the same kinds of commercial and political risks, as shown in Tables 3 and 4. The United States does usually require its exporters to carry a larger share of the risk, however, for it insures only 70-90 percent of the contract cost while most of the other countries cover 90-95 percent.

Several countries do offer special inflation or exchange rate insurance, though, to encourage exports by protecting firms against major changes in the domestic or international cost of their products. Some--the Netherlands and Germany--run these programs on a near-commercial basis. Others--most notably, France--provide substantial subsidies to defray the high costs involved. The United Kingdom has been quite cautious about issuing coverage under its insurance program. Also, the Germans and Japanese have found exchange rate coverage to be of questionable value in light of the strong position their currencies have in international money markets. The United States has tried to discourage the spread of these special insurance schemes and to limit subsidies in existing systems, in order to help encourage the industrial countries to move more towards free trade and to avoid the major budgetary cost of adopting similar programs of its own.

Export credit. There has been much more competition among the major industrial countries in their export credit and payment guarantee programs. In some respects, the different national programs have sought to achieve different ends: Most countries have tended to emphasize medium-term credits for a broader spectrum of goods, while the United States, Canada and--in its public lending program--West Germany have concentrated mainly on long-term lending for large capital projects. There is no current

Table 3. Comparison of Commercial Risks Covered

Period of Cover	Risk	Canada	France	Germany	Italy	Japan	U.K.	U.S.
Percent of Cover of Financed Portion Usually Available		90	90-95 1/	90 2/	10-85 3/	60-90 4/	90-95	70-90
Pre-Shipment	* Insolvency of the buyer	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Post-Shipment (transit period)	* Arbitrary non-acceptance by the buyer not due to the fault of the seller	Yes	No	No	No	No	Yes	Yes
Post-Shipment (credit period)	* Insolvency of the buyer	Yes	Yes	Yes	Yes	Yes	Yes	Yes
	* Failure to pay local currency deposit on due date	Yes	Yes	Limited to public buyer	Yes 5/	Yes	Yes	Yes

Table 4. Comparison of Political and Other Risks Covered

Period of Cover	Risk	Canada	France	Germany	Italy	Japan	U.K.	U.S.
Percent of Cover of Financed Portion Usually Available		95	90-95 1/	90	90 6/	90	90-95 7/	70-95
Pre-Shipment	* Cancellation of an export license not due to fault of exporter	Yes	Yes	Yes	Yes 9/	Yes	Yes	Yes
	* Cancellation of a contract by a public buyer	Yes	Yes	Yes	Yes	Yes	Yes	No
Post-Shipment (transit period)	* The events listed above but as post-shipment risks	Yes	Yes	Yes	Yes	Yes	Yes	Yes
	* Cancellation of previously valid import authority or other government restrictions rendering importation impossible	Yes	Yes	Yes	Yes	Yes 10/	Yes	Yes
	* Transport or insurance charges owing to diversion of shipment caused by political events	Yes	Yes	No	No	Yes 11/	Yes	Yes
Post-Shipment (credit period)	* The events listed above, but occuring in the credit period	Yes	Yes	Yes	Yes	Yes	Yes	Yes

Table 4 Comparison of Political and Other Risks Covered (Cont.)

Period of Cover	Risk	Canada	France	Germany	Italy	Japan	U.K.	U.S.
	* Currency inconvertibility and transfer delays	Yes	Yes	Yes	Yes	Yes	Yes	Yes
	* Outbreak, of war, hostilities, civil commotion, etc. preventing payment by the buyer	Yes	Yes 12/	Yes 13/	Yes 12/	Yes	Yes	Yes
	* Requisition, expropriation, or other government intervention which prevents payment	Yes	Yes	Yes	Yes	Yes	Yes	Yes

Notes to Tables 3 and 4

1/ Both commercial and political risks are covered for up to 90 percent of the credit in the case of supplier credits, and up to 95 percent for buyer credits.

2/ Ninety percent cover is available for pre-shipment protection for an exporter's actual costs.

3/ INA rations coverage because of budgetary restrictions. Cover is 85 percent of the financed portion of the first 200 million lire of contract value; from 201 to 400 million lire, cover is 60 percent; from 401 to 600 million, 30 percent; above 600 million, it is 10 percent. When the aggregate of credits insured by an Italian exporter exceeds two billion lire, additional credits can be insured only up to 10 percent.

4/ Sixty percent cover for individual policies, 90 percent for policies issued on a whole-turnover basis.

5/ Limited to public buyer, or private buyer if guaranteed by the government of other public entity.

6/ Coverage of 100 percent available for financial credits granted to governments or central banks for debt consolidation, development credits, or credits to enhance Italy's economic and political interests.

7/ Ninety percent cover for pre-shipment risks; 95 percent cover for post-shipment risks on whole-turnover policies.

8/ Political cover is 70-90 percent for medium-term sales and 95 percent for short-term sales.

9/ This is not standard cover in Italy but is available at an additional premium.

10/ Also covered is the inability of a buyer to import due to strikes or boycotts occuring outside of Japan.

11/ This is not standard cover and is covered under a separate policy at an additional premium.

12/ Also covered are natural castastrophes occurring outside of France or Italy.

Source: U.S. Export-Import Bank.

information available, however, on the precise portion of each national program that goes for medium and long-term direct lending.

A good deal of the competition among national programs centers on the share of the credit the official agencies cover and the interest rates they charge their final borrowers. The United States usually offers official credits for the smallest portion of the loan (30-50 percent, averaging 42 percent) for its long-term export credits, but its program seems to be generally quite competitive with the long-term lending programs run by the other major governments. The Eximbank indicates that, as of March 1977, the overall cost of its long-term credit was among the lowest available from any of the major industrial countries, (see Table 5.) As far as medium-term credit is concerned, however, the Eximbank reports that it has often been unable to meet the terms offered by the other major countries. The United States has a clear advantage in long maturities, for its capital markets are well developed and able to provide long-term capital at reasonable rates. Other countries usually prefer to make their concessions for export sales in the form of lower interest rates for shorter periods. The U.S. Eximbank is hampered in its ability to meet some interest rate competition, for it is legally required to be "self-sufficient" in its operations, and it usually returns a substantial profit to the Treasury each year. Except for Canada, most foreign export agencies receive annual budget subsidies from their governments and have no requirement that they return a profit on their annual operations.

on the private element of the financing package. The United States has tried to deal with this problem by having PEFCO, the private bank consortium, take a larger share of the middle maturities in Eximbank financing packages at a fixed interest rate, with an understanding that the Eximbank would increase its participation and reduce PEFCO's obligation if the cost of the private organization's capital turned out to exceed its committed lending rate. Some other countries compensate for the relatively high interest rates in their domestic markets by offering direct interest subsidies that lower the effective cost of their export credits below the comparable levels for domestic loans.

Table 6. Relative Cost of Export Credits and Domestic Corporate Bonds

	Effective Cost of an Export Credit	Domestic Corporate Bond Yield
Canada	9.2%	9.88
France	8.2%	11.12
Germany	8.6%	6.88
Italy	9.0%	11.7.
Japan	8.6%	8.19
United Kingdom	8.9%	13.48
United States	8.3%	8.00

Source: U.S. Export-Import Bank, June 1977 report

(See Table 6.) Interest rates are probably less important as far as export loans from countries with weak currencies, are concerned, however, since the foreign borrower can expect that future depreciation of the lender's currency will reduce the real cost of his loan payments in terms of his own local currency.

Table 5. Relative Rates for Official Export Credit Programs, Major Countries

	Most common rate		Percent of contract officially supported		Effective cost of funds to borrower a	
	medium-term	long-term	medium-term	long-term b	medium-term	long-term
Canada	— c	8.5	— c	60	— c	9.2
France	— d	—d	60	60	8.0	8.2
German	5.6	8.0	80	45	8.1	8.6
Italy	8.5	8.5	85	85	9.0	9.0
Japan	7.0	7.5	50	50	8.3	8.6
United Kingdom	7.5	8.0	85	85	8.7	8.9
United States	8.0e	8.4	85e	42	9.2e	8.3

a For good credit risks, including required insurance and bank charges.
b Provided on a fixed-rate basis. French and Japanese commercial bank financing is also provided on a fixed-rate basis.
c Canada has no program for medium-term official credits.
d Variable, in order to see that the final effective cost of combined public and private credit will be as low as allowable under terms of the international agreements limiting export credit competition.
e For Eximbank discount loans; the comparable figures for CFF loans are: 8.0% common rate, 42.5% usually supported, and 10.5% effective cost to borrower.

Source: U.S. Export-Import Bank, June 1977 report.

The competitiveness of government programs can often be affected by the relative cost of private capital, particularly in nations that require a substantial amount of private participation in their official export credit programs. The Eximbank reports that some of the current U.S. competitiveness is due to lower interest rates on private U.S. bank loans and that the total cost of long-term Eximbank credits may go up in the future if interest rates rise as domestic economic activity increases. Since most private bank loans carry floating interest rates, the relative attractiveness of U.S. and other countries' credits may be influenced by borrowers expectations about future interest rates on the private element of the financing package. The United States has tried to deal with this problem by having PEFCO, the private bank consortium, take a larger share of the middle maturities in Eximbank financing packages at a fixed interest rate, with an understanding that the Eximbank would increase its participation and reduce PEFCO's obligation if the cost of the private organization's capital turned out to exceed its committed lending rate. Some other countries compensate for the relatively high interest rates in their domestic markets by offering direct interest subsidies that lower the effective cost of their export credits below the comparable levels for domestic loans.

Table 6. Relative Cost of Export Credits and Domestic Corporate Bonds

	Effective Cost of an Export Credit	Domestic Corporate Bond Yield
Canada	9.2%	9.88
France	8.2%	11.12
Germany	8.6%	6.88
Italy	9.0%	11.7.
Japan	8.6%	8.19
United Kingdom	8.9%	13.48
United States	8.3%	8.00

Source: U.S. Export-Import Bank, June 1977 report

(See Table 6.) Interest rates are probably less important as far as export loans from countries with weak currencies, are concerned, however, since the foreign borrower can expect that future depreciation of the lender's currency will reduce the real cost of his loan payments in terms of his own local currency.

The Eximbank says that administrative practices also can be a significant factor in export loans, and that it has enhanced its own competitiveness by linking repayment terms to the cash flow prospects of the project rather than the wealth of the borrower country, as is the case in Europe and Japan.

Unlike France, Japan, and other countries that mix foreign aid with export credits to encourage the sale of their goods, the United States channels its bilateral foreign aid mainly through separate agencies that finance agricultural exports (the P.L. 480 program) and development projects (the Agency for International Development) in poor countries. The United States once put a good deal of emphasis on using its bilateral assistance program to encourage exports of major capital items for infrastructure and other big projects in developing lands. With its recent shift to "New Directions" programs, which seek to direct U.S. bilateral aid more to projects that directly benefit the poor and less to infrastructure and large industrial plants, the United States has begun to put less emphasis on financing large capital exports and more on funding goods which are now more relevant to its new concerns in the development field. Like most other foreign aid programs in other countries, though, the U.S. bilateral aid program continues to be a vehicle for low-cost loans to finance American exports--albeit new exports of a New Directions type--to lands that probably would be unable to buy them without that assistance.

U.S. Export Financing Programs Alternatives

The U.S. export financing system is generally quite similar to those of the other major countries, but there are things the others do that the United States does not do. Though the economic rationale of certain foreign programs might be questioned, they are alternatives the United States might wish to consider. The United States could emulate the French and Japanese, for instance, by establishing a special fund--similar to the Export Development Credit Fund orginally proposed (but not enacted) as part of the 1973 Foreign Assistance Act--for low-cost credits to developing countries which the Eximbank might blend with its regular credits for special loans in certain circumstances. It could adopt some form of interest subsidy system--for example, guaranteeing an acceptable rate of return to private banks if they offered low-cost, fixed-rate credits--to make the Eximbank program more competitive in medium-term lending. It could arrange general lines of credit for a country to cover future U.S. sales resulting from a special export drive to that nation. It might raise the level of Eximbank coverage from an average 42 percent on long-term credits and 50 percent of CFF loans, to the higher figures often covered by foreign programs. It might even adopt some type of special insurance system for U.S. exporters--or for foreign buyers--to protect against inflation or exchange rate fluctuations.

Some of these initiatives might be compatible with the legislation directing the Eximbank to offer its insurance, guarantees, and credits "at rates and on terms and other conditions which are competitive with the Government-supported rates"[1/] offered by other countries. Some might conflict with the guideline requiring the Bank to "supplement and encourage and not compete with private capital" in its financing operations.[2/] They would also be rather expensive, and there would always be the possibility that other countries might retaliate by adopting new subsidies of their own to maintain their relative position in specific areas.

Past and current U.S. administrations have sought to avoid an "export financing race" by rejecting new U.S. subsidy programs and urging negotiations instead on a new international agreement setting acceptable limits for national financing programs. The Congress has encouraged the Executive in this with legislation directing the Eximbank to seek to minimize competition in government-supported financing.[3/] In June 1976, the United States, Canada, France, Germany, Italy, Japan, and the United Kingdom signed a one-year Consensus Understanding (also called the "Gentlemen's Agreement") setting minimum standards to bring official financing practices closer to market norms. The guidelines provide for a minimum 15 percent cash payment; minimum blended interest rates of 7.5 to 8.0 percent for credits of 5 years or more and 7.25 to 7.75 percent for 2 to 5 year credits, depending on the market; and minimum repaymen terms of 10

1/ 12 USC 635 Eximbank Act 1945 Sec 2(b)(1)(A) as amended by 1974 Eximbank Act.

2/ Ibid., see 2(b)(1)(B).

3/ Ibid Sec 2(b)(1)(A)

years for developing countries and 8.5 years for other countries. They also provide for notification and consultation procedures on certain official transactions. The Netherlands, Switzerland, and nine other OECD countries later agreed to participate in the Understanding, and its terms were later extended to allow further discussion in the OECD on a long-term international agreement harmonizing national practices in this area. A number of major differences remain to be resolved, however, since there are a number of important exceptions and waivers weaved into the initial consensus agreement which allow countries to make significant departures from the general standards in specific situations. Consultations have been underway since mid-1977 to find ways of diminishing the remaining differences between the major countries in the export financing area.

CHAPTER III

TAX POLICIES AND INTERNATIONAL TRADE*

Introduction

The harmonization of national tax systems is a major issue in international trade. The existence of widely differing tax structures as well as the potential use of tax provisions to alter trade flows for achieving short or long-term policy goals raises important policy questions in assessing U.S. export promotion policies and practices. First, one might ask what methods of border tax adjustments 1/ are consistent with tax neutrality, 2/ since tax neutrality would lead theoretically to the most efficient use of resources and maximize and services. Secondly, given the existence of and potential for export promotion tax practices in other countries, one might consider whether the United States should also pursue such practices, either independently as a policy goal or as a means of countering export promotion practices engaged in by other countries.

The public debate about export promotion practices and border tax adjustments has centered on two major issues: the current GATT rules which allow rebates of indirect taxes -- such as value added taxes (VAT) -- and

---

* Prepared by Jane Gravelle, Specialist in Taxation and Fiscal Policy, Economics Division, and Jonathan Sanford, Analyst in International Relations, Foreign Affairs and National Defense Division.

1/ Tax rebates or surcharges on exports and imports used to reduce distortions of international trade resulting from domestic taxes.

2/ Tax neutrality exists in this context when taxes do not distort the location of production by creating artificial incentives encouraging or discouraging production in a certain country.

national systems for deferring taxes on earnings from exports, either through special plans like the U.S. Domestic International Sales Corporation (DISC) or other programs that postpone income taxes on offshore sales subsidiaries (subsidiaries organizied in a foreign country through which a firm channels its exports).

Tax Structures of the Major Developed Countries

The major industrial countries differ significantly in the share of government revenues which come from different types of taxes as well as in the absolute levels of different taxes. These taxes as a percent of GNP are shown in Table 1. Compared to other countries, the United States tends to rely less heavily on indirect taxes (such as sales, excise, and value added taxes) and more heavily on direct taxes such as corporate, personal income, and property taxes. U.S. has relatively lower levels of personal income and payroll taxes and lower taxes in general.

Europeans have tended to emphasize the use of value added taxes, a tax generally 8 to 12 percent (depending on the commodity) levied on value added at each stage of the production process. The Canadians have a federal sales tax of 12 percent on many goods (excluding food, clothing, and other items) and local sales taxes as well, while the Japanese impose a tax of 5 to 30 percent on a limited number of items as well as selected excise taxes. In the United States, indirect taxes are generally imposed at the state and local level in the form of retail sales taxes at typical rates of around 4 to 5 percent. In addition, in the United States excise taxes are levied by both national and subnational governments on certain items such as alcohol, tobacco, motor fuels, and guns.

Corporate income taxes are levied by varying rates in the major industrialized countries. As Table 1 indicates, the variation between levels of corporate income taxes in terms of total percentage of GNP is much smaller (ranging from 1.5 percent to 5 percent) as compared with variations in indirect taxes which range from slightly over 3 percent to almost 14 percent of GNP.

Table 1

TAX COLLECTIONS AS A PERCENT OF
GROSS NATIONAL PRODUCT

Country	Corporate Income	Personal Income	Goods & Services	Social Security	Wealth and Property	Total Taxes
Australia	4.00	10.89	6.90	--	1.37	27.18
Austria	1.59	9.23	13.40	9.73	.62	38.14
Belgium	2.97	11.19	10.46	12.02	--	38.13
Canada	4.44	12.16	9.60	3.18	2.97	34.79
Denmark	1.51	24.91	13.96	2.68	1.95	46.68
France	3.13	4.06	12.41	15.72	.13	37.50
Germany	1.77	11.49	8.97	13.26	.83	37.64
Italy	1.65	4.86	10.31	13.31	.03	31.86
Japan	5.16	5.36	3.29	4.58	1.15	22.18
Netherlands	3.04	12.48	9.97	17.42	.84	45.18
Sweden	1.52	19.90	11.04	8.53	.18	44.21
Switzerland	2.13	9.10	5.17	7.40	1.43	26.21
United Kingdom	2.88	12.51	9.01	6.09	3.69	35.54
United States	3.17	9.82	4.71	6.66	3.50	28.93

SOURCE: OECD, Revenue Statistics, 1965-1974.

Value Added Taxes and Other Indirect Taxes

Because of the generally higher reliance on indirect taxes by other countries, some critics have charged that GATT rules, which allow rebate of indirect taxes on exports, have unfairly discriminated against U.S. exports.

As allowed by GATT, most countries generally rebate their indirect taxes on exports and impose comparable taxes on imports.[1/]

Under general application of this rule, U.S. goods which are exported abroad are eligible for rebate of U.S. indirect taxes paid. Sales, excise, and value added taxes are imposed in the countries to which U.S. goods are exported. Similarly, goods produced by foreign countries are eligible for rebate of their countries' taxes and are subject to U.S. excise and sales taxes when imported or sold. Most U.S. indirect taxes are retail sales taxes, so no taxes are rebated on those U.S. exports because no sales taxes have yet been paid. For countries using value added taxes, however, the exporter does get a rebate because the tax has been previous paid.

The rebate of taxes on exports and levying of them on imports does not discriminate against U.S. goods, however. U.S. goods sold, for example, in Germany would be subject to the same taxes German produced goods bear. If the German tax were 10 percent on an item then a German made good which would have sold at $100 in Germany would have its price raised to $110 due to the tax. A U.S. export to Germany also selling at $100 then would have its price raised to 110 due to the tax. If the U.S. retail sales tax rate were 5 percent, each good would be sold at $105 in the United States. This system results in no discrimination between imported and home produced goods in either country. In fact, if the German exporter subject to a value added tax were not allowed a rebate, its price entering the United States

---

1/ Countries also impose tariffs which restrict trade in specific items. Such tariffs are not considered, however, in this study.

would be \$110. The U.S. sales tax of 5 percent would raise it to \$115.50, and German goods sold in the United States would be discriminated against.

Therefore, GATT rules 1/ allowing rebates of indirect taxes are consistent with the goal of nondiscrimination between foreign and locally produced goods. Of course, different levels of excise taxes will affect consumption patterns (and this result may be the purpose of such taxes as illustrated by those on alcohol, tobacco, and luxury items). Thus, another country's tax system can affect U.S. exports depending on how heavily or lightly taxes are levied on goods the United States tends to export. The structure of these foreign indirect taxes, therefore, affects U.S. exports indirectly by affecting the patterns of consumption in a given country.

The debate over the effect of the value added tax on international trade is concisely summed up by the following quote from a study on the value added tax and the corporate income tax:

> Of the debate concerning the potential effects of a value added tax, none have been more confused than those concerning international trade....
>
> ...Most simply stated, there are no trade effects of a VAT per se.
>
> ...If the VAT is fully shifted forward, its effect on export prices relative to world prices and import prices relative to prices of domestic import competing goods will

---

1/ These rules are also consistent with removing the influence of taxes under a fixed exchange rate regime. However, fixed exchange rate systems interfere with international trade themselves. For a more extensive discussion of these issues, see the chapter on international public finance in Musgrave and Musgrave, Public Finance in Theory and Practice. (New York: McGraw-hill, 1976).

exempt rebated indirect taxes from the list of improper tax subsidies subject to countervailing duties from member countries. The Treasury Department has sought to avoid applications of the 1897 law that might hamper U.S. adherence to GATT standards in this area by means of special administrative rulings and careful interpretations of the U.S. legislation. In 1974, however, the Zenith Radio Corporation used new provisions in the Trade Act of 1974 to sue the Treasury in the U.S. courts for countervailing duties on Japanese electronics imports that had received rebates of the Japanese commodity tax. The Treasury countersued, seeking a declaration from the customs court that decades of congressional inactivity had effectively ratified the Department's interpretation of the 1897 statute. The United States Customs found in favor of Zenith in its April 12, 1977 decision while the U.S. Court of Customs and Patent Appeals ruled in favor of the Treasury on July 28, 1977.[1/] In a decision announced June 21, 1978, the U.S. Supreme Court upheld the Treasury Department position as it ruled 9-0 that the Japanese commodity tax is not a bounty or subsidy under terms of the nineteenth century law.[2/]

A similar suit was also recently brought dealing with European rebates of the value added tax. In 1975, United States Steel Corporation petitioned the Treasury for countervailing duties on steel products imported from

---

1/ Zenith Radio Corporation v. United States. United States Customs Court, C.D. 4691, No. 79-300637, April 12, 1977; U.S. Court of Customs and Patent Appeals, CAD 1195, 77-19, July 28, 1977.

2/ Washington Post, June 21, 1978, pp. A1, A9, D10 and D12. Zenith Radio Corporation v. United States. United States supreme Court 77-539, June 21, 1978.

Belgium, France, Italy, Luxembourg, the Netherlands, the United Kingdom, and West Germany which had received rebates of value added taxes. The Treasury denied the request, citing its administrative rulings. U.S. Steel later sued in the United States Customs Court for action to overturn the Treasury practice and require countervailing duties. The steel company applied unsuccessfully for a summary finding in its favor, when the original Zenith decision was announced by the U.S. Customs Court. 1/ It dropped the case after the Administration posed a broad-based price reference system to limit domestic U.S. steel competition from imported steel. 2/

The Zenith case posed major questions for American policy makers. Had the high court found for the U.S. electronics manufacturer, instead of the Government, the United States would have had domestic policies conflicted directly with those embodied in the GATT. It then would have been subject to retaliatory levies which other countries could impose on U.S. exports because of its violation of the GATT rules.

The Corporate Income Tax, DISC and Offshore Sales Subsidiaries

GATT rules do not allow for rebating of direct taxes, which are assumed to be borne by the factors of production to which they apply. If factor prices fall following the imposition of a tax then the tax does not affect the price of goods offered by firms. Of course, the demand patterns after collection and spending of tax revenues may differ from the demand generated

---

1/ See discussion of this case in White Paper, op. cit.

2/ Wall Street Journal, Mar. 2, 1978, p. 6.

by incomes prior to the tax but the location of production remains neutral when rebates are not allowed. In line with this basic assumption, payroll, income and corporate profits taxes cannot be treated in the same manner as indirect taxes.

Generally, our major trading partners tax corporate profits at rates similar to our own. There is less dissimilarity among countries in the levels of these taxes than there is in the case of indirect taxes. Despite this similarity, there has been criticism of the GATT rules which give the countries involved the option of rebating indirect taxes but not direct taxes. As noted in the previous section, the rebate of indirect taxes is consistent with neutrality. However, questions have been raised about whether it is proper to allow rebates of direct taxes because they have the partial effects of indirect taxes.

There are a number of circumstances in which taxes on a factor of production can result in relative price changes. Without a rebate, the result of relative price changes due to taxes is that the supply of goods for both home production and export has a different compositional mix than would have been the case if the tax had not been imposed. Even if a tax such as corporate income tax is partially shifted forward in consumer prices, however, it is still not the precise equivalent of an indirect tax since it has its impact on relative prices via its effects on factor proportions as well as level of production.

Given the likelihood that there will be at least some price effects as a result of the corporate profits tax, what is the desirable treatment of this tax to ensure the efficiency in the location of production? Some critics of the present system suggest the United States ought to consider rebating part of its direct taxes (like the corporate income tax) in order to respond to foreign rebates of the value added tax. Perhaps the first point to note is that even if the portion of the tax passed on to consumers were viewed as equivalent to indirect taxes, the border tax adjustment process would be extremely complex. It would be necessary to determine the effect of the corporate profits tax on the price of each product exported. This would be based on the effective tax rate in the exporting industry, its capital intensity, and the degree of shifting which has occurred. The amount representing the increased price due to the tax would be rebated. The importing country should at the same time impose a duty on imported products whose effect on prices is equal to that of its own income tax on domestically produced products. The tax on imported products also would be a function of effective tax rate, capital intensity, and the degree of shifting of the importing country.

In practical terms, such a system would appear to be unreasonably complicated and virtually impossible to set up. Furthermore, it may be asked, why should this rebate and tariff duty be limited to corporate income taxes? Why not allow it for payroll taxes, property taxes, and individual income taxes as well?

Given these apparent impracticalities, the implications of the two remaining alternatives need consideration: allowing no rebates of direct taxes and allowing rebates of all or a portion of the direct taxes.

Where rebates are not allowed (which is the general GATT rule even though in practice this rule is not always adhered to), there is some potential for distortion in the location of production (in cases where the price effect on the tax is high). These potential distortions are modified, however, by the existence of similar taxes in other countries. If these taxes are reasonably similar in level and impact across industries and if the industries in different countries are relatively similar in the degree of market power and capital intensity, any allocational effects which occur would tend to be insignificant.

If rebates are allowed for corporate income taxes in various countries and no import compensating duty is imposed, the general effects expected would be an increase in the physical volume of trade (although not necessarily in the revenue value of trade) and a shift in the composition of trade towards those products which are more capital intensive. The world, as a whole, ends up with a higher level of trade than would be optimal and with a less than optimal composition of trade.

Certain partial rebate provisions in various countries have the same effect as the latter situation of rebates with no compensation duty. In 1971 the United States enacted a provision which allowed for a deferral of a portion of corporate income taxes for corporations setting up a Domestic International Sales Corporation (DISC). In 1976 this provision was restricted to apply only to exports over a base period amount, thus reducing the effect of the provision. The Japanese also have a limited deferral system for profit taxes.

Some European countries allegedly permit indirectly forgiveness of corporate income taxes by their failure to tax income on a current basis when it is channeled through offshore sales subsidiaries. Many countries do not tax--or do not tax on a current basis--income earned by export sales subsidiaries incorporated abroad. Unless the allocation of income and deductions is properly policed, a firm producing domestically could potentially allocate most of its profits to a foreign incorporated sales subsidiary in a low tax country and not be subject to tax on its export profits.

Critics charge that, in France and possibly some other countries, official government policy allows the exporter to arrange its intra-company transfer prices on sales through foreign sales subsidiaries in such a way as to realize most of the profits in the foreign low tax country if it can show that this arrangement is necessary to meet the competition in foreign markets. Most other countries, including the United States, have provisions which allow deferral or exemption of tax on foreign earnings and the possibility of transferring profits to a sales subsidiary. The United States has taken steps to tax such income under provisions of the tax law which require certain tax haven income to be taxed on a current basis. In addition, considerable effort has been devoted by the U.S. Government to policing intracompany transactions.

In 1973, the Dutch, French, and Belgian governments brought action in the GATT to have the American DISC declared a violation of the rules, on the theory that deferred direct taxes for exports were explicit tax benefits prohibited under the international trading code. The United States brought simultaneous action to have the GATT void those provisions of French, Dutch, and Belgian law which allow their companies to escape taxation on almost all exports by use of exempt foreign sales subsidiaries. A special GATT panel considered the issue for some time before deciding in November 1976 that all four countries were violating the GATT rules through these direct tax practices. The U.S. Government moved to have the GATT accept the decision of the panel on all four cases; the European countries expressed reservations about the findings regarding their specific practices.

In assessing how and why DISC was adopted, it is essential to keep in mind that, when DISC was being considered and adopted in 1971, the world was on a fixed exchange rate system in which U.S. exports were often overpriced because of the overvalued status of the dollar. DISC provisions could be viewed under these circumstances as a "second best" short term solution to the exchange rate problem, but a justification which may no longer be relevant to the current floating exchange rate regime.

U.S. Response to Export Subsidies of Other Countries

Other countries have or are alleged to have various types of export subsidies, some of which operate through effective forgiveness of income taxes. A basic policy question which arises is how the United States should react to these general tax subsidies.

The starting point for examining the effect of these subsidies is to determine what effects a typical export subsidy has. Basically, such a subsidy initially increases the supply of exports and thereby reduces the price and increases the quantity of exports. This initial result will also alter the quantity of export revenues, inducing exchange rate adjustments. This in turn will ultimately affect both exports and imports. The final configuration of trade is dependent on the elasticities of supply and demand. One result is certain, however—a relatively larger physical quantity of exports will be required to purchase a given physical quantity of imports. This effect occurs because the export subsidy changes the terms of trade (relative prices of exports and imports) to favor other countries. Therefore, from the point of view of long term, overall national welfare, the United States benefits from other countries' export subsidies and it is harmed by its own export subsidies.

In examining the U.S. response to other countries' export subsidies, proponents of export subsidies often focus on the competitive edge that foreign exporters gain over U.S. exporters in third country markets. This advantage is seen as harming U.S. exporters and justifying a subsidy to help them. Two factors which are often overlooked in this context mitigate these effects, or suggest a different focus. First, any foreign export subsidy would increase U.S. imports and harm domestic producers who compete with these imports, a point often made by those favoring protective tariffs. Secondly, though, exchange rate pressures should adjust currency values to bring the balance of payments back into equilibrium in the long run. These effects may harm U.S. import competing industries more than U.S. exporters--and, in fact, given the elasticities of demand for imports and exports, such effects are likely. However, the exchange rate adjustments should modify all of these effects.

It is unlikely that any unilateral policy of the United States can restore the original position of U.S. exports and import competing industries. Given estimated elasticities of demand, adoption of an export subsidy as a response, while helping exporters, will harm import competing industries by increasing the total level of trade. It will also, as discussed above, tend to reduce the total aggregate welfare of the United States because of its effects on the level and terms of trade.

An alternative approach is to impose countervailing duties on subsidized imports. Proponents of protective tariffs stress this response. This approach tends to reduce the level of trade and in the process helps import competing industries and generally harms exporters. Its effect on total U.S. welfare is uncertain. The countervailing duty approach is the one sanctioned by GATT as a response to illegal export subsidies.

A third approach is simply to do nothing. The exchange rate adjustments which eventually should occur would tend to reduce any initial harmful effects on U.S. exporters and import competing industries, and U.S. welfare would be slightly improved. However, worldwide efficiency of trade would be reduced so that another approach might be to negotiate to remove such export subsidies.

PART B

EXPORT STIMULATION PROGRAMS: COUNTRY STUDIES

The first part of this study (Part A) contained an overview and analysis of the export promotion, financing, and tax programs of the United States and eight major Western industrial countries. This part of the paper contains nine chapters which detail the individual characteristics of these export stimulation programs in each of the countries.

Chapter IV

EXPORT STIMULATION IN CANADA*

INTRODUCTION

The Canadian Federal Government plays a modest but still significant role in promoting exports of Canadian goods. Increased exports are important to Canada for many reasons. A relatively small country Canada finds that 22 percent of its gross national product (GNP) is derived from exports, and that it depends on growth in its export sector to generate growth throughout the entire economy. Exports also account for a major share of Canada's total employment, and the government wants to promote exports in order to expand job opportunities for its citizens. In 1976, for instance, the Export Development Corporation (EDC) justified its program by claiming it helped Canadian exporters obtain C$2 billion (US $ = C$.97 at that time) in foreign contracts involving 200,000 new jobs for Canadian workers.

The Canadian Government has relied on a modest network of trade missions and representatives, trade fairs, foreign aid and export credit and insurance to help stimulate national exports. The Canadian export promotion program seeks to expand foreign interest in Canadian

---

*Prepared by John A. Costa, Analyst in International Relations, with the assistance of Laura Corr, Consultant. Information on specific government programs derived or condensed from the following Export Expansion Programs, "April 14, 1976; U.S. Department of Commerce, Bureau of Internanal Commerce study "Competition Export Promotion Programs: Selected Aspecta and Techniques," July 1971, revised April 1974; U.S. Export-Import Bank Report to the Congress on Export Credit Competition and the Export-Import Bank of the United States, June 1977; and Price Waterhouse Information Guide Doing Business in Canada, September 1975.

goods through trade fairs and missions, as well as through a special program for export market development. The Canadian provinces also engage in a great deal of export promotion activity. Canada has traditionally been reluctant to use direct export tax incentives to promote exports. However, it does have some indirect tax incentives which help encourage growth in the export sector.

The Export Development Corporation (EDC), a Canadian crown corporation, administers the Canadian export financing and insurance program. Only about 5 percent of total Canadian exports receive such official government support. Long-term export credits can receive EDC preferential fixed-rate financing, while short and medium-term export credit transactions are financed commercially at market rates. EDC export credit insurance covers specific political and commercial risks.

Canada and the United States have been each other's most important trading partners for many years. In 1974 Canada exported 66.3 percent of its total exports to the U.S. and imported 67.2 percent of its total imports from the U.S. Canada's other main trading partners are the EEC countries, particularly the United Kingdom, Japan and West Germany. Until 1973, the United Kingdom was Canada's second largest trading partner with approximately 6.5 percent of total exports. Since 1973, Japan has displaced the UK as the second largest trading partner. In 1974 Canada exported 6.9 percent of its products to Japan, and another 14 percent was sold to the United Kingdom as well as other members of the EEC. The Canadian government has been seeking to diversify its exports in recent years by encouraging trade with the developing world, the oil producing nations, and the Communist countries.

Major products which Canada exports include automobiles and parts, agricultural products, raw materials, and metals. Total exports reached $38.1 billion in 1976. They are broken down as follows: manufactured goods, C$23 billion; inedible raw materials, C$8.3 billion; food, feed and tobacco, C$4.1 billion; and other items, C$2.7 billion.

Like other major industrial countries, Canada has suffered recently from serious economic problems brought on by the international recession, inflation, and the energy crisis. Canada experienced its worst economic conditions in thirty years in 1975, and the government found it necessary to impose strict wage and price controls. In a March 1977 budget speech to Parliament, Finance Minister MacDonald said that the underlying momentum of the inflation seemed to be slowing but that the controls would continue. Wage settlements seem to have come into line with the government's anti-inflation guidelines while real income is rising. There continues to be a serious unemployment problem in Canada, however, as 5 percent of adult men, 7 percent of adult women, and over 14 percent of young people remain without jobs. There is also a need for additional capital investment in the economy.

EXPORT PROMOTION PROGRAMS

Department of Industry, Trade and Commerce

The Canadian export promotion program is run by the Department of Industry, Trade and Commerce (ITC) through the Office of Export Programs and Services (OEPS). OEPS has responsibility for planning and administering the federal government's two major promotion programs, the Trade Promotion Projects Program (PPP), which consists of government-initiated projects in which selected Canadian companies can participate; and the Program for Export Market Development (PEMD) in which the government offers assistance to projects initiated by Canadian companies operating either individually or collectively. OEPS works closely with other divisions of ITC, using the ten regional offices of the ITC in Canada and the Department's Trade Commissioner posts abroad to gather and disseminate information. Funds to support the operational expenses of OEPS and its programs are allocated annually from ITC's total budget.

The promotional strategy of OEPS programs, although coordinated by the Market Planning and Coordination Division within the Office, is developed through a procedure involving input from the top ITC administrators, the ITC international bureaus, Trade Commissioner posts abroad, and the Department's industry sector branches. The Market Planning and Coordination Division functions in a staff role to service the policy and program formulation needs of both PPP and PEMD programs. It works closely with other divisions of ITC and its responsibilities include:

(1) the systematic development of trade promotion programs in light of export opportunities and ITC resources; (2) assisting in the coordination of regional marketing programs and industry sector plans; (3) analysis of such plans in relation to existing marketing strategy and the obtaining of priorities which can be used by the Promotional Program Review Board to evaluate alternate uses of resources; (4) liaison on Federal-Provincial export market promotional planning; and (5) provision of secretariat services for the Promotional Program Review Board.

In late 1974 the Minister of ITC enunciated the overall Canadian export promotion strategy. Speaking to the Canadian Export Association, the Minister listed five "priority markets" which the Department had established as a guide for "investment of promotional dollars and services". In their apparent order of priority, they were: (1) less developed "takeoff" countries — Brazil, Mexico, Venezuela; (2) newly (oil) rich markets in the Middle East; (3) less developed aid program countries in Southeast Asia -- Philippines, Indonesia, Malaysia, Singapore, Thailand; (4) traditional markets -- E.E.C., U.S., Japan, Australia, New Zealand; and (5) special markets — Cuba and China. In addition, Eastern Europe appears to be another priority market being developed by the Canadian Government.

The Promotional Program Review Board has responsibility for reviewing all proposals for the Promotional Projects Program (PPP). Membership on the Board includes representatives of the Export Development and Industry Development divisions of ITC, the International Bureaus, and OEPS. The implementation divisions within OEPS have the responsibility for managing fairs, missions, and visitors programs after they have been approved by the Promotional Program Review Board.

According to some experts in export promotion programs, the planning and evaluation aspects of Canada's trade promotion program have been major problems. They state that no division in the Department of Industry, Trade and Commerce (ITC) bears clear responsibility for setting and coordinating long-range priorities.

The provinces of Quebec, Ontario, and Alberta also have major export promotion programs of their own, while Manitoba, Saskatchewan and British Columbia also engage in some trade promotion activities. The U.S. State Department indicates that New Brunswick, Nova Scotia, Prince Edward Island, and Newfoundland are generally less active in this area, except for promotion of tourism. The high level of provincial activity in export promotion is not surprising given the federal structure of the Canadian Government. All the provinces involved and ITC seem satisfied with the coordination and cooperation in trade promotion which exists between the two levels of government.

The Canadian Government works with private organizations which have an interest in trade promotion. In January, 1975, for example, the ITC announced an agreement with the Canadian Export Association for a series of monthly meetings between members of the Association and ITC to discuss subjects related to export promotion and the joint planning of seminars and conferences to acquaint the business community with trading opportunities. In one instance, Canadian trade commissioners posted in Latin America toured Canadian cities to address groups of businessmen organized by the Export Association. Such cooperation facilitates Canadian Government access to the business community and offers feedback to the Government on the merits of specific trade promotion techniques. The ITC also works with the Minister's Advisory Council, which was formed in 1969 to bring prominent businessmen, bankers, and professors together with the Government to discuss trade problems and prospective solutions. The ITC does not have joint programs with the private sector to actually implement export promotion concepts developed in these meetings, however, since private organizations and provincial governments do mount their own export promotion efforts.

The Canadian Government actively attempts to reach exporters and potential exporters both to create an interest in exporting and to create an awareness of ITC programs. This effort takes place predominantly through the Government's own channels — through its eight domestic field offices. These offices perform information dissemination services, answer trade questions, and assist in obtaining participants in trade fairs and other promotion programs. Their most important function is to develop exporting interest among potential exporters — particularly among smaller firms. In this they rely on a great deal of personal contact with individual firms. The ITC supplements the work of its field office personnel with an extensive program of domestic visits by Canada's overseas commercial officers. Publicity and advertising are also employed by the ITC to generate awareness of exporting and of ITC services.

34-201 O - 78 - 7

Government Programs and Techniques

The Canadian export promotion program, run by the ITC, is comparatively small and not concentrated on any particular group of companies by size or by degree of export sophistication. The ITC's means of achieving its new-to-export objectives are generally limited to trade fairs, informational publications, and the personal efforts of its field personnel.

The first major trade promotion program administered by the Office of Export Programs and Services (OEPS)--the Promotional Projects Program (PPP)--consists primarily of trade fairs, trade missions, and the sponsorship of trade visitors. Participation in PPP-sponsored trade missions is by special invitation of the Minister or his delegate. Members of a trade mission are usually obliged, upon their return, to submit a report which is made available to the industry at large.

The Canadian Government has recently favored participation targeted toward a specific industrial sector (vertically) rather than in fairs (horizontally) of a general nature. Solo exhibitions are occasionally organized in specific countries. The Canadian Government coordinates the design, construction, erection, and operation of the exhibits at all trade fairs but the costs for the trade fairs are shared with the participating companies.

Under the trade visitors program, the Canadian Government invites foreign government and business leaders to examine a particular Canadian industry or visit a domestic exhibition. A special Export-Oriented Training section of this program brings to Canada foreign technical trainees who are employees of potential customers or otherwise in a position to influence sales of Canadian products abroad.

Cost sharing formulas under the PPP program have changed over time. Until recently the cost of trade exhibits was shared with participating companies on a percentage basis. In April 1976 the basic participation fee which companies paid for trade shows in all areas of the world except the United States was C$300 for a minimum 100 square feet of exhibit space, with C$3 for each additional square foot. For trade shows in the United States the fees were C$400 and C$4 respectively. The Canadian Government paid the full cost of shipping a company's unsold exhibited products or displays back from the fair site to Canada. In addition, for trade fairs outside Western Europe and the United States, the Canadian Government paid one single round-trip economy air fare per participating company. For fairs in Western Europe, travel assistance was limited to a maximum of two and one-half economy round-trip air fares and could not be combined to make one single fare.

In mid-1971, the Canadian Government initiated a second major export promotion program which was designed to assist firms entering high risk markets. This program, known as the Program for Export Market Development (PEMD), has grown to include five components (PEMD A-E) offering specific forms of assistance indifferent situations. The first PEMD A, for instance, helps Canadian firms compete for capital projects abroad by defraying costs of exploratory studies and the preparation of initial proposals and bids.

The Canadian Government's normal contribution is C$70 for each day spent on the project by eligible personnel and 50% of transportation, special and unusual costs. This must be repaid in two equal installments six to twelve months after the signing of the contract. No repayment is necessary if the contract is not secured.

The second section, PEMD B, assists firms in identifying more precisely a potential foreign market or adapting to unfamiliar marketing practices which may require translations, technical advice, after-sales service, etc. The markets must be outside Canada and the continental USA. The Canadian Government's contribution is based on the same $70-50% formula as for PEMD A, and must be repaid if the export business is obtained.

Section three, PEMD C, encourages Canadian firms to participate in international trade fairs. This assistance is in addition to the ITC's program of establishing national booths at selected fairs. The Canadian Government's contribution is, again, C$70 per diem and 50% of other costs, subject to repayment on the same formula as for PEMD B.

The fourth section, PEMD D, encourages Canadian firms to invite foreign buyers to inspect Canadian manufacturing facilities. Buyers from the United States, however, are not eligible. The Canadian Government pays 50% of the buyer's air fare from the country of origin to an agreed upon destination in Canada plus C$25 per day for the length of the visit. If the firm obtains business as a result of the visit, the Government's contribution must be repaid on the formula for PEMD A.

The fifth, PEMD E, helps small and medium-size firms compete in export markets through the formation of consortia. Normally there should be at least five firms in the application, and the Canadian Government will support costs incurred in the formation and initial operation of the consortium. The Government's contribution is on the C$70-50 percent formula and should be repaid in the event a consortium is created. The amount of Canadian Government support to any one consortium will normally not exceed $50,000 per calendar year.

The Canadian Government's most recent export stimulation project is the Center for Joint Ventures and Turnkey Projects. This ITC Center facilitates Canadian bidding on major international projects by helping to identify the scheme, perhaps organizing a consortium, and then when approved, offering Canadian Government guarantees to the project. Unlike other export promotion programs, the Center is not administered by OEPS but rather by the Office of International Special Projects within the ITC.

The Trade Commissioner Service, an overseas arm of the ITC, will prepare brief market reports free of charge for Canadian firms. The reports vary from summary market surveys to more detailed studies. The latter cover local demand and preferences, domestic and third country competitive factors, sales and distribution requirements, any unusual features of local trading, terms of payment, tariffs, import and exchange controls, and other market factors and government regulations pertaining to the inquiring firms product. Summary reports are published in ITC's trade promotion magazine, "Foreign Trade," and more extensive reports are available.

Budget

In Fiscal Year 1976 the Canadian Government reported that its budget allocation for export promotion totaled C$12.8 million (US $13.2 million; US $1.00=C$.97) in contrast to the C$12.9 million (US $12.8 million; US $1.00=C$1.03) reported for Fiscal Year 1975. The two largest areas of budgetary support, 72 percent of the total, were allocated for joint export associations and other private sector support (C$5.1 million), and trade event support — trade missions — (C$4.1 million). The remainder was spent for such things as support of quasi-governmental trade promotion organizations, market research, information services, and domestic export interest stimulation.

Export Financing

The Canadian export financing program is administered by the Export Development Corporation (EDC), a Canadian Crown Corporation. The EDC is run by a twelve-member board which is responsible for all business done by the EDC for its own account. The board is chaired by the Deputy Minister of Industry, Trade and Commerce and includes the President of the EDC, five other senior government officials and five business representatives. Transactions which benefit the national interest but involve extraordinary risk or terms are referred to the

Minister of Industry, Trade, and Commerce, who may instruct EDC to provide support on the Government's account.

The EDC operates within statutory ceilings on both the direct credit and insurance and guarantee programs and is expected to be self-sustaining. It operates on a nonprofit, break-even basis and seeks to maintain a sufficient reserve to meet operating expenses and net claims. The EDC receives its funds by borrowing from the Government's Consolidated Revenue Fund; it is also authorized to borrow in the private capital market.

The EDC provides various forms of export credit, including (1) preferential fixed-rate financing of credits over five years, (2) Government-to-government lines of credit, often at preferential fixed interest rates, and (3) short-term and pre-shipment financing at market interest rates.

Some long-term export credits--those five years and over--benefit from preferential fixed-rate financing. All capital equipment or service exports with customary terms over five years -- and which have a Canadian content of 80 percent or more--are eligible for EDC support, but many sales are financed without official support. In addition, credits are extended to foreign buyers (buyers' credit) on EDC's account or, in the case of large export transactions considered to to be in the national interest, on the Government's account. EDC currently finances approximately 60 percent of the contract value--generally the later maturities--with commercial banks financing the remainder of the loan, following a downpayment of 15 to 20 percent. In certain cases, EDC may finance or guarantee a portion of the local costs. EDC does not extend suppliers credits directly to Canadian exporters.

The EDC's schedule of rates varies considerably, though they usually are somewhat above the agency's cost of funds. The actual rate charged varies from transaction to transaction and is based on a number of factors, particularly the competitive situation. The normal fixed rate was between 8.5 and 9.5 percent in 1976, and the typical blended rate to the borrower was about 9.2 percent, including EDC and commercial bank fees of about 0.2 percent.

In addition to interest rates the EDC and commercial banks impose the following fees: (1) a flat commitment fee of 0.5 percent to 1 percent; (2) a flat management fee of 0.25 percent to 0.5 percent; and (3) a fee for legal expenses actually incurred. EDC also charges a premium if it guarantees the commercial bank financing, anywhere from 0.5 percent to 1 percent per annum, depending on the credit risk. The combination of EDC direct credits and bank guarantees may cover up to 100 percent of the export credit.

Short and medium-term export credit transactions are financed privately at market rates. Charges range from 0.25 percent above the prevailing prime rate. Commercial banks do not require EDC guarantees for short and medium-term export financing.

The typical cost of funds to the borrower in 1976 under the Canadian export credit system varied with the repayment term of the credit according to the following schedule:

Repayment Term of Credit	Most Typical Basic Rate	Typical Cost of Funds Including Fees and Premiums: Good Credit Risk (Unguaranteed)	Typical Cost of Funds Including Fees and Premiums: Poor Credit Risk (Guaranteed)
Up to 5 years	Market Rate	10.5*	11.1*
5 years and over**	8.5-9.5	9.2	9.5

*Variable
**Where Preferentially Supported

Key features of the Canadian financing program are summarized below:

Percent of contract value usually supported	60
Are insurance of guarantees required?	No

	1975	1976
Statutory or budget ceiling (millions of U.S. $)	5,100	None
Outstanding credits	2,527	3,077
Credit authorizations	1,137	718
Credit disbursements	355	504
Credit disbursements as a share of capital goods exports	7.1	4.2
Outstanding lines of credit	850	n.a.

Export Insurance and Guarantees

The Export Development Corporation (EDC) provides Canadian firms with export credit insurance covering specific political and commercial risks. Approximately 75 percent of total official Canadian export credit support is in the form of insurance and guarantees. Insurance is provided by EDC either for its own account or for the Government's account. In all, the EDC insures Canadian exporters for the following classes of export transactions: (1) consumer goods sold on short-term credit; (2) capital goods sold on medium-term credit; and (3) services rendered to foreign customers. EDC also insures payment on credits for "invisible" exports such as the sale or licensing to a foreign customer of any right in a patent, trademark or copyright, advertising fees, auditors fees, etc. When a project is not acceptable under normal EDC criteria but is judged to be in the national interest by the Minister of Industry, Trade and Commerce, the EDC may underwrite it under the Government's authority.

For exports sold on short-term credit, a comprehensive policy is available which covers an exporter's entire export sale on an acceptable spread of risk for one year. Specific political and commercial risks are covered up to 90 percent of contract value. For exports sold on medium-term credit, specific policies are issued for each transaction. There are two types of medium-term policies for which coverage is not generally split: (1) contracts policy -- which provides coverage from the time an exporter receives the order until payment is received; and (2) ship ments policy -- which insures the exporter from the time of shipment only -- at lower premium rates. About 90 percent coverage is provided for specific commercial risks and 95 percent for political risks.

The political and commercial risks covered under the Canadian export credit insurance program are as: (1) insolvency of the buyer, (2) inability of buyer to pay within six months after due date, (3) repudiation of exports by a foreign buyer; (4) blockage of funds or transfer difficulties, (5) war or revolution in the buyer's country, and (6) cancellation or nonrenewal of an export permit beyond exporter's or buyers accountability. Specific coverages may be limited to specific phases of the pre-shipment and post-shipment periods.

The EDC may also issue, for a fee, unconditional guarantees to financial institutions which have agreed to provide medium-term, non-recourse supplier financing. These guarantees may be issued only for insurable sales of capital goods or services and can cover 100 percent of the export credit. As a further aid in financing, EDC will, at the request of policy holders, assign the proceeds of any losses payable under an insurance policy to a bank or other agent providing export financing. It should also be noted that EDC assess premiums according to individual risk based on length of credit and country of destination. The average medium term insurance rate, however, was approximately 0.61 percent per annum in 1976.

EXPORT TAX INCENTIVES

Foreign Branch and Affiliate Operations

A company in Canada which operates through an overseas branch office is subject to Canadian taxes on a current basis for its overseas branch profits. A credit for foreign taxes is allowed, however, and any overseas losses can be deducted from the parent company's other income in computing its taxes. Various conditions limit the degree to which losses in one year are available to offset income from another, including the nature of the loss and the continuity of ownership between the two periods.

A Canadian company that operates overseas through foreign affiliates has been subject to tax in Canada since 1976. Complex rules determine how the earnings from various overseas activities (property, capital gains, active or inactive business, etc.) will be included in the taxable income of the Canadian resident, whether or not it is remitted to Canada. A foreign affiliate is defined for this purpose as companies outside Canada in which the Canadian parent owns 10 percent or more of any class of the stock either directly or indirectly through another subsidiary.

The rules for taxation of dividends received from foreign affiliates are very complex. Until January 1976, most receipts were excluded from the taxable income of the Canadian corporation. Currently, however, dividend income is segretated into three basic categories for purposes of Canadian taxation: exempt dividends, taxable dividends, and pre-acquisition dividends. Different rules apply for determining the amount and levels of taxation for each of these groups.

Exempt dividends generally involve business income from foreign affiliates through 1975, or later if the foreign affiliate resides in a country which has a comprehensive tax treaty with Canada and the earnings are derived from the treaty country. The exempt dividends are not included in the taxable income of a Canadian corporation owning at least 10% of the stock of a foreign company, through they are taxable in other respects. Since the beginning of the 1976 tax year, a Canadian corporation has been able to deduct exempt dividends from its foreign subsidiaries and affiliates, so long as they are residing in a country which has entered into a tax treaty with Canada or is covered by similar legislation.

Taxable dividends include income or capital gains earned by a foreign affiliate which resides in or derives its income from a non-treaty country. The Canadian shareholder's income is subject to Canadian taxes as it is earned, whether or not it is remitted to Canada. Dividends from the taxable surplus are included in the taxable income for or from the Canadian shareholder, after an adjustment for the portion that includes capital gains already taxed. Canadian companies that own 10 percent or more of a foreign corporation may get some relief for underlying foreign taxes through deductions that allow for the foreign tax payments in computing Canadian taxes at the standard Canadian corporate tax rate.

Foreign Tax Credits

Canadian companies are usually eligible for tax credits on their Canadian taxes for income or profit taxes paid to a foreign country government or to a sub-division of a foreign country, up to the amount of Canadian taxes which would be otherwise payable on such income. This limitation is applied on a country-by-country basis and calculated separately for the firm's foreign business and investment income. Foreign income taxes which exceed this ceiling may be carried forward (but not back) for a period of five years.

Specific Export Tax Incentives

Canada traditionally has been hesitant about using direct export taxes to encourage exports. It has relied instead on a world-wide network of trade missions and representatives, trade fairs, foreign aid, and export credit and insurance facilities to encourage growth in its foreign trade and commerce. The Canadian Government published complex price and income control regulations on December 18, 1975, which affect national trading arrangements. A special anti-inflation levy has been proposed for export sales whose revenue exceeds the guide-line limits. Refunds of up to 90 percent of the money could be obtained for any investments in approved Canadian projects, and three-quarters of the levy would be returned to the exporter within ten years of the end of the anti-inflation program.

Other Considerations

The Income Tax Act has specific provisions relating to the purchase or sale of property to related firms. These provisions provide generally that transactions between related firms must be based on terms and prices which would be reasonable for parties with an arm's length relationship. The Canadian tax authorities have not issued clear guidelines in this area, in order to determine what is a reasonable price, but intercompany pricing policies and intercompany charges from ononresident affiliates to their Canadian subsidiaries have been subject to close scrutiny in recent years.

The Customs Act permits repayment of duty on imported goods used in manufacture of products for export and for imported materials used in manufacture of goods otherwise exempt from input duties.

ABBREVIATIONS

ITC — Canadian Federal Department of Industry, Trade, and Commerce

OEPS -- Office of Export Programs and Services, a unit of the ITC

PPP -- The Trade Promotional Projects Program, administered by OEPS

EDC -- Export Development Corporation, a government-owned company specializing in export credits and insurances operations

CHAPTER V

EXPORT STIMULATION IN FRANCE*

INTRODUCTION

The seventh French Economic Plan identifies the vigorous expansion of the export sector as the principal mechanism to offset a worsening trade deficit. Particular attention is to be paid to the imbalance of trade with the United States and to the promotion and expansion of markets in the U.S. for the smaller French companies. This focus was selected on the basis of three beliefs;

— the relatively small proportion of exporting firms is a major factor limiting the future expansion of French exports;

— large companies have well-established techniques and contacts and benefit little from government export promotion services in terms of increased exports; and

— smaller companies can compete internationally if they receive assistance in locating and penetrating foreign markets--assistance

---

* Prepared by Robert L. Beckman, Consultant and John A. Costa, Analyst in International Relations. Information on specific government programs derived or condensed from the following sources: U.S. Embassy, Paris, Airgram, "French Export Expansion Programs," April 27, 1976; U.S. Department of Commerce, Bureau of International Commerce study "Competitor Export Promotion Programs: Selected Aspects and Techniques," July 1971, revised April 1974; U.S. Export-Import Bank Report to the U.S. Congress on Export Credit Competition and the Export-Import Bank of the United States, June 1977; Arthur Anderson & Co., Statement on U.S. Companies in International Markets--the Competitive Factor in Tax Policy. Submitted to the U.S. Senate Finance Committee in conjunction with public hearings on H.R. 10612, 94th Congress, 2d Session, April 20, 1976.

34-201 O - 78 - 8

which the French feel export promotion programs are ideally suited to provide.

The Government of France has an extremely diversified export promotion program. Their official export credit and insurance system is reputed to be one of the most comprehensive in the world. The Directorate of Foreign Economic Relations (DREE) is the center of policy-making with regard to export promotion activities. A sub-division of the Ministry of Economy and Finance, the DREE reports both to that Minister and, since 1975, to the Minister of Foreign Trade. It also has links to the Ministry of Industry. The DREE has several major functions: it directs the commercial counselors at the French embassies and oversees the export promotion services of the French Center for Foreign Commerce (CFCE); it supervises the export finance and credit guarantee programs of French Insurance Company for Foreign Commerce (COFACE) and the French Bank for Foreign Commerce (BFCE); it coordinates the French interagency position on trade issues; it negotiates bilateral trade agreements, mostly with developing countries; and it participates and defines the French position in multilateral talks in the GATT, OECD, EEC, and other forums.

The French Center for Foreign Commerce is concerned with developing and disseminating information on foreign markets and identifying prospective foreign buyers. The CFCE has developed a tailored market exploration program, for instance, to help specific companies—small and medium sized firms with few export sales--break into overseas markets. The French Bank for Foreign Commerce and the Bank of France administer the preferential fixed-rate financing program, and the French Insurance Company for Foreign Commerce administers the insurance and guarantee program.

THE FRENCH ECONOMY

France is the second largest trading nation in Europe, after the Federal Republic of Germany, but it is less dependent on foreign trade than are most of its neighboring countries. Exports represented about 17% of the French GNP in 1975 and took roughly 47% of manufactured production--significant levels but less than the proportion recorded for other major European states. The French Government justifies its large export expansion efforts in terms of their impact on French employment and national income. In 1975 approximately 25%, and in 1976 39%, of all French exports received some official support from the French Government. Half the country's exports go to other member nations in the European Community, while another 10% goes to other major Western European countries and 5% to the United States. The French Government has tried in recent years to increase the country's export markets by expanding trade with the Middle East, Eastern Europe, and the Soviet Union. French exports are quite diversified, with steel, textiles, machinery, transport and electrical equipment, agricultural goods and chemicals being the most prominent. Despite repeated pronouncements about priority assistance to small and medium-sized firms, the emphasis of the French export stimulation programs continues to be on support for large firms that specialize in industrial goods.

The French economy is relatively sophisticated and dynamic, with about 12% of the labor force employed in the rather efficient agricultural sector and another 40% in the industrial sector. The French Government plays a larger direct role in the national economy than is the case for other Western European countries, with the possible exception of Italy. State planning has a long history in France, reaching back to Colbert, Napoleon and Saint Simon, and the government is a major force in French industry through its regulatory functions and its ownership and operation of major facilities, such as railroads, communications, banks, and key firms in the coal, electric power, gas automotive, aerospace, and capital goods industries. Some analysts have estimated that almost half of all investment in France is controlled by the state.

EXPORT PROMOTIONS PROGRAMS

The French Center of Foreign Commerce (CFCE)

Nature and role of the CFCE. The CFCE is an autonomous state-owned company managed by a Director appointed by the Minister of Economy and

Finance under the close supervision of the Directorate of Foreign Economic Relations (DREE). It has its own domestic administrative services and domestic field services. The French Government is represented on the Board of Directors, as is the case with any entity which receives a majority of its funds from state sources. A government representative exercises veto rights over CFCE decisions.

The CFCE is largely separate from the policy making and regulating agencies of the government. It is essentially concerned with developing and disseminating information on foreign markets and informing foreign buyers of the availability of French products and techniques. This involves:

-- programming and coordinating export promotion activities abroad in cooperation with French industry;

-- educating and supporting French exporters by providing statistical information, market surveys, commercial intelligence information about foreign firms, foreign trade regulations and procedures, trade leads, and information on foreign bids;

-- maintaining liaison with local French entities concerned with trade regulations, and international trade organizations;

-- providing information concerning agricultural exports, and insuring quality control over agricultural exports;

-- publishing Moniteur Official du Commerce International (MOCI), its biweekly magazine.

While its administrative regulations are basically in line with civil service regulations with regard to pay scales and retirement benefits, the CFCE does enjoy greater flexibility with respect to hiring high-caliber experts required for specific projects. In 1976 it had a staff of 520 persons and a budget of FF 75 million (5 francs = 1 dollar), including FF 54 million from government subsidies and the rest from self-financing (from fees for credit rating reports, publications, and participation in special events organized by the CFCE).

The CFCE was reorganized on March 1, 1976. It intends to improve its efficiency through establishing an advisory board with increased private sector participation, strengthening its domestic field services, and extensive structural and personnel changes. More decisions are to take place at the regional level. No additional budgetary resources are to be provided except for those by inflation.

To strengthen the ties between the CFCE and French trade associations, the latter will now be represented on the CFCE's Administrative Council. The new Council will have 33 private sector representatives, 9 of whom will be designated on the recommendation of trade organizations. The President of the CFMEE (see below) also will be the Vice-President of the CFCE.

In place of the four former divisions of the CFCE, four new divisions were created with the following responsibilities:

-- geographic areas (DRGS)

-- specific industry commodities (DMP)

-- promotion, marketing and information technology (DDI)

-- agri-food products (DPA)

The number of specialized geographic offices was increased and the responsibilities of these offices were expanded. Exporters' associations will be established to support these offices and commercial counselors will be called back on consultation more frequently.

The CFCE plans to concentrate more of its efforts on small and medium sized firms, particularly those firms which export little or nothing. In 1974, 33 firms accounted for 33 percent of all French exports. Another survey reveals that 1,363 firms accounted for 90 percent of total exports (whereas over 40,000 exporters were known to the French Customs).

The New-to-Export Market Drive. This program offers French firms a "diagnosis", at CFCE's partial expense, of their export prospects in specific foreign markets. With the personal assistance of consultants — retired specialists of the CFCE — a firm receives advice in directing studies, investigations, and internal adjustments needed to reach its export potential.

French commercial representatives abroad will assist the new potential exporter in the most promising markets after the candidate firm has entered into a market research contract. They will assist the candidate in establishing a research program, and a commercial specialist abroad will be detailed to accompany a visiting French businessman. In line with this close support, COFACE (see below) has a special insurance policy to cover exchange risks essentially for small exporters for periods of less than a year. The simplified policy applies to almost all countries.

The Individualized Market Exploration Program. This program aims at experienced exporting firms that are not sufficiently established in the North American market. To qualify for assistance under the program, the firm must export more than five percent of total sales but have less than ten percent of exports directed to the North American market. Companies selected for the program receive individualized mission planning services, but no direct financial subsidies. Representatives of eligible firms are accompanied on their visits to country markets by government export promotion officials. In 1973 a similar program was initiated to promote French exports in the United Kingdom.

Tailored Market Development, or market research, has been developed on another level to emphasize the needs of "pre-qualified" firms, regardless of size. When a company requests export development assistance, the Market Research Division of CFCE (PROMEX) evaluates the request to determine if the company has the ability to export and if its products have export potential. Regionally-based French commercial agents have a major input at this stage of the application process. Detailed information on individual firms is gathered and analyzed at the regional offices.

After PROMEX determines that a firm is qualified to receive export assistance, it signs a contract with the firm. Under this agreement, PROMEX consults with the firm concerning the development of an export plan and strategy. As part of its planning assistance, PROMEX, if deemed necessary, will analyze a particular market which appears to offer optimum export potential for the firm. The firm incurs all the costs for the market research and, in addition, contributes to a general fund to cover CFCE overhead expenses. Previously, the costs of market surveys were shared by CFCE and the individual firms.

Budgetary Control. The Ministry of Economy and Finance has final decision-making authority over CFCE's annual budget requests, giving the Ministry effective control over CFCE's objectives and activities. The normal practice is for the CFCE to submit an outline of its budgetary needs by program -- explaining why these efforts are considered essential -- to the Ministry's Bureau of Foreign Economic Relations (DREE) before the beginning of each fiscal year. The DREE establishes the overall budgetary level and discusses some program allocations.

One of the major advantages of CFCE's organizational structure as a "public establishment" relates to its ability to operate with greater budgetary flexibility than would be possible if it were a line organization within the Ministry. CFCE enjoys considerable freedom in the expenditure of its allocated funds during the course of the year. Although DREE acts as an overseer with regard to the CFCE expenditures and satisfies itself that CFCE actually spends in accordance with programs previously submitted and approved, DREE does not veto or control CFCE program expenditures in such a way as to modify substantially CFCE's activities. CFCE is considered to be the best judge of the appropriate trade promotion programs and events as well as the most able to provide relevant cost estimates. Any disagreements which emerge between CFCE and DREE are resolved by the Minister of Economy and Finance. It should also be noted that the Ministry possesses virtually complete authority over any CFCE management issue.

Commercial Offices Abroad

Other government entities are also involved in French export promotion either directly, with respect to agricultural products and military equipment, or indirectly, via technical and cultural exchange activities. In addition, the French Government seeks to promote key export industries, particularly aerospace, telecommunications, and computer goods.

The staff connected with French commercial offices abroad is extensive. In 1976, this amounted to 172 French commercial officers and 987 other French employees, 559 local employees hired on a temporary basis, and 200 draftees with business school training (or equivalent) doing their required national service. The U.S. State Department reports that the French spent FF 145.8 million for personnel engaged in economic expansion activities abroad.

In terms of the location of staff, they are concentrated for the most part in oil and other raw materials-producing countries and a number of developing countries, specifically: Brazil, Mexico, Venezuela, South Africa, Algeria, Libyia, Nigeria, Zaire, Iraq, Iran, Indonesia, Malaysia, Argentina, and the Philippines.

French Chambers of Commerce Abroad

French Chambers of Commerce abroad--which also represent Port Authorities, cities, etc.--are financed through membership fees, service fees, and modest subsidies from the CFCE (FF 700,000 in 1975). Government subsidies represent about fifteen percent of overall expenditures by the chambers, but their distribution is not uniform. In 1975, FF 320,000 went to chambers located in EEC countries, FF 200,000 to those in other OECD countries, FF 50,000 to the French Chamber of Commerce in Algeria, and the balance, some FF 125,000, was split among all others. Since there are no French Chambers in the OAPEC countries, the French-Arab Chamber of Commerce (largely subsidized by Arab countries) is the preferred vehicle for dealing with the Arab countries.

The French Committee for Foreign Economic Shows (CFMEE)

CFMEE organizes the participation of French exporters in selected trade fairs, single country or product shows, "French Weeks," etc. CFMEE, is housed in CFCE premises, though it is technically not a part of the government's trade promotion company.

CFMEE's activities in items 1 and 2 below were directed towards Eastern European countries and LDCs where there is not sufficient diversification to justify a specialized show. Out of 22 specialized shows (item 3) in 1974, 10 took place in Western Europe, 6 in North America, and 4 in Eastern European countries. Four "French Shows" were also organized by CFMEE in 1975:

-- Singapore's horizontal French show;

-- Moscow's equipment for the petroleum and chemical industries;

-- Participation in Europolia in Brussels;

-- Technical weeks in Warsaw

	1974	1975
1. Group participation in horizontal fairs	8	8
2. Business Information Centers in horizational fairs	9	6
3. Group participation in specialized international fairs	22	18
4. French expositions abroad	17	4
5. In-store promotions	8	6

CFMEE's budget was FF 16.7 million in 1975 and reached FF 18.7 million in 1976. Fair-insurance, whereby French participants are partially reimbursed for exhibit expenses if they have not realized incremental sales, cost the French government 38 million francs in 1975.

A recent development to increase the exposure of French products in Arab markets was the inauguration of a floating exhibition under the sponsorship of the French national maritime company. Sofremer (an acronym for Societe Francaise d'Etudes et de Realisation Maritimes, Portuaires et Navales) is an autonomous company with mixed public-private ownership operating under the general supervision of the Transportation Ministry. It was formed by the French government, the major shareholder, to promote French maritime techniques abroad, particularly in the fields of ports, shipyards, and maritime transport. Cooperating with CFMEE, Sofremer sent its floating exhibitions to visit several Arab ports in February and March 1976, showing industrialists and government officials a number of industrial products which the French would like to promote in that region.

The only trade center operated by the French is located in Tokyo. There are no present plans to establish additional trade centers, the stated reason being that trade initiation objectives are adequately achieved through extensive French participation in trade fairs throughout the world.

SOPEXA: Agricultural Exports

Though the CFCE devotes some resources (about $2.49 million in 1976) to promote French agricultural exports, the principal responsibility for government programs in this area lies with SOPEXA, the Society for the Expansion of Sales of Agricultural and Food Products. A quasi-governmental organization which receives most of its funds (FF 58 million of the FF 69.8 million budgeted in 1976) from the government, SOPEXA is concerned with market promotion of products other than field crops through participation in trade fairs and point-of-purchase promotions. Four of its 12 directors are named by FORMA, the French Agricultural Intervention Agency, while four are named by chambers of commerce and four by chambers of agriculture. Its annual budget is subject to review and approval by FORMA, and it operates under the general policy supervision of the DREE.

Another semi-governmental ogranization, the Interprofessional Cereals Board (ONIC), promotes cereal exports in cooperation with the French cereal producers association. Funded through checkoff fees, its activities include trade teams and promotional material, with special emphasis on grain sales in the European Community and flour exports to the Middle East. No figures are available concerning government subsidies.

Budget for Promotional Activities

As the previous discussion indicates, it seems the French Government spent approximately FF 382.5 million in fiscal 1976 ($80.72 million; $1=FF 4.74) for export promotion activities. As reported by the U.S. State Department, almost half this outlay was for personnel abroad in French commercial offices (FF 145.8 million). Some FF 75 million was budgeted in 1976 for the French Center of Foreign Commerce (CFCE), while an additional FF 18.7 million was allocated for the Committee on Foreign Economic Shows (CFMEE). The State Department also notes that another FF 46 million was budgeted for office equipment and miscellaneous expenses in the export promotion area. French Government outlays as a result of its fair insurance program also cost FF 38 million in 1976. The U.S. Agriculture Department indicates that the government subsidy to SOPEXA in 1976 was FF 58 million.

EXPORT FINANCE PROGRAMS

The BFCE and COFACE were both established in 1946. They are joint stock companies with a quasi-public status and conduct their business as commercial operations.

The French Bank of Foreign Commerce (BFCE)

BFCE is both a regular French commercial bank and the official French export credit bank. Its Board of Directors is made up of representatives from private banking, foreign trade, and organized labor. Two government commissioners are also appointed with a veto power. BFCE has no direct decision-making authority in the export-credit area; transactions that have been approved by COFACE or DREE for BFCE participation are routinely approved by the BFCC. There is no overall or annual statutory or budgetary ceiling.

BFCE finances its export credit activities primarily by borrowing in private capital market although it may also borrow from the French treasury. About one-half of BFCE placements have been in France and the remainder in the United States and the Euro-market. Approximately 60 percent of BFCE's assets are related to its official export credit activities and about 40 percent to its regular commercial banking functions.

Financing. Essentially all medium and long-term export credits benefit from preferential, fixed-rate financing from this government program. Medium-term export credits--with repayment terms from 18 months to seven years--are extended to French exporters or to foreign buyers by commercial banks at rates set in cooperation with the government. The banks may in turn discount with the Bank of France from 60 to 72.5 percent of the credit, depending on the repayment term and the market. The special Bank of France discount rate is set at a level which yields an acceptable rate of return to the commercial banks on the whole of the credit, as of March 1977, the discount rate on credits to countries outside the EEC was 4.5 percent, with an additional commission charge of about 1.05 percent, most of which is retained by the commercial bank. The portion of a medium-term credit not discounted with the Bank of France is financed from a pool of funds provided by the commercial banks.

For longer-term (i.e., more than seven years) export credits, the maturities for the first seven years are financed in the same way as medium-term export credits. The maturities in the later years are financed by the BFCE through a direct loan to the buyer or thorugh discounting credits extended to French exporters by their commercial banks.

The basic preferential interest rate set by the French government ranges from 6.3 to 7.5 percent, fixed, depending on the repayment term and the market — generally reflecting the minimum interest rate guidelines of the GATT Consensus Understanding on export credit standards. This rate, referred to as the "taux de sortie," results from the mixing of credits from a variety of sources as described above. Bank commitment and negotiation fees add roughly 0.2 percent annually to the cost of a buyer credit.

COFACE insurance (see following) is required on all transactions benefitting from preferential financing and having a repayment term over three years. Insurance premiums are set for five categories of markets and add roughly 0.5 to 2.4 percent annually to the cost of a credit, with the average premium around 1.0 percent annually.

34-201 O - 78 - 9

The typical cost of funds to the borrower under the French export credit system in 1976 varied with the repayment terms as follows:

Repayment Term of Credit	Most Typical Basic Rate	Typical Cost of Funds Including Fees and Premiums	
		Good Credit Risk	Poor Credit Risk
Less than 18 months	Market Rate	12.1*	13.1
Pre-shipment	9.0	9.7	10.7
2 to 5 years	***	8.0	9.0
Over 5 years	***	8.2	9.2

* Variable

*** Conforms to the interest rate minimums of the GATT Consensus Understanding

Key features of the French financing program are summarized below:

— Percent of contract value preferentially supported: 85

— Are insurance or guarantees required? Yes, for credits with repayment terms over three years.

	1975	1976
—Annual statutory or budgetary ceiling	-None-	
	(millions of U.S. dollars)	
— Outstanding credits*	1,913	1,799
— Credit authorizations (including direct and discount loans)	7,326	7,595
— Credit disbursements*	1,377	**
— Credit disbursements as a share of capital goods exports (percent)	10.7	**

* The figures relate only to the maturities financed directly by the BFCE.

** Not available

The French also combine foreign aid credits with export credits (mixed credits) for transactions in the national interest. Up to 50 percent of the contract value may be provided as a special credit on development aid terms, with an interest rate as low as 3.0 percent and 25 years repayment.

Medium and long-term credits with lower than normal interest rates are available in special circumstances. An example of French flexibility in this regard is the $2.8 billion line of credit to the Soviet Union in 1976. Long-term credits extended under this line carry an interest rate of 7.55 percent, including all fees and premiums. For Soviet projects of over $100 million, the interest rate is 7.2 percent, subject to an 8.5 year repayment term, a 20-percent cash payment, and no local cost financing.

The French have established extensive export credit lines with Poland and the Soviet Union. At present, these lines total over $4.3 billion. Only very large projects -- valued at over $100 million -- receive preferential support under the Soviet line.

The French Insurance Company for Foreign Commerce (COFACE)

COFACE has a board of 15 directors appointed by the government, of whom one-third represent insurance and banking interest, one-third business, and one-third labor. Two government commissioners, who have veto power, are also appointed. COFACE is free to make decisions on short-term commercial risks, which are for its own account, up to a ceiling. All other undertakings require the approval of DREE through a special joint ministerial committee. In practice, however, COFACE exercises substantial delegated authority and only certain large or extraordinary transactions are formally reviewed by the joint committee. These transactions may also be reviewed by the Bank of France. There is no overall or annual statutory or budgetary ceiling.

Insurance and guarantees. COFACE provides credit insurance covering specific commercial and political risks for up to 90 percent of the credit in the case of supplier credits, and for up to 95 percent of the credit in the case of buyer credits. For exports of consumer goods, commercial coverage is provided on a whole-turnover basis, while political risk coverage applies only to those countries individually selected. Exports of light capital goods may be covered by either individual or whole-turnover policies. Exports of heavy capital equipment are covered by individual policies. Insurance premiums are set for five market categories. The premium adds roughly 0.5 to 2.4 percent annually to the cost of the credit.

Exchange risk and inflation insurance. COFACE offers two extraordinary forms of insurance coverage: exchange-rate fluctautation insurance and inflation indemnity insurance. Exchange risk insurance protects against losses from exchange rate fluctuations exceeding 2.25 percent per annum for a premium charge of 0.36 percent per annum for currencies within the EEC "snake". For other currencies, the protection costs 0.65 percent per annum. When exchange rate gains exceed 2.25 percent per annum, the entire gain must be surrendered to COFACE.

Inflation risk coverage is also available through COFACE. For an annual fee of 1.0 percent, a French exporter can insure himself against the entire increase in his production costs that exceed 6.5 percent annually. The smallest eligible contract is $460,000 and contracts must involve capital goods with delivery periods for over one year. The estimated subsidy cost of this program to the French Treasury is approximately $500 million in 1977.

Total authorizations under the French export credit insurance program are summarized below:

	1975	1976
— Annual statutory or budgetary ceiling (millions of U.S. dollars)	- NONE -	
-- Outstanding insurance	15,490	24,477
— Insurance authorizations	19,626	21,920

EXPORT TAX INCENTIVES

Foreign Source Income

The principle of territorality applies in French taxes and only the income generated from activities within France is taxable. A company residing in France, conducting business operations through a branch in another country, generally is not subject to French tax on the foreign branch profits on a current basis. Similarly, losses sustained by the branch are currently not deductible against the domestic income of the parent company.

An exception to the general rule relating to the non-taxable foreign profits concerns the expenses of starting foreign operations (to include foreign sales, research, or information office or subsidiary). A deductible reserve for these expenses is permitted. This reserve, however, must be added to taxable income in equal installments during the sixth to tenth years following the year of deduction. Start-up costs related to sales and information or study offices located in foreign countries generally qualify for this treatment. The total allowable reserve varies according to the foreign country involved. For EEC countries, the total allowable annual reserve is equal to the losses incurred during each of the first five years, but the amount generally is limited to the capital invested during that period. For all other foreign countries, except those considered to be tax havens, the reserve is equal to the capital invested during the first five years, irrespective of the losses incurred.

A similar tax deduction is available in France for industrial operations in prescribed developing countries if prior approval is obtained from the Ministry of Economy and Finance. The amount of the deductible reserve is negotiated with the tax authorities but cannot exceed one-half of the funds invested in the first five years.

French law also provides that a taxpayer may enter into an agreement with the Minister of Finance to permit the inclusion of the results of foreign branch operations in taxable income. The Minister's consent is difficult to obtain, and this privilege has been granted to only about 20 companies in France. For these few companies, the tax paid to the foreign country is creditable against French income but only to the extent of 50 percent of the total.

In general, French-owned foreign subsidiaries do not have their profits taxed, nor may they deduct losses from the domestically-generated income. Dividends received from a 10 percent or more owned subsidiary are not taxable in France; however, expenses equal to 5 percent of any dividend received are deemed to be attributable to the tax-exempt income and are included in taxable income. If the parent company can show it incurred expenses of less than 5 percent of the distribution, the inclusion in taxable income is limited to the lesser amount. Dividend withholding taxes paid to the other country are not deductible.

An exception to the non-inclusion of subsidiary profits in current taxable income is available in the French tax structure. All foreign subsidiaries and branches may be consolidated in a single tax return. 1/ To be included, any subsidiary must be at least 50 percent owned. The use of this procedure requires the permission of the Minister of Finance; in practice, this permission is almost never given. A credit is allowed for foreign income taxes paid up to 50 percent of the foreign income.

The deduction for losses and subsequent return to taxable income is also applicable if the foreign subsidiary is at least 50 percent owned. Under those circumstances, current subsidiary losses can be offset against other taxable French income. French

---

1/ The advantage of either electing to compute French taxable income on worldwide basis by adding together the profits and losses of their French and foreign branch subsidiaries, or, alternatively, making a computation on a consolidated basis for all branches and subsidiaries, either domestic or foreign, is that losses from foreign operations can be used to eliminate otherwise taxable profits from French operations. This provision was enacted to put French oil companies on a par with the U.S. oil companies. Election of group taxation is not strictly limited to oil companies.

companies operating outside of France and granting medium-term loans are allowed to establish a reserve amounting to ten percent of the funds receivable from the loans which is deductible for tax purposes.

Royalties or the proceeds from the sale of patent rights received by a French company are taxible to French entities at a reduced rate of 15 percent. This rate applies to royalties resulting from agreements between affiliated entities when the licensee is a foreign company.

Foreign Tax Credit

The law in France does not provide specifically for a direct or deemed foreign tax credit, since most of the foreign income involved is not taxable. As noted above, there are provisions which allow for the consolidation of all foreign subsidiaries and branches or the inclusion of all branches in one tax return. In such circumstances, a credit is allowed against the French tax but may not exceed 50 percent of the foreign tax included in the return. The limitation is computed on a per country basis. There is a five-year carry over period for unused credits; if the taxes are not claimed as a credit during that period, they are automatically lost.

A foreign tax credit is allowed for certain withholding taxes applicable to taxable income if the credit is provided for in a treaty. Some treaties provide for a credit higher than the tax withheld, as an investment incentive. There is no provision for a carry-over or carry-back of an unused credit. If it cannot be utilized, it is forfeited.

There is no requirement in the French law for allocating direct or indirect expenses against foreign-source income for purpose of a foreign tax credit limitation.

Other Export Tax Incentives

French banks and exporting companies are allowed to create deductible reserves to cover the risks inherent in the extension of credit. The duration and amount of the reserves are limited, but this system in practice allows an exporting company to defer a portion of its taxable income from exports indefinitely. In addition, substantial tax advantages are accorded French companies which associate in a joint export program.

When small or medium-sized businesses coordinate to make a joint effort to improve their businesses and set up a company for that purpose, they can negotiate a tax agreement with the Minister of Economy and Finance. This so-called joint export program offers the following tax advantages:

— the shareholders' investment in the stock of the company is deductible in the year made;

— the company may depreciate its assets in the annual manner;

— capital gains upon the sale of shares in the company may be reinvested without taxation within one year in share of a similar company.

France also exempts exports from a special inflation levy law. A new law is aimed at fighting inflation by penalizing business "margin" increases which are not the result of an increase in employment, exports, or investment. It excludes from the margin computation all transactions which are made in connection with exports.

The French also use intracompany pricing rules to benefit their export market. Indeed, the French have issued an official circular specifically stating that the intracompany pricing rules should generally not be enforced in cases of sales between subsidiaries of exporting companies.[1/] These reallocation rules are instrumental in determining the extent to which income from exports can escape taxes or reduce the tax liability. Since foreign-source income is in one way or another substantially free of tax, and, if under the reallocation rules more of the income can be treated as foreign-source income, much of the income enjoys a reduced tax liability.

Value-Added Tax

The value-added tax system was gradually introduced in France after World War II for purposes of simplification and minimization

---

1/ Companies which posses an exporter's card may sell to foreign affiliates at a price approaching its cost, provided the transaction is motiviated by commercial necessity other than the desire to transfer profits abroad.

of tax fraud. The rate which applies on most transactions is twenty percent. France also adopted the zero-rating system by which exporters may recover the amount of taxes levied upon purchases of goods and services made in connection with the manufacturing or sale of goods to be exported. Finally, a "franchise" system is allowed for goods and materials imported, either to be exported as such, or after processing. This is provided so that an exporter can purchase at a zero tax rate goods or materials which are destined for exportation.

GLOSSARY

BFCE -- La Banque Francaise du Commerce Exterieure
The French Bank for Foreign Commerce

CFCE -- Le Centre Francaise du Commerce Exterieur
The French Center for Foreign Commerce

CFMEE -- Le Comite Francais du Manifestations Economiques a L'Etranger
The French Committee for Foreign Economic Shows

COFACE -- La Compagnie Francaise d'Assurance pour le Commerce Exterieur
The French Insurance Company for Foreign Commerce

DDI -- Direction de la Diffusion de l'Information
Bureau for the Dissemination of Information

DMP -- Direction des Moyens de Promotion
Bureau for the Means of Marketing

DPA -- Direction des Produits Agro-Alimentaires
Bureau for Agricultural Food Products

DREE -- Le Direction des Relations Economiques Exterieures
The Directorate of Foreign Economic Relations

DRGS -- Direction des Relations Geographiques Sectorielles
Bureau for Relations between Geographic Sectors

SPOEXA -- Society for the Expansion of Sales of Agricultural
and Food Products

CHAPTER VI

EXPORT STIMULATION IN THE FEDERAL REPUBLIC OF GERMANY*

INTRODUCTION

The Federal Republic of Germany is one of the world's major trading nations, but like Switzerland and the Netherlands it depends mainly on its private sector to promote and facilitate exports and has only a modest government program to stimulate foreign trade. The West German economy tends to be organized on the basis of laissez-faire economic principles and its private sector is relatively more independent of direct governmental management than is the case with most other advanced industrialized states. Private trade associations and overseas German Chambers of Commerce do most of the country's foreign marketing and commercial research, though the government does provide some assistance and subsidies in certain areas as it oversees these commercial activities. The government also supervises German participation in trade fairs and marketing exhibitions, though private firms are responsible for most of the actual operations in this area.

---

*Prepared by John A. Costa, Analyst in International Relations, with the assistance of Robert Beyer, Consultant. Information on specific government programs derived or condensed from the following sources: U.S. Embassy, Bonn, Airgram "Competitor Nations Export Expansion Programs," March 18, 1976; U.S. Department of Commerce, Bureau of International Commerce study "Competitor Export Promotion Programs: Selected Aspects and Techniques," July 1971, revised April 1974; U.S. Export-Import Bank Report to the U.S. Congress on Export Credit Competition and the Export-Import Bank of the United States, June 1977; Arthur Anderson & Co., Statement on U.S. Companies in International Markets--the Competitive Factor in Tax Policy. Submitted to the U.S. Senate Finance Committee in conjunction with public hearings on H.R. 10612, 94th Congress, 2d Session, April 20, 1976.

The private sector is also primarily responsible for financing most German exports, but the government does provide some discount credits to encourage exports to poorer countries. A program for direct loans through the official export credit agency and indirect loans through the private banks has been constrained lately by limited funds and tightened eligibility requirements, lessening its impact on trade with developing countries and sales from less competitive German industries.

THE WEST GERMAN ECONOMY

The Federal Republic of Germany (FRG) is today the second largest export nation in the world, after the United States, and the largest exporter of manufactured goods. Over half its total manufactures and 23 percent of its Gross National Product is involved in the export trade. In 1976, German exports increased by more than 15 percent and the country had a balance of payments surplus of over DM 34 billion ($14 billion) for the year.

West Germans enjoy a broad diversity in their exports which complement the needs of their trading partners. The FRG exported DM 256 billion ($104 million) in goods in 1976, most of it to the other countries of the EEC. The largest purchaser, France, bought DM 34 billion ($14 billion) in German goods in 1976, 14 percent of the FRG's total exports. The Netherlands accounted for another 10 percent and Belgium/Luxemburg and Italy another 8 percent each. The United States was one of the few countries that sold more to Germany in 1976 than it purchased. That year, the U.S. bought about DM 14.5 billion ($5.9 billion)—most of it automobiles—from the FRG.

Four major industries dominate the West German export picture, accounting for some 60 percent of its total export sales. The mechanical engineering industry led the way with 21 percent of all exports. Almost 62 percent of the country's machinery production went into international trade. Automobiles, chemicals and electrical equipment have also been very important, amounting to 15 percent, 15 percent and 11 percent respectively of the country's exports in 1976.

West Germany continues to have an admirable economic record. Its real growth rate was nearly 6 percent in 1976 and its inflation rate fell well below the level of most other industrial countries that year. The Federal Government's budget deficit also fell by DM 7 billion ($2.8 billion) during that period. Nevertheless, the Germans continue to have several serious problems affecting their economy. Labor costs are increasing and unemployment is higher in Germany than before, with over a million people lacking work. German goods are now more expensive, and therefore less competitive, in the international market due to the gradual appreciation of the Deutschemark against other national currencies. Economic growth has slowed and the rate of capital investment had declined as many German-based firms invest heavily in the United States and other foreign countries.

In spite of its present worries about the national economy and its export trade, the FRG continues to rely mainly on its traditional free market principles in managing the West Gemany economy. The relative strength of the German economy compared to its major competitors and the conservative official views of the government explain why the Bonn Government has proportionally one of the smallest export assistance programs of any of the major industrial countries.

EXPORT PROMOTION PROGRAMS

Public Agencies

The official West German export promotion program involves mainly activities which complement and facilitate private promotional efforts. There are three principal parts to the Federal Republic Government's program: (1) the Budestelle fur Aussenhandelsinformation (BfA), the Federal Office for Foreign Trade Information, (2) the commercial officers at diplomatic posts abroad, and (3) the Foreign Economics and Economic Development Assistance Division of the Federal Ministry of Economics.

The first of these government programs, the BfA, is a semi-autonomous agency in the Ministry of Economics established in 1951 primarily to gather, prepare, and furnish data on foreign markets and economic developments pertinent to the needs of West German exporters and foreign investors. The Central BfA office in Cologne employs about 150 people and is responsible to the Administrateive Council of the Ministry of Economics, a 32-member body whose members are drawn from government, industry, and the trade associations. The Administrative Council normally prepares the guidelines under which the BfA conducts its operations.

As an information service to industry, BfA maintains correspondents in major export markets throughout the world. These correspondents, although employed for BfA purposes, report to a subsidiary of BfA known as the Foreign Trade Information Center (GfA). This "separation" from government service is thought to facilitate the correspondents' information gathering ability. BfA also receives information from and furnishes information to overseas commercial officers and foreign German Chambers of Commerce. The information is finally disseminated to the business community through a number of sources, including the publication Nachrichten fur Aussenhandel (NfA) (the Daily Foreign Trade News).

Another component of the government trade promotion system is the Economic/Commercial sections of the German embassies and consulates abroad. According to a 1976 State Department report, the West Germans had roughly 120 staff members at 65 foreign posts working on export promotion and commercial tasks. The embassy sections (usually 1 or 2 people) devote 75 percent of their efforts to reporting on overseas economic policy and 25 percent to handling commercial inquiries. The time was divided fairly equally in the consulate sections. There generally appears to be open channels between GfA and the overseas offices which enhance information gathering efforts.

While trade fair programs are handled almost entirely by the private sector, a division of the Ministry of Economics carries out the third part of the government's program through oversight and some subsidies for the private sector. There exists in the Foreign Economics and Economics Assistance Division of the Ministry of Economics a small 15 member staff which is responsible for trade fair matters. Their functions are: 1) to serve on the Foreign Trade Fair Participation Committee, 2) to review and approve the committee's recommendations, 3) to prepare budget recommendation for the Bundestag (the West German Parliament), and 4) to select official contractors and disburse subsidies. Subsidies are disbursed directly to private trade fair contractors and essentially cover the costs of procuring and setting up display booths.

Private Organizations

Over the years, it has been the private sector that has played the most active and highly motivated role in export promotion. Essentially four groups play the primary role of helping industry expand its exports.

1) The German Chambers of Commerce abroad
2) The domestic Chambers of Commerce and Industry including the Deutsche Industrie and Handelstag (DIHT) plus trade associations
3) Ausstellungs und Messe-Ausschuss der Deutschen Wirtschaft (AUMA) (The German Council of Trade Fairs and Exhibitions)
4) the five official trade fair contractors.

The overseas German Chambers of Commerce perform many of the duties normally carried out by foreign commercial attaches of other countries. They assist in locating agents and distributors, reporting on business conditions, suggesting trade fair themes, publicizing German products and performing a variety of other commercial services including market research.

All of the 36 German Chambers of Commerce located abroad are in some way subsidized by the government. Despite relatively heavy subsidies (up to 80 percent, in some instances, and averaging around 40 percent) the organization remain completely autonomous. About 70 percent of the 400 overseas chambers of commerce employees are in countries which are members of OECD. The overseas chambers of commerce provide the main information gathering services in the private sector.

On the other end of the export information system are the Chambers of Commerce and Industry within West Germany. By law all companies are required to belong to local chambers, and in turn these local chambers belong to the National Chamber of Commerce (DIHT). It is the primary function of this organization to disseminate foreign trade and marketing information as well as advise industry on commercial matters. In contrast to the German Chambers of Commerce abroad, this organization is financed entirely by membership dues of the companies.

The trade fair program is almost entirely in the hands of the private sector. One organization, Ausstellungs and Mess-Ausschuss der Deutschen Wirtschaft (AUMA) - (the German Council of Trade Fairs and Exhibitions) is primarily responsible for setting up a coordinated working group between government and the private sector to submit proposals which determine the foreign trade fair activities of German industry. The AUMA employs 15 people at its office in Cologne who are responsible to a board of directors representing 30 leading German fair authorities and trade associations. This group receives no government support to operate its budget, although its publications are subsidized for trade promotion. The AUMA works with The National Chamber of Commerce, the Ministries of Economic and Foreign Affairs, German Chambers abroad, and with industrial and trade organization leaders in planning and scheduling trade fairs. The group known as the Foreign Trade Fair Participation Committee, however, has no responsibility for execution of any programs. Its recommendations are simply forwarded to the Ministry of Economics, which reviews the proposals and submits them in the annual trade budget to the Bundestag.

There are five official private trade fair contractors responsible for the execution of the trade fair programs. NOWEA is the largest contractor. Its home office, located in Dusseldorf, employs approximately 30 people for its foreign operation and 300 for its domestic operations. The four remaining contractors devote their time entirely to government sponsored fairs abroad. Each of the contractors generally specializes in fairs for certain geographic areas throughout the world.

The contractors provide nearly all required services to exhibitors including renting space, designing displays, setting up transportation arrangements for personnel and products, advertising and press releases, etc.

Trade Fair Techniques

With regard to the nature of the actual foreign trade fairs, two catagories emerge: 1) The "vertical" or specialized fairs which display only "theme" products and 2) the horizontal or universal fairs which display goods from a variety of German industries. There is some evidence that the specialized fairs are gaining in popularity, though German producers attend both types regularly.

The West German Government uses three types of trade fair techniques: 1) representative shows, 2) joint exhibitions and 3) business information booths. The most innovative are the representative shows, which allow German products to be displayed with or without a company representative. This was originally considered a relatively important step for trade promotion because it offered small and medium size firms the opportunity to display their products to markets where the cost and man-hour requirements had previously prohibited such exposure. International trade fairs often have a near-term focus, and the corporation may find its sales and distribution efforts hampered if no company representative is available. Representative shows are entirely sponsored by the government, with the only cost to producers being repayment of transportation costs on sold items and a percentage of rental space and shipping charges on large and/or heavy machinery.

A more traditional approach between business and industry is the joint exhibition. (This technique is comparable to U.S. trade fairs.) Essentially all costs are paid by individual firms except for booth construction, publicity and catalog entry fee. Since costs for these fairs are very expensive, smaller firms tend not to participate.

Business information booths are another official form of participation in trade fairs. The entire costs of these displays are carried by the government including travel expenses. However, recent figures show a marked decline in the use of this technique from 26 percent of the Government's trade fair outlay in 1974 to less than 9 percent in 1976.

Budget

The German Government export promotion expenditures are among the smallest of the industrialized nations. Table 1 gives a breakdown on Government promotion expenditures for the last two years. In 1976 support for trade events was cut from $6.8 million to $6.4 million while support to other areas increased modestly. In contrast, the private sector has shown increased support for export promotion. For example while joint exhibitions are the most costly of trade fair exhibits (since the government does not subsidize the displays and therefore the industry bears most costs), over the last few years they have increased from 55 percent to 76 percent of all types of exhibits.

Table 1

West Germany Government Export Promotion Expenditures

	($1,000) 1975	1976
Personnel costs of Government		
Trade Promotion Organization		
(Commercial Officers in dipl.	-	-
posts, subdivision of the Econ.		
Ministry, BfA)	NA	4,704
Market Research and Information		
Service (BfA)	1,252	1,293
Tradė Events Support: Trade Centers		
Trade Fairs		
(Economic & Foreign Affairs Min.)	-	-
Trade Missions	6,809	6,420
Domestic Stimulation	-	-
(Subdivision of Economic Min.		
Promotion)	NA	151
Joint Export Ass'ns & Other	-	-
Private Sector Support (German		
Chambers of Commerce abroad -	2,718	2,833
Economic Ministry)		
Advertising of German Fairs	-	-
abroad	70	78
Total Gross Costs		
	10,849	15,579

Source: U.S. State Department Airgram March 18, 1976

EXPORT FINANCE

Traditionally there has been a close relationship between the commercial and banking communities in West Germany which accounts in part for the modest size and limited scope of the official export finance program. There was significant expansion in the amount of government activity in this area during 1976, due to the slowdown in German economy and the softening of Germany competitiveness in the world market. Even so, the West Germans saw a smaller proportion of their exports benefiting from preferential financing that year than did any of the other large industrial countries.

The German export credit financing support program depends largely on two institutions. The first is the Ausfuhrkredit-Gesellschaft mbH (AKA) and the second is the Kreditanstalt fur Wiederaufbau (KfW). The AKA is a private corporation established in 1952, having as its shareholders 56 of Germany's leading commercial banks. Its purpose is to facilitate the financing of private export credits by pooling the resources of its members. They offer no special arrangements for short-term export credits with maturities of less than one year, since these are generally available through commercial banks. The KfW, on the other hand, is a government investment institution, established in 1948 to help finance reconstruction of the German economy. Its 32 member Board of Directors represents the Ministries of Finance, Foreign Affairs, Economics, Economic Cooperation, Agriculture, and Transport, five state Governments, the German municipalities, the Deutsche Bundesbank (the Central Bank), labor unions, and trade associations. Today its purpose is to extend official export credits for the sale of both capital goods to developing countries and German-built ships to all areas at fixed rates and on longer terms than are normally available commercially.

The AKA: Private Credits

The AKA provides medium term (generally 1 to 4 years) and long term (7 to 10 years) export credits to German exporters or suppliers and foreign buyers or importers. These credits may be extended by any of the 56 shareholder commercial banks under different credit funds.

Revolving credit lines amounting to over DM 8 billion ($3.3 billion) are availabe through AKA under 3 separate programs. (1) Under the "A" fund, AKA extends some supplier credits at variable market interest rates up to about 60 percent of the total contract value. The other 40 percent is usually financed by the member banks sponsoring the loan. Although 10 years is usually given as the maturity date of the loan, no official ceiling is held. (2) Under the "B" fund, AKA finances a limited supplier credit for a period of 1 to 4 years. With these special government credit rates, suppliers can finance about 50 percent of their loans at a substantial discount (in this case the supplier must finance 30 percent himself which can be done by borrowing under the "A" fund.) (3) Under the "C" fund, credit is extended to the buyer at market rates for a period of not more than five years. This is a recent form of financing (set up in 1969) by which the German exporter is paid on delivery or contract completion by a bank belong to the AKA, thus relieving him of the need to extend credit facilities to the importer.

Funds available for financing export programs are limited by the member banks' own liquidity for loans not officially supported, and by the ceiling on the special rediscount credit line which is extended by the Deutchsche Bundesbank.

As of January 1977 ceilings for the three different funds were as follows:

(1) "A" credit line not officially supported - DM 6.11 billion ($2.6 billion) a substantial increase from the previous years DM 3.76 billion ($1.6 billion)

(2) "B" credit line - eligible for rediscounting at the Bundesbank-the same, at DM 2.8 billion ($1.2 billion)

(3) "C" credit line-not officially supported. Contained within the overall A fund ceiling it has been raised substantially from about DM 1.4 billion ($0.6 billion) to DM 4.2 billion ($1.8 billion)

As the available funds have increased over the last year, interest rates have decreased for export loans. The floating "A" fund credit rate was 7.0 percent in 1977, down .3 percent from the 1976 rate. The special "B" fund rate in 1977 was at 5.0 percent (the discount rate of 3.5 percent plus the margin of 1.5 percent) holding steady from the year before, but it may vary over time as discount rates change. Credit from the "C" fund in 1977 carried either a floating rate of 7.25 percent (down .25 percent from the year before or a fixed rate of 9.0 percent for medium term and 9.5 percent for long term loans (down 1.0 percent and 0.5 percent respectfully).

In addition, a commitment fee charge of 0.6 percent and finance charge of 0.1 percent are imposed annually to the cost of the credit.

The KfW: Public Funds

The KfW direct lending program consists of a mix of credits from both domestic and foreign borrowers. It provides official export credits directly to foreign buyers or to German banks for relending to German suppliers. Virtually all its credit is long-term, with maturity dates ranging from 5 to 10 years, though there is no clearly defined maximum maturity.

Four principal catagories of external financing are available through KfW.

The fastest growth area of KfW activity involves export credits for developing countries. The amount of lending for capital goods and projects has risen substantially in the last two years, helped doubtlessly by a $800 million twelve-year credit (at 8 percent) to Brazil. Total credit authorizations for 1975 and 1976 were just over $1.6 billion for all countries.

Another important area of KfW financing involves export credits for the sale of German ships to developing and centrally-planned countries. While this is classified as "export financing," it is administered separately through a shipbuilding assistance program whose services are available to buyers from all countries. The KfW states in its 1976 annual report that this assistance is provided to exporters of German ships in order to compensate for the aid their foreign competitors receive from their own national governments. In recent years the vast majority of these credits have gone to European countries, particularly the Scandanavian nations. The terms for these credits meet OECD requirements, with a maximum maturity of seven years from delivery, and minimum rates of 30 percent down, and 8 percent funding.

A third catagory of KfW financial credit is the so called "untied" financial credits -- generally balance of payments loans, often provided multilaterally, or loans which ensure the supply of raw materials to the Germany economy. The KfW provides these direct balance-of-payments loans at the request of the federal government which subsidizes their interests rates and provide KfW a special guarantee on repayment of the loan. The raw material loans are made available to foreign mining interests as buyer's credits through German banks. Currently these loans run around 8.5 percent with normal maturity about 10 years.

The final category of financial credit under KfW is loans for German foreign investments. These loans make up less than $5 million of the total credit commitments of KfW and are geared toward small and medium sized firms in developing nations.

The following is a summary of AKA and KfW major authorizations under the German Governments programs:

<u>Refinancing (AKA B-fund) [$ millions]</u>

Percent of contract value preferentially supported	Up to 80
Are insurance or guarantees required?	Yes

	1975	1976
Annual statutory or budgetary ceiling	None	
Credit authorizations	$714	$409
Credit disbursements as share of capital goods exports (percent)	NA	

Direct Lending (KfW) [$ millions]

Percent of contract value usually preferentially supported:	45%
Are insurance or guaranteees required?	Yes

	1975	1976
Annual statutory or budgetary ceiling	None	
Outstanding credits	$1,280	$1,334
Credit authorizations	$ 538	$1,135
Credit Disbursements	$ 201	$ 392
Credit disbursements as share of capital goods export	0.7%	1.3%

Hermes: Export Insurance

The system of export credit insurance in Germany is provideded by Hermes, a private firm established in 1926 as a private joint-stock company specializing in private credit insurance. The government has to used Hermes as an agent since 1949 and offers official support enabling it to extend exchange risk insurance, and credit insurance and guarantees for political and commercial risks.

The FRG's export credit insurance system is centralized: all regulations, policy decisions and approval of individual export credit insurance policies are made by the government. In addition, the German Government has established an Interministerial Committee in Bonn, chaired by an official of the Ministry of Economics, on which the Ministries of Foreign Affairs, Finance, and Economic Cooperation are represented. The committee meets biweekly and is advised by Hermes and representatives of industry, banking, commerce, and export related sectors. The Ministry of Economics has the power of veto in committee.

Hermes usually insures all types of goods and services, including consumer and capital goods, construction projects, consignment projects, goods exhibited at trade fairs, and offshore inventory accumulations. It does, however, restrict its coverage on buyer's credits to capital goods or projects. Insurance is generally available for a single transaction, for all of an exporter's annual business with a single foreign customer, or for the entire export business of an exporter, regardless of the number of buyers or destinations. Single transactions and single customer coverage accounts for most of Hermes' outstanding insurance.

Maturities are normally limited to five years for capital goods and construction projects, but they may exceed these time periods to meet foreign competition. Hermes also limits maximum maturies of ten years on export credits for capital goods to developing nations.

Hermes is authorized to underwrite, for the account of the government, supplier and buyer credits up to 85 percent of their value against potential losses for specified commercial risks, and up to 90 percent of their value for political risks. At the present time, commercial risk insurance covers the insolvency of the buyer and protracted default (limited to the public buyer); political risk insurance covers noncommercial events beyond the control of the buyer or supplier, such as expropriations, moratoria on debt payments, exchange restrictions, and transfer delays. Percentage of coverage pertains to the financed, or credit, portion of an invoice.

Guarantees for political and other risks cover pre-delivery and post-delivery risks caused by major events or circumstances such as: (1) cancellation of an export license not due to fault of exporter; (2) cancellation a contract by a public buyer, (3) cancellation of previously valid import authority or other government restrictions rending importation impossible (4) transport or insurance charges owing to diversion of shipment caused by political events; (5) currency inconvertibility and transfer delays; and (6) outbreak of war, hostilities, civil commotion, etc., preventing payment by the buyer. Coverages may be limited, though, to specific phases of the pre-shipment and post-shipment periods and the maximum indemnity that can be paid is 85 to 90 percent of the loss.

Financial guarantees to commercial banks are provided by Hermes to support export credits of particular importance. There is, however, no significant interest rate reduction by commercial banks when Hermes provides such guarantees. Hermes also offers insurance against pre-shipment losses for some speciality manufactured goods. Coverage extending over the production period is available for up to 85 percent of production costs.

Premium rates charged by Hermes vary according to the amount insured, length of credit period, type of risk, and coverage. Since most of Hermes' policies are for single transactions or single markets, premium rates are considerably higher than those charged by export insurers who spread their risks over a number of markets. Typical premium rates average roughly 1.5 percent annually for private buyers and, although the rate is somewhat more complex, about 0.7 percent for public buyers.

Since 1972, Hermes has also provided coverage for exchange risks related to the United States dollar, the British pound sterling, and the Swiss franc. This coverage is limited to credits exceeding two years in maturity and only takes effect two years after a contract is signed. Realized exchange losses that exceed 3 percent will be compensated, and exchange gains in excess of three percent must be surrendered to Hermes. For a single currency: (1) a premium of 0.7 percent per annum is charged, plus a fee; and (2) for a combination of currencies, a premium of 0.6 percent per annum is charged, plus a fee.

EXPORT TAX INCENTIVES

The Federal Republic of Germany does have some tax rules that provide incentives for increased exports. For the most part, though, they are the result of basic principles of the income tax law and administrative procedures governing tax jurisdiction and foreign-source income, not guidelines established specifically to encourage German exports.

The Value-Added-Tax

Perhaps the most problem provoking tax systm which effects both exported and imported goods is the Value-Added-Tax (VAT). Since 1968 the VAT has been charged on the value added to each item at each stage from raw material purchases to finished product sale.

VAT was adopted because it maintains the surest method of accurate and complete tax collection within Germany and permits manufacturers and agents to segregate operating costs and taxes paid. However, this tax has drawn criticism within the government of West Germany as well as from outside its borders.

Critics argue that the Germans bias their system in favor of exports and against imports because they receive a rebate on the VAT and imports to West Germany have an import equalization tax imposed in order to include the VAT in the price of the good. In practice, though, the Germans have also sought to expand imports and cut exports in recent years through a a special turn over tax on exports and a tax refund on imports which equalizes import prices with domestic prices. The system can be manipulated to favor either exports or imports. In January 1978, the VAT on deliveries and services was increased to 12 percent, one percent more than the previous rate.

Foreign Source Income

Because of the double taxation treaties the Germans have negotiated with other countries; the German tax system exempts companies that have foreign branches from German taxes on their foreign earnings. In such cases, the right to tax profits rests with the country in which the "permanent establishment" exists. Similarly, the firm is not taxed for any losses that are not deductable under German income tax rules, but are deductable under foreign country's laws. Resident companies can apply for loss deductions on German taxes under provisions of the double taxation treaties, though their subsequent profits would also then be subject to German taxes.

These treaties set down eligibility requirements, specify which taxes qualify for which credits, and at times stipulate that both countries may tax income source. A business does not qualify for foreign tax credits if it may claim a deduction allocable to income taxable in Germany. On the other hand, no credit is given which exceeds the German tax allocable to the item.

Foreign source income may still receive very favorable treatment where no tax treaty exists. A German corporation is taxed at the rate of 51% but only on its undistributed profits. Profits which are intended for distribution to shareholders are taxed at the reduced rate of 15 percent. This provision applies to any type of income wherever derived.

A Germany corporation may establish a foreign sales subsidiary and not be subject to current taxation on the income of the foreign sales. The dividends are then taxable only when they are received from the foreign subsidiary. If the subsidiary is located in a developing nation, almost no tax is levied on the dividends.

Tax credits for partial ownership of subsidiaries are based on at least 25 percent holdings. The methods used to adjust and compute these credits is similar to procedures carried out in the U.S.

In certain situations losses in foreign subsidiaries are deductible by the German parent corporation. For instance, under the German Foreign Investment Law, a German corporation which directly owns at least 50 percent of the share capital of a foreign corporation (25 percent if the foreign corporation is located in a developing nation) may establish a tax deductible reserve for that portion of the foreign subsidiary's losses applicable to investments. However, the investments must have (1) either increased the parent's ownership to 50 percent or more or (2) when added to previous investments increased the ownership to at least 50 percent, and (3) must be at least 5 percent of the subsidiary's capital. There are also certain other prerequisites for establishing the tax deductible reserve. The foreign subsidiary must have income from industrial or commercial activities. The subsidiary's loss must be computed under German tax accounting rules, and any foreign tax incentives claimed must be disregarded.

In addition to the reserves based on current losses, other reserves may be established for certain investments made in developing countries (under the Developing Countries Tax Act). A transfer of 50 percent to 100 percent of the cost of an investment to the tax-free developing country reserve is permitted for six years. At the end of six years, the reserve must be credited to taxable profits in annual installments of at least one-sixth of the reserve.

Taxation at a flat rate is also available if it applies to foreign unincorporated entities or from an investment in a foreign commercial entity located in a non-tax treaty country. Because they are not allowed to fluctuate, these flat rate taxes (25 percent) become advantageous to the investor as the foreign tax rate decreases.

GLOSSARY

AKA: "Ausfuhrkredit Gesselschaft mbH" - Export Credit Corporation.

AUMA: "Ausstellungs und Messe-Ausschuss der Deutschen Wirtschaft" The German Council of Trade Fairs and Exhibitions.

BfA: "Bundestelle fur Aussenhandelsinformation"-The Federal Office for Foreign Trade Information.

Bundebank: The Federal Bank of West Germany

Bundestag: Lower House of the West German Legislature

DIHT: "Deutsche Industrie and Handelstag"-West German's National Chamber of Commerce

DM: Deutsche Mark

FRG: Federal Republic of Germany

GfA: "Gesellschaft fur Aussenhandels"- The Foreign Trade Information Center.

Hermes: "Kreditversicherungs-Aktiengesellschaft"- The Hermes Insurance Stock Corporation.

KfW: "Kreditanstalt fur Wiederaufbau"-Institution for Reconstruction.

CHAPTER VII

EXPORT STIMULATION IN ITALY*

INTRODUCTION

The Italian government is actively involved in encouraging exports, while its private sector plays a smaller role in stimulating and promoting Italian trade. The Instituto Nazionale per il Commercio Estero (ICE), a government agency responsible to the Ministry of Foreign Trade (MFT), oversees all export promotion programs. In particular, small and medium size companies are given all possible support. Participation in trade shows and fairs, Italian trade center activities, and trade missions and reverse trade missions are among ICE's major promotional activities. In addition, market research and advertising and domestic "awareness" campaigns are growing in importance. Business-government cooperation is not as well developed in Italy, though, as in many other major trading nations.

Exporters benefit from a number of tax incentives. The value added tax refund places exporters on an equal footing with foreign goods in foreign markets. Under this program, exporters recover the amount

---

*Prepared by Sallie M. Hicks, Consultant, and John A. Costa, Analyst in International Relations. Information on specific programs and agencies is derived or condensed from U.S. State Department Airgram "Competitor Nations Export Expansion Programs: Italy," April 16, 1976, by the U.S. Embassy, Italy; U.S. Department of Commerce, Bureau of International Commerce study "Competitor Export Promotion Programs: Selected Aspects and Techniques," July 1971, revised April 1974; U.S. Export-Import Bank Report to the Congress on Export Credit Competition and the Export-Import Bank of the United States, June 1977; and Authur Anderson & Co. Statement on U.S. Companies in International Markets--the Competitive Factor in Tax Policy submitted to the U.S. Senate Finance Committee in conjunction with public hearings on H.R. 10612, 94th Congress, 2d Session, April 20, 1976.

of taxes levied upon purchases of goods and services made in connection with the manufacturing or sale of goods that are to be exported. Foreign branch and subsidiary operations are also exempt from certain types of income tax.

The export credit program is administered by the Instituto Centrale per il credito a medio termine (Mediocredito Centrale). Mediocredito provides interest rate subsidies or refinancing on loans to special credit institutions which, in turn, provide credits. Export credits are also available from commercial banks, sometimes with government backing. In practice, credit programs are not as well funded as in other countries.

Export insurance and guarantee programs are administered by the Instituto Nazionale delle Assiourazioni (INA) of a special section within INA -- Sezione Speciale per l'assicurazione del credito all' esportazione (SACE). Coverage is provided for commercial and political risks. In addition, there are two other types of insurance: coverage against inflation and exchange rate fluctuation. Lack of funding, however, has resulted in the latter two programs remaining dormant in practice.

THE ITALIAN ECONOMY

While the Italian economy has grown significantly in the three postwar decades, Italy remains the poorest and least developed of the nine major industrial countries studied in this survey. Italy experienced a long period of export-led growth in the years before 1971 which helped modernize the economy and integrate it firmly into the contemporary European economic system. It continues to have problems, though, as it seeks to deal with lingering difficulties from the past. The agricultural sector has shrunk considerably, down to 18.8% of the total labor force in 1971 from 43.9% in 1951, but it remains very large and very inefficient by general European standards. A labor surplus economy with major population migration from the agrarian south to the industrial north, Italy still finds its industrial sector dominated by small firms in spite of the consolidations and transformations of the recent period. The public sector is much more extensive in Italy than in most other Western industrial countries, as the government has intervened directly to encourage change and growth in the national economy. Many basic industries in transportation and communications have long been nationalized, and a number of large government-controlled conglomerates are prominent in the chemical, steel, hydrocarbon, automotive, electrical, and other major industries. Autonomous state-owned or joint public-private companies are active in almost all sectors of the Italian economy.

The Italians have experienced successive periods of real economic growth and stagnation in the years since 1971. Political uncertainties, the energy crisis, world-wide recession, labor unrest, and the problems in bringing an underdeveloped, rural South in line with an industrial North are among the factors that have affected the economic outlook. In 1970 the country was experiencing a high rate of inflation and a slow rate of industrial growth. The government was partially successful in implementing programs to encourage production, but it was unable to bring inflation down to an acceptable level. As a result, the country was faced with a very large deficit in its balance of payments by 1973. The energy crisis of 1973-74 (with its concurrent rise in oil prices) was particularly hard on the economy of Italy--causing, for example, the trade deficit to climb at an alarming rate. The government initiated an austerity plan, including credit restrictions, tax increases, and import levies.

After the government eased its 1975 austerity measures and introduced programs to stimulate growth, production picked up so that in 1976 there was a 12.4 percent rate of industrial expansion. Gross domestic product (GDP) also grew by 5.6 percent, topping the pre-recession peak. The rate of inflation, however, rose to over 20 percent, and the trade deficit grew worse. Moreover, despite the economic activity, unemployment rose from 3.3 percent of the labor force (1975) to 3.7 percent (1976)--although underemployment (short-term work of less than 33 hours per week) did decrease. In 1976 there was also a sharp depreciation in the lira resulting not only from the economic situation but also from political uncertainties (in particular, the growing strength of the Communist Party in Italy). In mid-1976 the government initiated a stabilization program to reduce inflation, the growth of labor costs, public spending, speculation on the lira, and the deficit in the balance of payments. These measures included among other things tax increases, credit ceilings, currency controls, price increases on certain goods (e.g., gasoline), import restrictions, and export incentives.

Italy's future economic prospects are relatively brighter. If the lira remains reasonably stable and government programs are successful, the 1978 rate may decrease to around 11%. It is hoped that unemployment will also decrease. Both industrial management and the confederations of unions are cooperating with the government to bring about overall economic recovery. The unions have agreed to keep down wage demands. In addition, the International Monetary Fund (IMF) and the European Economic Community (EEC) have approved loans to Italy which will not only bolster Italy's reserves but also help restore international confidence in Italy's economic future. A positive long-term economic picture ultimately depends upon a number of factors including a stable political climate, cooperation of the labor force, the internal north-south integration of the economy, creation of new employment, a comprehensive energy plan, and development of investments and exports.

Italy has been plagued by a chronic trade deficit, over $6 billion in 1976, a steep increase from 1975, though its balance of payments deficits dropped from $2.6 billion in 1975 to merely $318 million in 1976. The government's stabilization program has sought to rectify the country's trade problems. In mid-1976 the government implemented temporary import controls to help restrain growth of imports, which expanded in 1976 by 15.2 percent while the volume of Italy's exports grew only 12.1 percent. The value added taxes on a number of imports were increased and a non-interest bearing three-month deposit of 50 percent was required on most foreign exchange purchases. A 7 to 10 percent tax on foreign exchange purchases was also imposed. Both the deposit and the tax were gradually phased out in mid-1977.

At the same time, the government has launched a "Buy Italian" campaign and has revised portions of the export credit and insurance law (see below). Italy's exports are an important part of its GNP -- accounting for over 20 percent. The country's major trading partners include EEC member countries (particularly West Germany and France) and the United States. The government has expressed concern that exports are too concentrated in terms of products, exporters, and markets. Thus, since the mid 1970s, Italy has been encouraging product diversification and fostering trade with the OPEC countries (particularly Libya, Saudi Arabia, and Iran) because of the need for petroleum. The country also maintains strong trade ties with East European countries.

EXPORT PROMOTION PROGRAMS

Administering Agent

Responsibility for Italy's export promotion program is highly centralized and rests with the Instituto Nazionale per il Commercio Estero (ICE). The Institute originally was established in 1926 to maintain quality control over exports of agricultural products; but as Italy became an industrialized nation, its functions were redefined to include the promotion of Italian exports and commercial relations in general.

ICE is a government agency; it reports to, and operates under the policy directives and budgetary control of, the Ministry of Foreign Trade (MFT). In practice, however, ICE operates largely as an independent and autonomous body. The Ministry of Foreign Trade confines itself to delineating ICE's objectives and to approving its strategic plans. ICE's financial needs are included as a separate item in the Ministry's own budget request to the Italian legislature, but once allocated for the year, funds may not be shifted from the ICE to the Ministry or vice versa. These government funds are ICE's prime source of income. Any revenue earned by ICE for its services is insignificant and is used to cover operating costs, rather than reallocated to support promotion activities.

ICE is headed by a President, who legally represents the Institute, shapes its policies, and directs its activities. Both he and the Vice-President are nominated by the Minister of Foreign Trade and appointed by the President of Italy. The Institute President and Vice-President may be regular civil servants or persons outside the administration. The chief operating executive, however, is the Director General. He is responsible for the management and coordination of ICE's various divisions, offices, and programs. The Director General is appointed by the President of the Insitute after consultation with the General Council. He is normally a career ICE employee, thus assuring a degree of managerial continuity.

ICE's top policymaking group is the General Council. This group is responsible for interpreting the Ministry of Foreign Trade's guidelines and directives, and for approving ICE's strategic and financial plans. The General Council is chaired by the President of ICE and includes representatives of the: 1) Ministry of Foreign Trade, 2) Economic and Financial Ministries, 3) Italian Exchange Control Board, 4) National Union of Chambers of Commerce, 5) National Association of Industry, Commerce, and Handicraft, 6) credit, insurance and labor sectors, and 7) Italy's foreign trade business community.

ICE's other policy-making group is the Executive Committee, which is responsible for elaborating on, and supervising the implementation of, the policies approved by the General Council as well as overseeing the technical operations of the Institute. The Executive Committee is a smaller group than the General Council, and it meets more frequently. Its membership is comprised of the President and Vice-President of ICE, three representatives from the Ministry of Foreign Trade, representatives from the Ministries of Treasury and Foreign Affairs, and one representative each from the banking, industry, commerce, and handicraft sectors.

As of 1976, ICE included a main office in Rome and a network of domestic field offices (37) and overseas offices (59). ICE's Rome headquarters is located in its own building separate from the Ministry of Foreign Trade. The headquarters is organized into three major components: 1) the Technical Executive Departments--responsible for export promotion, 2) the Inspecting Executive Departments--responsible for agricultural export quality control, and 3) the Administrative Executive Departments-responsible for accounting, personnel, and other administrative functions. Originally, ICE's domestic offices focused upon quality control in agriculture, but since the early 1970s these offices have begun to provide information services to small and medium sized firms interested in entering the export field. ICE's overseas offices, however, continue to provide the most important services in terms of export promotion programs (i.e., market surveys, promotion/exhibit assistance, distributor-location services, etc.). Each overseas office is headed by an Italian Trade Commissioner. These ICE offices are completely separate from the Italian Embassies and Commercial Consulate offices, and their staffs do not enjoy diplomatic status. ICE has nearly twice as many employees as its parent organization, the Ministry of Foreign Trade. Although members of its staff are considered government employees, they are not ranked as civil servants. ICE maintains its own entrance examinations, salary scales, pension plans, and so forth.

ICE officials generally express satisfaction with their semi-autonomous status -- or what they often call their "middle-ground" status. In their view, the fact that they remain somewhat independent from their Ministry allows for quicker and more effective action, provides them with more opportunities to involve the business community in their programs, and permits then to concentrate solely upon one interest -- export promotion.

Business-government cooperation. Business-government cooperation in export promotion is less developed in Italy than in many of the other major trading nations. Still, there are some manifestations of such cooperation. ICE, as noted, seeks to include representatives from private industry on its General Council which is concerned with planning programs for export promotion. Moreover, although Italy relies principally on ICE's foreign offices, it does subsidize its chambers of commerce abroad. (The chambers, however, tend to limit their contacts to businesses already established in foreign trade.) In addition, the domestic network of chambers of commerce are widespread, and the ICE has cooperated with them in encouraging local firms to engage export promotion programs. The private trade associations develop promotion events and then submit them to MFT for approval in order to obtain subsidies. (The net result is that the private organizations enjoy a degree of autonomy while public funds are saved by minimizing governmental intervention.) In 1976 this new trend was reflected by a sharp increase in the number of promotional events carried out by private trade associations. Of 350 events in 1976, 122 (34.8 percent) were carried out by private organizations; in 1975 only 44 (13.4 percent) of the total were scheduled by private associations.

Regional and local efforts. The Ministry of Foreign Trade and trade associations have expressed strong opposition to export promotion activities by regional and other local government agencies. Such efforts are thought to be ineffective and frequently affected by local political motives. Private firms are discouraged from participating in such programs.

Programs and Techniques

ICE's stated objectives are to facilitate business contacts overseas and to increase exports. Indeed, as noted, Italy has a serious need to increase its export volume in order to overcome a chronic trade deficit. To this end, ICE employs a number of promotional strategies -- trade fairs and shows, trade centers, trade missions, and so forth. Most of these are executed in conjunction with ICE offices abroad and are meant to generate interest and demand for Italian products in other countries. ICE has traditionally neglected the domestic side -- that is, generating interest among Italian exporters themselves to seek out new markets abroad.

Through its promotional activities, ICE attempts to assist primarily small and medium sized companies, and in fact, such companies do account for the vast majority of ICE expenditures and services. The government hopes, through assisting these small/medium firms, both to increase exports and to strengthen these companies. Large business organizations, it is felt, are in a better position to cope with promotion needs on their own. For the same reason, ICE gives priority to new-to-market firms rather than old-to-market firms. This, however, does not preclude the granting of program subsidies to large firms and old-to-market firms if their presence is thought necessary for a successful program or if they have a proven need for such funds.

Prior to 1976 it was necessary for ICE to secure advance approval from the Ministry of Foreign Trade for each promotional program and expenditure. This is no longer necessary. Some of the more important Italian export promotion programs include the following:

Trade shows and fairs. Exhibition of Italian products in foreign trade shows and fairs has been traditionally one of ICE's major promotional activities. For officially sanctioned exhibitions, ICE covers completely indirect costs (publicity, representational events, and the salary/travel of ICE officers assigned to the show) and divides with the participating firms the direct costs (per diem for non-resident ICE officers, contruction of displays, space rentals, guards, and cleaning). ICE normally pays about 80 percent of the direct costs and the participating firms about 20 percent. This ratio is not fixed so that there is variation from show to show, but the participating firms rarely contribute more than 50 percent of the direct costs. ICE also may partially cover travel expenses -- about 50 percent of the economy class air ticket for one person for each participating company -- for those shows held outside Europe. Exhibitors generally pay for shipment of their display merchandise, although in the past ICE has paid the return freight for unsold display merchandise.

In recent years ICE has favored supporting individual Italian exhibitors at trade shows and fairs approved and/or selected by ICE in addition to the support given to officially designated shows within its national pavillions or exhibit areas. Participants in these "non-official" shows receive from ICE between 30 and 35 percent of the cost of exhibit space rental fee (60 to 100 percent if the company is from southern Italy). ICE provides an office and staff to coordinate, publicize, and assist the Italian exhibits.

Solo trade shows. ICE organizes a number of product exhibitions in foreign countries that are not part of another show or fair. ICE pays all the costs of publicizing, organizing, and setting up the show, including rental of an exhibit hall and necessary overhead. Usually the Italian firms pay for the shipment of their products, although occasionally ICE pays the shipping costs of products for particular exhibitions. Lodging, subsistance, and travel expenses are the responsibility of the participants although there may be partial travel compensation, as above.

Trade centers. Italy operates one trade center in London and a second in Dusseldorf. In the early 1970s, ICE seemed to be disillusioned with trade centers as a promotional strategy. The Institute closed its center in Stockholm in 1970, expressing concern over the costs of maintaining a permanent facility as measured against returns in terms of trade. The Dusseldorf facility was opened in 1976, however, and there are plans for opening other centers. Financing is similar to trade fairs (officially sanctioned) where there is an Italian pavillion. The cost borne by each show participant, in other words, is roughly equivalent to what the firm would pay at an equivalent ICE sponsored exhibit.

Italian weeks. ICE occasionally cooperates with department stores in foreign countries in staging Italian Week exhibitions of consumer goods. ICE contributes a percentage of the direct expenses (usually 15 to 20 percent) of advertising, decoration of stores, and so forth.

Trade missions. Trade missions to foreign countries normally include both new-to-market and old-to-market firms so that there exists a mix of fresh ideas and hard experience. Many of the new firms, in fact, benefit from the contracts already developed by the older participant firms. In recent years a number of trade missions have been expanded to incorporate experts from several different areas -- economic, industrial, and technical experts as well as businessmen. The purpose of these missions transcends export promotion *per se* and includes also the promotion and encouragement of joint ventures, direct investment, technical assistance, and economic relations in general. ICE pays for economy class air ticket and other group travel expenses for those participating in the trade missions. The Institute also covers the cost of group meeting facilities, representational activities, and miscellaneous group expenses. Participants pay their own lodging, subsistence, and individual travel expenses.

Reverse trade missions. Reverse trade missions involve bringing selected foreign businessmen to Italy. The number of these missions has been increasing over the years due largely to the fostering of ties between Italy and the developing countries (particularly countries in the Middle East). Financing is similar to regular trade missions: ICE pays group travel expenses and the participants pay lodging and subsistence.

Market research and publicity. Market research and advertising are, of course, central to trade promotion activities. ICE pays for all market research undertaken in connection with trade promotion events. Italian foreign traders may also obtain from ICE reports on foreign firms. ICE produces its own publications abroad and also sponsors some advertising of Italian products in foreign publications. In addition, ICE will translate and publish at cost product catalogs for Italian firms interested in foreign trade.

One important innovation for Italy's export promotion program as a whole, but for market research in particular, is the establishment of an electronic data center at ICE headquarters in Rome. The date center will provide current information on specific markets, customs rates and regulations, requests for Italian products, and public tenders abroad. Video terminals will eventually link all ICE offices abroad and in Italy. Specific data will probably be supplied on a subscription basis to trade associations, chambers of commerce, and private firms.

Joint export associations. Since the early 1970s, ICE has been planning to establish joint export associations. The idea is for private contractors to join together into associations in order to spread the costs of marketing among several firms. The associations, in turn, would share with ICE the cost of overseas market research, advertising, publicity, distribution of technical data and samples, participation in trade exhibitions, international promotional travel, and training of sales and service personnel. Business earnings invested in joint export associations would be exempted from their applicable income tax. As of mid-1976, legislation to authorize Joint Export Associations was still pending.

Domestic awareness/education campaigns. The strategies outlined above rely primarily upon the services of ICE overseas offices. Domestically oriented export promotion programs, as mentioned earlier, have not been developed. In the past several years, however, Italian officials have been concerned over the relatively low degree of export awareness in the Italian business community -- particularly on the part of the smaller and medium sized firms for which promotion assistance is intended. Basically, these firms lack the information, managerial "know-how," and financial resources to explore and penetrate foreign markets on their own. Therefore, ICE has increased the number of its domestic offices (29 in 1971 and 37 in 1976) and is retraining its staff to handle education programs. ICE has been aided in its efforts by the local and regional chambers of commerce, agriculture, and industry.

Market Diversification

For the past several years, Italy has been interested in diversifying its export markets. It has gradually been expanding its operations in the Middle East. During 1976-77, Italy and individual OPEC countries began experimenting with barter arrangements whereby Italy was to receive petroleum (its largest import item) in return for particular Italian manufactured goods and services. Italy also maintains a trade relationship with the East European countries, the Soviet Union, and China. ICE's primary function there has been to act as a liasion between State-trading agencies and interested Italian businessmen. The major impediment to trade with these countries, however, has been financing rather than export promotion.

Export Promotion Expenditures

In 1976, the Italian Government spent over fifty-five billion lire (about $59.8 million) for export promotion programs. (See Table 1). Most of these funds, some 38 billion lire, were channeled through the Ministry of Foreign Trade or ICE to finance the export promotion programs discussed above. The State Department estimates that another 9.9 billion lire were spent by the Foreign Ministry to support the 183 commercial officers or commercial assistants who do reporting and promotional services at 96 foreign posts. The U.S. Agriculture Department also indicates that the Italian Agriculture Ministry spends an additional 1.58 billion lire to promote Italian agricultural exports in addition to the 1.19 billion lire spent by ICE for this purpose.

Table 1

Italian Export Promotion Expenditures, 1976,
by Category
(millions of lire)

Support of quasi-governmental and other trade promotion organizations	Lit 350
Publications and Media Services	900
Ministry of Foreign Trade expenses, including subsidies to private organizations for trade exhibitions	8,000
Market Research and Studies	7,145
Subsidy for ICE	18,100
Foreign Ministry Commercial Officers	9,000
Agriculture Ministry promotion programs	1,581
	Lit 55,976

EXPORT FINANCING PROGRAMS

Italian export credit support programs remain relatively uncompetitive with the programs offered by the world's top trading nations -- primarily, it would seem, because of inadequate funding. Italian programs include:

1) preferential fixed-rate financing for credits over two years

2) short-term and preshipment financing at market interest rates

3) "national interest" credits and preferential interest rates and terms

4) local cost financing

5) credit insurance for commercial and political risks.

Administering Agent

The Instituto Centrale per il credito a medio termine (Mediocredito Centrale) administers the preferential fixed-rate financing program. Mediocredito is a public institution that operates both in the export and domestic areas. It is directed by a nine-member Administrative Council appointed by the government and includes representatives drawn from the Treasury, Commerce, and Foreign Trade Ministries. There is also a fifteen-member General Council which is responsible for the formation of general policies. Mediocredito derives its operating funds from several sources, including an appropriated endowment fund. The agency may borrow from the national treasury or in the private capital market.

Normally Mediocredito does not lend funds directly; rather it provides interest rate subsidies and refinances loans to special credit institutions or special sections within some of the large commercial banks. In turn, these institution (which may be private companies or public agencies) and the special bank sections extend credit to Italian exporters (supplier credits) or to foreign buyers (buyer credits) at fixed preferential interest rates set in cooperation with the government. The four largest such institutions are IMI (partly state-owned), EFIBANCA, MEDIOBANCA, and ICIPU. A 1977 law (#227) now permits Mediocredito to provide interest rate subsidies directly to Italian exporters, foreign buyers, and banks authorized to engage in medium-term financing. This applies, however, only if the credits in questions are in foreign exchange (i.e, financed abroad).

Preferential Fixed-Rate Financing

The institutions engaged in export credit financing may receive for each credit an interest rate subsidy from Mediocredito that is equal to the difference between the preferential rate and an agreed rate of return; or they may refinace up to 85% of the export credit. In practice, the ceiling is closer to 75%, and Mediocredito's participation is often less. Mediocredito prefers to grant interest rate subsidies rather than to refinance loans — which entail greater public expenditure.

The typical interest rate paid by the borrower on medium and/or long-term credits varies depending upon the financing source. In 1976 Mediocredito's interest rates ranged from 8.0 to 9.0 percent fixed, depending on the type of goods involved and the amount of cash down-payment. These rates did not include insurance premiums (ranging from 0.5 to 0.9 percent annually depending on length of credit and risk involved) or bank fees (roughly 0.2 percent annually). Since Mediocredito's funds were entirely committed, it could only issue informal commitments to support export credits at these preferential rates if and when additional funds became available. Moreover, since the special institutions have had problems in raising capital, it has been difficult for exporters to obtain fixed-rate financing for that portion of the credit not supported by Mediocredito and for other export credits even at the usual medium-term credit rate (15 to 17% in 1976, including normal financing fees).

In practice, a limited amount of medium and long-term export credits have benefited from preferential fixed-rate financing. Although all exports with terms over two years are eligible for official support, there have been so many administrative and funding problems that many sales (particularly to European countries and the United States) are financed without official support or on market terms. Applications, for example, traditionally outpace available funds, and, during the course of a given year, funds allocated to Mediocredito have often been committed to credits approved during previous years. In 1975 only about 13 percent of the total Italian exports were officially supported. It is probable that this percentage fell in 1976 given the restricted availability of funds. Export credit authorizations in 1975 reached $2.9 billion, in 1976 they had fallen to $1.5 billion. Officials hope that the new 1977 export credit law will alleviate, in part, the funding problem of Mediocredito. Under the law new funds for Mediocredito's interest subsidizing operations are included as part of the central government budget. In the past, it was necessary for the Italian parliament to pass a special law each time Mediocredito required such funds. (Mediocredito's refinancing activity, which is based on capital contributions, will still depend special legislation.)

Short Term Credit

Short-term export credits (less than 24 months) and preshipment financing are provided by commercial banks at market interest rates, although since 1977 the law authorizes Mediocredito to provide interest subsidies on preshipment financing. (Commercial banks may also finance the early maturities of long-term credits, and some may now extend medium term export credits up to 15% of the combined demand and time deposits.) The 1976 effective cost on a one-year export credit which does not benefit from Mediocredito support was about 19.5 percent floating. This reflects the interest rate of the commercial bank financing -- around 16.75 percent as of June 1976 but varying during the life of the credit -- plus bank charges of 2.0 percent per annum and insurance fees that averaged about 0.75 percent per annum.

Lines of Credit

There are signs that the Italians have been attempting to be more aggressive in providing official support for exports. In October 1975, for example, Italy extended a $900 million line of credit to the Soviet Union and a $500 million line of credit to Poland.

Local Cost Financing

Local cost financing is sometimes provided by Mediocredito up to the amount of the cash payment and at the same rate as the underlying export credit.

Aid Credits

A clear separation is made under the law between commercial credits (as above) and aid credits. According to the 1977 law, Mediocredito will negotiate and extend through a new fund all aid credits. In the past, such credits were negotiated by the various medium-term special credit institutions.

EXPORT INSURANCE AND GUARANTEE PROGRAMS

A separate agency, the Instituto Nazionale delle Assicurazioni (INA), operates the Italian export insurance and guarantee programs. Among the programs offered are credit insurance for political and commercial risks, exchange rate fluctuation insurance, and inflation insurance (5 to 15 percent for fixed-price contracts). The latter two programs, however, have never been adequately funded and, as a result, have remained dormant.

Administering Agent

For a long time, Italian exporters had complained that the procedures for obtaining insurance coverage were too complicated and drawn out, and were geared only to the needs of large companies.

In 1977, therefore, the government passed a new law that established a special export insurance section (Sezione Speciale per l'Assicurazione del Credito all'Esportazione, SACE) within INA. The managing board of SACE consists of representatives from various relevant ministeries, INA, and Mediocredito. SACE is responsible primarily to the Ministry of the Treasury and reports to Parliament twice a year. It will, however, enjoy a degree of functional autonomy and a separate legal status. The purpose of SACE is to consolidate operations formerly dispersed among a number of other bodies. Such operations include: 1) application approvals for export credit insurance, 2) setting premium rates and percent coverage for insurance, 3) authorization and issuance of guarantees and insurance for medium-term export credits (one to five years), and 4) informal advance commitment of Mediocredito for the financing of such credits. Traditionally, it has taken an average of six months to complete the applications and review procedure; it is hoped that the time for the total procedure will be cut to ten days as a result of the establishment of SACE.

INA's export credit insurance program operates on the government's account, subject to an annual authorization ceiling. For short-term coverage there is a 5,000 billion lire revolving fund ($5.7 billion, at 1977 exchange rates) this has been effective since May 1977. For coverage of two years or longer, the ceiling is fixed each year by Parliament.

In 1976 the insurance ceiling was around $3 billion. That same year there were about $3.3 billion in authorizations. This was a decrease from 1975 when the ceiling was $5.3 billion and authorization reached $4.6 billion. The 1977 revision of the insurance law will enable (optimistically) about one-third of Italian exporters to receive coverage compared with a previous one-tenth. One-third is about equal to the portion of exporters covered by the insurance programs of other advanced industrial countries.

Export Credit Insurance Plan

INA offers insurance for political risks up to a maximum of 85% for short-term credits, 90% for medium and/or long-term credits, and up to 100% for financial guarantees. For medium and long term commercial risks INA offers insurance up to 85% of contract value. In practice, however, the INA generally lowers its coverage on larger credits. Prior to mid-1977, insurance for commercial risk on short-term credits was unavailable although INA could reinsure private insurance companies that, in turn, provided short-term commercial coverage. Since then, however, INA has been authorized to provide such coverage.

Insurance coverage is provided for up to five years beginning normally with shipment; treasury approval is required for cases over five years. For financial credits -- usually government-to-govenment loans -- terms of up to ten years may be supported. The INA will cover local costs and foreign content, usually up to the amount of the down-payment.

Premium rates charged by INA are calculated for five categories of markets. For political risks only, premiums range between 0.10 and 1.75 percent per annum for supplier and buyer credits of any length. Premiums for commercial risks, when insured in the past, have ranged between 0.50 and 2.50 percent per annum.

Types of Guarantees for Commercial and Political Risks

Specific guarantees for commercial risk cover pre-delivery and post-delivery risks caused by such major events or circumstances as insolvency of the buyer, or protracted default. The indemnity that can be paid is 10 to 85 percent of the loss, but INA rations coverage because of budgetary restrictions by only making it available on a declining basis. Thus, coverage is 85 percent of the financed portion for the first 200 million lire of contract value; from 201 to 400 million lire cover is 60 percent; from 410 to 600 million lire cover is 30 percent; and above 600 million lire it is 10 percent. However, when the aggregate of credits insured by an Italian exporter exceeds two billion lire, additional credits can be insured only up to 10 percent.

Guarantees for political and other risks cover pre-delivery and post-delivery risks caused by such major events or circumstances as: 1) cancellation of an export license not due to fault of the exporter, 2) cancellation of a contract by a public buyer, 3) cancellation of previously valid import authority or other government restrictions rendering importation impossible, 4) transport or insurance charges owing to diversion of shipment caused by political events, 5) currency inconvertibility and transfer delays, 6) outbreak of war, hostilities, civil commotion, natural catastrophes, etc., preventing payment by the buyer, and 7) requisition, expropriation, or other government intervention which prevents payment. Particular guarantees, however, may be limited to specific phases of the pre-shipment and post-shipment periods. The maximum indemnity that can be paid is 90 percent of the loss.

EXPORT TAX INCENTIVES

Foreign Branch and Subsidiary Operations

Business income in Italy is generally subject to two income taxes: a corporate tax at a rate of 35 percent and a local income tax at varying rates up to 14.7 percent. The foreign source income of an Italian company that operates through a branch in another country is subject to corporate income tax on a current basis. The local income tax, however, does not apply if the branch has separate management and accounting. Conversely, for corporate tax purposes, losses sustained by the foreign branch are currently deductible against the income of the parent company.

The undistributed profits of a foreign sales subsidiary of an Italian company are not currently taxable. (A subsidiary may be maintained either in a foreign country or in Italy if it does not sell in Italy.) Distributed profits are subject only to corporate income tax. Losses sustained by the foreign subsidiary are, in effect, allowed as deductions for income tax purposes. A provision in the law allows a company to reduce the carrying value of any investment not quoted on a stock exchange by the proportionate reduction in net book value of the subsidiary as reflected by its latest approved financial statements. If the subsidiary's stock is quoted on an exchange, a deduction is allowed to the Italian parent company to the extent necessary to reduce the investment to market price, based on the average price during the last quarter of the year.

To avoid double taxation on income, Italian corporations subject to the Italian corporate tax on foreign source incomes (i.e., dividends, branch profits, royalties, etc.) may claim a credit against the Italian corporate tax for foreign income taxes actually paid abroad. This foreign tax credit is a relatively new feature of Italian tax law (effective January 1, 1974). The credit depends upon the extent to which the foreign country is imposing the tax reciprocally allows a foreign tax credit. Thus, it is limited to the lower of: 1) actual taxes paid, 2) two-thirds of the corporate taxes where the foreign country allows a similar credit on income, 3) 25 percent of the corporate tax where the foreign country does not allow a reciprocal credit. For foreign branch operations, the credit applies to foreign income taxes imposed on branch profits. For foreign subsidiary operations, the credit can be claimed for withholding taxes on dividends paid, but not for the underlying foreign tax paid by the subsidiary itself.

Dividends are not subject to tax on income from moveable wealth. However, when an Italian company invests in a foreign company engaged in a similar business in Italy, that part of the dividend received by the Italian company (representing income produced in Italy by the foreign company) may be subjected to the tax on income from moveable wealth. Dividends are treated, in other words, as part of the business income of the Italian company for purposes of corporation tax.

Value Added Tax

In 1973 the Value Added Tax (VAT) replaced the General Sales Tax. The sales tax was a turnover tax -- applied whenever a good changed hands so that, by the time a product reached the consumer, its price reflected the total of all taxes incurred during the production process. In contrast, the VAT spreads the tax out over the whole production process and assesses only the increased value of the article in the transaction. The standard VAT rate in Italy is 12 percent. The amount of tax does vary, however; the rate for luxury items may reach as high as 30 percent, while the rate for certain goods may fall well below 12 percent. As with other EEC countries, companies engaged in export may recover the amount of VAT levied upon the purchases of goods and services made in connection with the manfacturing and sale of products for export. This includes purchases made in Italy but excludes food imported for use by Italian exporters. The refund of VAT is designed to promote export of Italian products and place them on an equal footing with foreign goods and foreign markets.

GLOSSARY OF ACRONYMS AND TERMS

ICE — Instituto Naxionale per il Commercio Estero (National Institute for Foreign Trade)

IGE -- General Sales Tax (turnover tax)

INA -- Instituto Nazionale delle Assicurazioni (National Institute of Insurance)

IVA — imposta valore aggiunto (Valued Added Tax, known in the U.S. as VAT)

Mediocredito Centrale — Instituto Centrale per il credito a medio termine (Central Institute for Medium-Term Credit)

MFT -- Ministry of Foreign Trade (known in Italy also as Mincomes)

SACE — Sezione Speciale per l'assicurazione del credito all'esportazione (Special Section for the Insurance of Export Credits)

EXCHANGE RATES (LIRE PER DOLLAR)

653 for current 1975 values
840 for current 1976 values
884 for current 1977 values

CHAPTER VIII

EXPORT STIMULATION IN JAPAN*

INTRODUCTION

Japan was the first Asian nation to transform its economy from an agricultural to a modern industrial base and take a major place in the international economic system. Its growth and development were achieved on the basis of a market economy that differs substantially from other OECD economies. In 1975, Japan's gross national product was $480 billion, the third largest in the world. The country's per capita income ranked thirteenth among the countries of the world.

The Japanese islands encompass a land area approximately the size of California, of which only one-sixth is arable. It is also the most resource poor of any major economy and, hence, depends heavily on imported resources. The percentage of imports to total domestic consumption in 1975 was 100 percent for oil, bauxite, and iron ore, 97 percent for copper ore, and 87 percent for coking coal. Raw materials imports account for 17 percent of Japan's total imports, including 44 percent of her fuel, about 15 percent of her food, and 20 percent of her manufactured goods. Major sources of imports include the United States, Saudi Arabia, Iran, Australia, Indonesia, and Canada.

---

*Prepared by Geoffrey B. Hurwitz, consultant, and John A. Costa, Analyst in International Relations. Information or specific agencies and programs was derived or condensed from the following sources: U.S. Embassy, Paris, Airgram "Competitor Nation Export Expansion Programs-Japan," April 20, 1976; U.S. Export-Import Bank Report to the Congress on Export Credit Competition and the Export-Import Bank of the United States, June 1977; and Arthur Anderson & Co., Statement on U.S. Companies in International Markets--the Competitive Factor in Tax Policy. Submitted to the U.S. Senate Finance Committee in conjunction with public hearings on H.R. 10612, 94th Congress, 2d Session, April 20, 1976.

Although the economy is based on a free enterprise system, it is characterized by a close, cooperative, and mutually supportive relationship between government and business. This relationship is quite evident in Japan's export promotion program, which has been nurtured and directed in part by administrative advice from government ministries and agencies. The system rewards private initiative, but individuality is somewhat tempered by the tendency of business to cooperate with government policies and to respect national planning goals. While the government plays a decisive role in directing the course of the economy, guidelines for the operation of the system have been pragmatic rather than doctrinaire.

One of the outstanding aspects of Japan's economic ascendancy has been the phenomenal growth in total trade, with exports increasing from the equivalent of U.S. $12,972 million to U.S. $55,743 million between 1968 and 1976 (see table 1, below).

Table 1

External Trade
(U.S. $ Million)

	1968	1969	1970	1971	1972	1973	1974	1975	1976
Imports	12,987	15,024	18,881	19,712	23,471	38,314	62,110	57,863	64,800
Exports	12,972	15,990	19,318	24,019	28,591	36,930	55,536	55,536	67,200

This strong export performance has been a major factor in Japan's sustained economic growth and in Japan's perennial strong balance of payments position.

Exports continued to grow during 1977, despite a policy to promote imports, and the trade surplus was nearly $10.6 billion.

Principal export items include iron and steel, ships, automobiles, radios, televisions, and cameras. The major recipient of Japanese exports is the United States (U.S. $11.1 billion in 1975). Other major markets for Japanese products include the other countries of Asia, the United Kingdom, Australia, and the Soviet Union.

Japan's share of total world exports was 7.5 percent in 1976 compared to 6.9 percent in 1970. However, the country's share of world exports of manufactured goods was over 14 percent in 1976. The ratio of Japanese exports to GNP was 12.1 percent in 1976 compared to 9.8 percent in 1970, a fairly low ratio when measured against the GNP/export ratios of most other OECD countries.

The Japanese Government's export promotion program is considered by many to be one of the best. The Ministry of International Trade and Industry (MITI) formulates Japan's trade promotion policies, while the Japanese External Trade Organization (JETRO) carries them out. MITI and JETRO export promotion activities are also related to other economic objectives, such as maintaining a favorable balance of payments position with other countries. Developed country markets, particularly OECD nations, receive the bulk of JETRO attention, but JETRO also carries out programs in the developing countries. JETRO makes use of other government agencies and personnel, as well as the private sector.

JETRO trade fairs take place across the globe. JETRO underwrites the cost of travel for overseas representatives to conduct market research, operates a reverse mission/visitor exchange program, and maintains sophisticated information retrieval systems.

The Japanese Government provides a number of direct incentives for exports. In particular, companies may deduct: (1) a certain amount of their taxable income from exports for overseas market development; (2) overseas investment losses; (3) foreign exchange losses; (4) certain entertainment costs; and (5) an export allowance. While Japan imposes an excise tax on some imported commodities, commodities exported are exempt from the tax. Japan also has a number of indirect tax incentives for exports.

The Japanese official export credit program is extensive. Official credit support is provided by the Export-Import Bank of Japan (Eximbank). Japanese suppliers and buyers can receive Eximbank medium and long-term credits, in conjunction with medium-term funds from private commercial banks.

Export insurance is granted by the Export Insurance Division of MITI. An extensive insurance program covers general exports, export proceeds, and export bills. The U.S. Eximbank reports that about 49 percent of total Japanese exports benefited from official Japanese Government credit and insurance support in 1976.

EXPORT PROMOTION ACTIVITIES

Organization of Activities

The Ministry of International Trade and Industry (MITI) is preeminent in the formulation of Japan's trade promotion policies and is most responsible for assuring that these policies are implemented. While most of the Japanese Government's export promotion programs are funded as part of the MITI budget, they are largely carried out by a special agency, the Nippon Boeki Shinkokai or Japan External Trade Organization (JETRO). JETRO is an organization controlled by MITI but receiving part of its operational funds from the private sector.

In addition to its supervisory responsibilities and financial support of the trade promotion activities of JETRO, MITI also conducts several other types of programs related to exports. The programs include: (1) general supervision of the export promotion financing programs of the Export-Import Bank of Japan; (2) operation of several types of export insurance programs; (3) support of research organizations such as the Institute of Developing Economies; (4) financing of market research (non-JETRO) done by the Japan Consulting Institute and other organizations; (5) support of various types of overseas technical cooperation training; and (6) operation of a floating trade fair.

Another government agencies that also plays an important role in the formulation of export promotion policies is the Ministry of Agriculture and Forestry (MAF). The Ministry of Finance, which combines functions is found in the U.S. Department of Treasury and the U.S. Office of Management and Budget, also has a heavy influence on Japanese export promotion policy through its tight hold on MITI's purse strings. Not only does the Ministry of Finance set the budgetary limits on MITI-financed direct export activities and the MITI-administered export insurance programs, but it also has a major responsibility (which it shares with MITI and MOFA) for the formulation of the Japanese Government's overall export financing policy. The Ministry of Agriculture and Forestry (MAF) is involved in policy formulation involving agricultural and fisheries matters, though this ministry is not responsible for independent trade promotion activities of its own.

The Ministry of Foreign Affairs (MOFA) plays a secondary role to MITI in the formulation of export promotion policies. However, as the agency with the principle responsibility for conducting the country's bilateral and multilateral relations, MOFA is intimately involved in the implementation of those policies. Within the context of Japan's general international economic and financial policies, a major function of the MOFA is to attempt to maintain and expand the access that Japanese products have in foreign markets. On the other hand, the MOFA is considerably less involved in such activities as market research, credit information, support of trade missions mounted by associations, etc. The MOFA exerts only general supervision over JETRO participation in specific international trade fairs overseas and JETRO support for privately sponsored trade missions.

Japanese diplomatic and consular posts abroad are involved deeply in trade promotion as part of the conduct of overall bilateral economic relations with host countries. In countries where it has facilities, JETRO handles most of the programmed trade promotion activities and the bulk, though by no means all, of the *ad hoc* direct trade promotion assistance extended to private firms. In countries where JETRO facilities are not available, however, officials at diplomatic and consular posts perform the full range of trade promotion activities. As of 1975 there were an estimated 265 Japanese Government employees in diplomatic and consular posts abroad who devoted at least 50 percent of their time to export promotion. In addition to MOFA officials, this figure includes a number of MITI, MAF, and other Japanese Government agency officials assigned at diplomatic and consular posts and engaged in commercial affairs.

The export promotion activities of MITI, JETRO, and other government agencies are frequently closely related with other major economic objectives of the Japanese Government, most importantly with: (1) the attempt to secure reliable sources of petroleum, food, and other natural resources, in part through direct Japanese investment abroad, and

(2) promotional efforts to encourage imports from countries with which Japan may have large, and politically embarrassing, trade balances in its favor. A large, but indeterminable, portion of MITI's budgetary support of JETRO's activities, as well as of its own trade promotion activities, are actually used for achieving these other economic policy objectives and not for export promotion per se. MITI and JETRO's program descriptions, as well as available budgetary figures, do not make a clear distinction between direct export promotion activities and those programs which may have other policy objectives. It is, therefore, difficult to determine the amount of resources actually devoted by MITI, JETRO, and the other government agencies solely or primarily to export promotion.

JETRO

The Nippon Boeki Shinkokai, or Japan External Trade Organization (JETRO), is entrusted with responsibility for the promotion of Japan's international trade. The Law Concerning the Japan External Trade Organization (Law No. 95 of April 26, 1958, and Revised Law No. 61 of April 18, 1964) provides the legal authorization for JETRO, which was officially established in July 1958. The original law establishing JETRO specifically indicated that its objective was to assist small and medium-sized firms "to make them more export minded." The rationale behind the government's focus on the small and medium-sized companies was that the larger companies in general were highly motiviated to export and already had information sources and international marketing capabilities or the resources to develop them. Throughout the 1960s and early 1970s, JETRO's export promotion services were tailored to, and were utilized principally by, small and medium-sized firms, though many of JETRO's informational services were of benefit to firms of all sizes.

During the past few years, however, there has been a considerable shift away from the earlier emphasis on providing services for the small and medium-sized firms. There are currently only a few programs which provide special arrangements for such firms--mainly lower service fees. The main reason for JETRO's shift in export promotion activities seems to be the fact that smaller manufacturers find their export potential to be greater if they work through one of the large trading companies. In addition, since JETRO is also now more deeply involved in import promotion and overseas investment activities, it is natural that it is obliged to work increasingly with large Japanese firms. As of 1974, the breakdown of JETRO membership was as follows: large firms - 36 percent; small and medium-sized firms - 47 percent; others' (associations, banks, etc.) - 17 percent.

JETRO is not an autonomous organization, and more accurately should be regarded as "operationally" (or semi) autonomous. JETRO operates within the guidelines of the MITI, which has complete discretionary authority over all JETRO activities.

JETRO evolved from a half privately, half publicly financed Osaka-based organization created in 1951 to assist in the reestablishment of Japanese foreign trade following the Second World War. Osaka's business and prefectural government leaders saw the need for an organization to provide market information and other assistance to smaller and medium sized firms in order to facilitate the reestablishment of trade. JETRO was then known as the Japan Export Trade Research Organization.

Three years later this body was reorganized and renamed the Japan External Trade Recovery Organization. By 1958, the Ministries of International Trade and Industry, Agriculture and Forestry, and Foreign Affairs were interested in promoting exports and in establishing their own offices overseas. Business had also come to recognize the importance of direct national export promotion assistance. It was concluded that JETRO--as a proven vehicle--should be expanded to assist all Japanese firms, not just those in Osaka. JETRO thus became part of the central government with the enactment of the law cited above. Once JETRO joined the Japanese Government, however, all private equity participation ceased.

Budgetary Control and Structure. JETRO derives almost half of its budget (48 percent in Fiscal Year 1974; April 1 through March 31) from the Japanese Government. JETRO obtains its annual appropriation through MITI, presenting its budget request--outlined and justified by program--to MITI before the beginning of each fiscal year. After reviewing the request and discussing problem areas with JETRO, MITI determines the amount actually sought for JETRO. This amount is included as a separate line item on MITI's own budget request. After Ministry of Finance, Cabinet, and Diet approval, JETRO's budget is appropriated to MITI--which turns it over to JETRO as a subsidy. Once approved, JETRO funds cannot be transferred back from JETRO to MITI. The MITI subsidy for JETRO earmarks funding levels for specific budgetary items: administrative costs, market research, trade fairs, etc. In terms of target industries, the MITI budgetary subsidy for JETRO earmarks some trade promotion funds for specific industries in the following product lines: agricultural and marine products; light machinery and auto parts; textiles and sundry goods; ship machinery; and chemical industry products. These funds are used primarily to assist certain industrial associations to maintain representatives abroad. It is estimated that about 95% of all Japanese Government export promotion funds are for manufactured goods.

To some degree, however, JETRO officials have a considerable amount of leeway in making use of subsidized funds. Most programs do not require prior approval of the MITI. On the other hand, in areas such as participation in international trade fairs abroad, JETRO must have prior MITI budget approval as well as Ministry of Foreign Affairs political clearance.

MITI's involvement in JETRO's budgetary affairs also extends to financial planning and control. According to the JETRO law, JETRO must put together a business program and a financing plan and get approval from the Minister of International Trade and Industry before the beginning of each business year.

As noted above, JETRO is, in addition to its export promotion program, heavily involved in import promotion activities and programs to assist Japanese investors abroad. Entries in the MITI budget make no distinction between export promotion and other activities, and precise figures on export promotion have not been available from the Japanese Government. U.S. officials, however, have attempted to assess Japanese national government expenditures for export promotion on the basis of a line-by-line review of the MITI budget. Most entries in the budget which appear to have at least some export or export-related elements are included under the expenditures for the International Trade Policy and the International Trade Administrative Bureau of MITI.

In FY 1976, overall support for JETRO (e.g., the MITI subsidy) was 9,130,000,000 yen, the equivalent of U.S. $30,433,333. This constituted 68 percent of the overall Japanese Government budget related to export promotion. Overseas public relations activities, participation in overseas trade fairs and exhibitions, trade promotion with developing countries, and trade promotion for specific industries constituted 26 percent or the 1976 JETRO budget, while JETRO research on overseas economic and trade trends, and overseas economic and trade information services (library services, trade inquiry services, publication of overseas economic and trade information, etc.) only amounted to 18 percent of the JETRO budget. Operating funds for JETRO overseas facilities constituted 38 percent of the JETRO budget.

In addition to the MITI subsidy, JETRO derives its financial support from several other sources: membership fees from private companies; charges from trade fair participation and market research; and contributions from associations and local governments. Most of the latter are used to defray the cost of having representatives of these governments and associations located in JETRO offices abroad. According to JETRO, there are approximately 4,800 Japanese firms and organizations holding about 5,200 "supporting membership" shares in the organization. Each share costs 50,000 yen (about U.S. $150) per year. Large trading firms and banks may have several shares each, but the membership consists primarily of one-share holders. A "supporting member" receives the following benefits: gratis copies of JETRO's publications, free copies of market studies and special research reports on economic trends and trade systems and conditions in specific areas, a 10 percent discount on the cost of "small scale" surveys, and invitations to JETRO sponsored trade fairs.

Managerial control and structure. Final decision-making authority over all JETRO management and program matters rests with MITI, as is specified in the law establishing JETRO. In general, however, MITI formulates broad objectives and policies but does not become involved in program details. JETRO coordination with MITI is achieved through day-to-day personal liaison and through regular monthly meetings at the division chief level. JETRO contact with MITI is primarily with

34-201 O - 78 - 14

the International Trade Administration Bureau, and there is an office for JETRO affairs in the Promotion Project Section, General Affairs Division of this Bureau.

The programs and operations of JETRO are formulated and directed by a management structure including the following officials: the President, Vice President, seven Directors, and two Auditors. The President, Vice President and auditors are appointed by the Minister of International Trade and Industry, while the Directors are appointed by the President with the approval of the Minister. JETRO's organizational structure also includes a Board of Directors, which is composed of the officials described above. At weekly meetings the Board discusses such questions as management improvements, new program initiatives, trade fair schedules, and market research activities.

An Operational Council facilitates JETRO contact with the business community. Fifteen Council members are appointed by the President with the approval of the Minister of the MITI. Most of these individuals are high-level business and association personnel, selected for two year terms. In compliance with requests from the President of JETRO, the Council is responsible for conducting investigations and deliberations on JETRO operations and activities. The Council's major practical function is to keep business leaders informed of JETRO's programs and obtain their advice.

<u>Organization and staffing</u>. JETRO employs about 1,433 individuals (1975). Approximately one-half (442) of its 861 domestic employees are stationed in Tokyo. Its overseas staff totals about 572 (272 Japanese and an estimated 300 locals). The U.S. State Department reports that about 67 percent of the overseas staff are serving in the United States, the European Community, and the other OECD countries. The number of personnel employed by JETRO is strictly controlled by MITI, and MITI approval must be obtained prior to hiring each new Japanese employee.

In addition to its head office in Tokyo, JETRO maintains 29 local offices in principal cities throughout Japan. The Tokyo headquarters and about 15 local JETRO offices maintain commercial libraries as part of their services to the Japanese business community. The smaller JETRO offices primarily provide advice to small Japanese businesses interested in developing trade contacts abroad.

Overseas, JETRO maintains 76 offices in 54 countries, including 21 Japan Trade Centers and one Japan Machinery Center (in Mexico City). Though previously involved in organizing trade promotion shows for Japanese firms in their own facilities, JETRO trade <u>centers</u> now concentrate their efforts on general business assistance, market research, and participation in international trade fairs. The Japan Machinery Center (which is specifically designed to stimulate exports of Japanese capital equipment) and JETRO <u>offices</u> (which are usually smaller than the trade centers) perform essentially the same functions on a more modest scale.

Overseas placement of local government employees. Approximately 30 percent of JETRO's overseas personnel are local government and trade association employees. The employment of local government officials at JETRO's overseas facilities has resulted from JETRO's absorption of a number of local government offices abroad. In most cases, the local governments involved considered it advantageous to have their own employees remain overseas, and have continued to provide financial support to maintain their representatives within the JETRO structure.

In terms of total resource allocation, local government contributions to export promotion in general, and trade fair activities in particular, are quite small compared with the funds expended by the national government. However, some municipal and prefectural governments are quite active in the field of trade promotion. A small number of prefectures and cities maintain their own trade promotion organizations overseas, funded primarily by locally generated tax revenues. The Japanese Government makes some contributions to support the trade promotion activities of local chambers of commerce and industry in a larger number of prefectures and municipalities.

In JETRO offices overseas there is a total of 30 Japanese representatives of prefectural and municipal governments, plus an estimated 50 local-hire employees. In some cases JETRO helps fund these prefectural or municipal offices, and the personnel work at least part of their time on general JETRO activities. However, some of these offices are fully funded by the prefectural and municipal governments which pay personnel expenses and rent space from JETRO.

<u>Division of reponsibility between government and private sector</u>. An unusual characteristic of JETRO is its widespread use of personnel from other organizations--both government and private. A number of managerial personnel at JETRO's Tokyo headquarters, for instance, are employees of MITI, the Ministry of Agriculture and Forestry, the Ministry of Foreign Affairs, or the Ministry of Finance. In addition, several associations maintain offices in JETRO headquarters to handle reports to and from their overseas counterparts.

In Japan where business-government relations are very close, it is extremely difficult to define clearly the division or responsibility between the private sector and the Japanese Government in international economic affairs--including export promotion. However, what is clear is that the extent of government-assisted and/or funded export promotion programs is extremely small when compared with the efforts made by Japanese firms and associations on their own. The bulk of Japanese exports are in the hands of a relatively few of the larger of Japan's more than 8,000 trading companies. In 1974, the top ten trading companies handle 57 percent of all Japan's exports. A significant part of the rest is carried out by large Japanese manufacturers on their own.

and resource allocation occurs annually in conjunction with the formulation of MITI's draft budget for submission to the Ministry of Finance. For example, the extent of JETRO's trade fair participation in any one year is worked out jointly by MITI and JETRO officials in conjunction with the Foreign Ministry.

JETRO organizes product exhibitions involving the direct participation of Japanese firms in a number of major international trade fairs every year. During FY 1974, JETRO participated in approximately 15 industrial trade fairs abroad, not counting several film fairs, 20-30 cultural events, and public relations exhibits in many countries.

The U.S. State Department estimates that JETRO normally pays 25 percent of a participating firm's costs in an overseas trade exhibition. JETRO underwrites half the cost of certain specified items (space cost, exhibit booth design and construction, temporary employees, return freight for exhibited products unsold, promotional literature and show mangement expenses), and the full cost of "image" or cultural exhibitions, receptions, and other attractions which may be associated with the trade exhibitions. The exhibitors must pay the full cost of other items (e.g. packing and shipping of exhibits, insurance, and the travel of company officials). Participation fees for a company are based on the estimated costs of the exhibition.

JETRO does not have a trade mission program, per se, which organizes or helps organize trade missions consisting of exporters. However, JETRO does underwrite the cost of overseas travel of representatives of associations to undertake market research. This subsidy normally covers half the round-trip airfare and per diem for a maximum of 14 days. Participating firms are generally obliged to publish their findings, either in an association or a JETRO publication. JETRO, upon recommendation of MITI, will also help finance the overseas travel of the representatives of associations or private--normally small or medium-size--firms to undertake various types of activities which are believed to be of special interest to a particular industrial sector. Private firms or associations cover the costs not paid by JETRO.

The Japanese also operate a reverse mission and/or business visitor program designed to encourage key, high level foreign businessmen or government officials in specific fields to visit Japan. JETRO invites influential journalists, industrialists, and businessmen from abroad for inspection of the economic situation in Japan and arranges for them to meet with Japanese officials and businessmen.

As part of Japan's efforts to cooperate with developing countries, JETRO conducts various activities to encourage trade and particularly to increase imports from these countries. Among the most important of these activities are market surveys on the export potential of developing country products, product exhibitions in Japan, trade promotion seminars, and assistance in product improvement. In addition, JETRO is affiliated with Japan Overseas Development Corporation (JODC), whose programs are indirectly related to export promotion. The JODC finances investment by small and medium-sized Japanese firms in developing countries. It loans interest-free funds on a long-term basis (not exceeding 20 years) for establishing joint ventures in response to requests from the governments of developing countries. The U.S. State Department says that, six years after JODC's establishment in 1970, 16 joint ventures had been approved, and the loans extended have totalled 1,560 million yen (about U.S. $5,200,000). JODC is subsidized in the MITI budget separately from JETRO.

JETRO also sponsors various market research techniques for aiding general export promotion. They include: (1) the JETRO credit information service which supplies firms with credit information on U.S. and other foreign country firms at a cost dependent upon the size of the requesting firm; (2) the JETRO International Trade Information Center libraries throughout Japan for Japanese and foreign firms; (3) the Japanese International Trade Information Retrieval System (know as JETAC), which gives Japanese firms access to a computerized information from the ITIC libraries without charge; and (4) extensive Japanese and English language publications on foreign trade issues issued either daily or monthly and available by annual subscription. In addition, JETRO operates several types of export-oriented market research programs. JETRO pays the full cost of contracted market research performed abroad to support the exports of small and medium-sized industries at the request of trade associations. The associations involved, however, are charged certain administrative costs incurred by JETRO.

Each year JETRO requests industry, trade associations, and MITI to submit product/market research recommendations. JETRO's annual research program is based on these recommendations, resulting, in part, in the initiation of "small scale" market studies. Pricing of such studies is based on the number of "units" to the study. The cost of each "unit" is considered to be 160,000 yen (about U.S. $533), with JETRO covering half the cost. These studies are normally done by JETRO's overseas staff and its first "unit" consists of a report on: (1) production; (2) imports; (3) distribution and sales; and (4) related literature on a given product. Additional "units" depend upon the scope of the study, as requested by the firms or associations involved. The program is sufficiently popular among small and medium-sized companies that if JETRO's annual budgetary allocation is exhausted, firms will pay the full cost.

JETRO also receives funds from various government agencies, including MITI and the Ministry of Finance, to conduct studies either on a contract basis or by JETRO's staff. As a rule, these studies are made public after the removal of classified or sensitive information. JETRO studies undertaken for other agencies have included country market trends, surveys of multilateral firms, and an analysis of the United States Trade Law.

Expenditures for Export Promotion

In 1976, the Japanese Government spent an estimated $60.7 million on export promotion programs and services. Some $44.5 million of this

(13.357 billion yen) went for direct expenditures through MITI and JETRO, including $30.4 million (13.36 billion yen) for direct MITI subsidies to JETRO, $11.9 million (3.558 billion yen) for non-JETRO economic and trade research, $1.9 million (0.555 billion yen) for non-JETRO information services, and $0.38 million (0.114 billion yen) for subsidies to export associations and trade groups and for domestic stimulation. In addition, the U.S. State Department estimates that the Japanese Ministry of Foreign Affairs spent roughly $16.2 million to support its 275 commercial officers doing export-related activities at overseas posts.

JAPANESE EXPORT FINANCING PROGRAM

Japan's Export-Import Bank, the Bank of Japan, and the MITI administer the Japanese export support system. Together they offer: (1) preferential fixed-rate financing for credits over two years; (2) project lines of credit extended by the government and private firms at preferential, fixed interest rates; (3) credit insurance for commercial and political risks; (4) local cost financing; (5) combining foreign aid credits with commercial export credits; and (6) exchange risk insurance. In 1976 about 49% of total Japanese exports benefitted from official financing support, the largest share of any major industrial country.

The Export-Import Bank of Japan was established in 1950 (Law No. 268 of December 15, 1950) to supplement and encourage commercial bank operations in financing exports, imports, and overseas investments. Japan's

Eximbank is a wholly owned government institution. It receives its policy guidance from the Ministry of Finance and its annual budget must be approved by the Diet, the national legislature. The Japanese Prime Minister appoints the Bank's President, Deputy President, and two Auditors, while the Pesident names up to six Executive Directors.

Japan's Eximbank operates under an annual budgetary ceiling, although in the past the budget has been increased through supplementary appropriations when necessary. There is no overall ceiling on its credits. Eximbank currently obtains about 90 percent of its funds from the government Trust Fund Bureau, at an interest rate of 7.5 percent, and about 10 percent from the government's Industrial Investment Account, interest free. The Eximbank is also authorized to borrow foreign currencies from foreign banks and other financial institutions but has so far not used this authority.

Financing

Medium and long-term export credits benefit from preferential fixed-rate financing by Japan's Eximbank. Eximbank has traditionally extended credits principally to Japanese suppliers, but an increasing share of the Bank's financing is now being devoted to buyer credits. Most officially-supported loans combine Eximbank funds with fixed interest rate funds supplied by Japanese foreign exchange banks (commercial banks). Eximbank finances approximately 50 percent of the contract value, after a 15 to 20 percent cash payment. The commercial bank provide the remainder. Eximbank's participation may increase, however, in transactions of special interest.

The preferential interest rate Eximbank charges for credits ranges from 6.0 to 9.0 percent, depending principally upon the goods to be exported, their destination, the loan's maturity, and the competitive situation. The most typical rate in 1976 is about 7.5 percent. Commercial bank funds are supplied at fixed, prime market rates--9.2 percent as of March 1977. The typical blended interest rate (excluding fees and premiums) was about 8.1 percent. Eximbank and private bank commitment fees add roughly 0.2 percent per annum to the cost of a buyer credit; there are no commitment fees on supplier credits.

Pre-shipment financing is provided to Japanese suppliers by authorized Japanese foreign exchange banks at market interest rates. Short-term export credits up to 12 months are also available from Japanese commercial banks at market interest rates. The banks may discount a limited portion of their short-term export obligations with the Bank of Japan. This short-term refinancing was provided at preferential rates--two percent below the official discount rate--until August 1971. The Bank of Japan currently discounts these export obligations at its normal discount rate, which was 6.5 percent in June 1976.

Insurance protection from MITI is required for all supplier credits financed by Eximbank. On buyer credits, insurance is provided on the private portion and Eximbank assumes the risk for its portion and adds a corresponding premium to the interest rate to equalize the cost of a buyer and supplier credit. The premiums add roughly 0.3 to 0.5 percent annually to the cost of the credit.

According to the U.S. Export-Import Bank, typical interest rates paid in 1976 by borrowers under the Japanese export credit system varied with the maturity of the credit according to the following schedule:

Repayment Term of Credit	Most Typical Basic Rate	Typical Cost of Funds Including Fees and Premiums	
		Good Credit Risk	Poor Credit Risk
Less than 2 yrs.	Market rate	8.0 1/	8.52 1/
2 to 5 yrs.	7.0	8.3	8.5
Over 5 yrs.	7.5	8.6	8.8

The Japanese may also combine foreign aid credits with export credits generally for natural resource development projects to foreign government buyers in developing countries. The overall interest rates on these mixed credits may range from 4.00 to 6.75 percent with maturities to 25 years.

Other features, including total authorizations, of the Japanese preferential fixed-rate financing program are summarized below:

Percent of contract value preferentially supported	50	
Are insurance or guarantees required?	Yes--for supplier credits	
	FY 1975 2/	FY 1976 2/
Annual statutory or budgetary ceiling for disbursements (millions of U.S. $)	1,604	2,747
Outstanding credits	8,163	13,131
Credit authorizations	2,377	3,266
Credit disbursements	1,998	2,263
Credit disbursements as a share of capital goods exports (percent)	7.9	9.8

1/ Variable

2/ Japanese financial year (April to March)

Insurance and Guarantees

Export credit insurance is provided by the MITI, in accordance with the 1950 Export Insurance Law (Law No. 67 of March 31, 1950). MITI provides credit insurance and guarantees for commercial banks covering specific commercial and political risks. Insurance is generally provided on a whole-turnover basis for an industry or trade association; as a consequence premium rates and administrative costs are relatively low, while the share of exports officially supported is exceptionally high.

The U.S. Export-Import Bank reports that over 99 percent of MITI's insurance business falls into three policy categories:

1. General export insurance--Covers up to 90 percent of contract value for political risks and usually 60 percent for commercial risks on pre-shipment risk for consumer and capital goods, and post-shipment risks for consumer goods.
2. Export proceeds insurance--Covers up to 90 percent of contract value for political risks and commercial risks on post-shipment risk for long-term capital goods exports. Export proceeds insurance--which is required on all supplier credits financed by Eximbank--is usually purchased together with general export insurance.
3. Export bill insurance--Covers banks against default risk, up to 80 percent of contract value for commercial or political reasons, on export bills which they have purchased and for which there is no outstanding letter of credit.

Premium rates are calculated for five market categories with most premiums ranging around 0.3 to 0.5 percent annually.

Specific guarantees for commercial risk cover pre-delivery and post-delivery risks caused by major events or circumstances such as insolvency of the buyer and protracted default. The maximum idemnity that can be paid is 60-90 percent of the loss; 60 percent cover for individual policies, and 90 percent for policies issued on a whole turnover basis.

Guarantees for political and other risks cover pre-delivery risks caused by major events or circumstances such as: (1) cancellation of an export license not due fault of exporter; (2) cancellation of a contract by a public buyer; (3) cancellation of previously valid import authority or other government restrictions rendering importation impossible; (4) transport or insurance charges owing to diversion of shipment caused by political events; (5) currency inconvertibility and transfer delays; (6) outbreak of war, hostilities, civil commotion, etc. preventing payment by the buyer; and (7) requisition, expropriation, or other government intervention which prevents payment. The maximum indemnity that can be paid is 90 percent of the loss. It should be noted that specific coverages may be limited to specific phases of the pre-shipment and post-shipment periods.

MITI also offers exchange risk insurance and operates an export loss reserve system. MITI's new performance bond insurance program--which protects against arbitrary calling of bonds--became operational in October 1977.

Total authorizations under the Japanese export credit insurance program are summarized below, in billions of dollars.

	FY 1975	FY 1978
Outstanding insurance	$ 38.1	$ 51.9
Insurance authorizations	$ 25.7	32.0

JAPANESE EXPORT TAX INCENTIVES

Foreign Branch and Subsidiary Operations

A Japanese company which conducts business operations through a branch in another country is subject to Japanese tax on the foreign branch profits on a current basis. A foreign tax credit for taxes paid in the other country is allowed. Conversely, losses sustained by the branch are currently deductible against other income of the Japanese company.

A Japanese company's profits derived through an overseas subsidiary, not a branch, are not currently taxable and losses are not currently deductible. Tax at the normal rate is imposed when dividends are distributed from the subsidiary with a deemed foreign tax credit generally being available.

Subsidiary losses create tax benefits recognized only upon liquidation or bankruptcy of the subsidiary or when there has been a "significant deterioration" of the value of the subsidiary. A "significant deterioration" occurs when the value of the original investment has decreased by 50%, and there is little prospect of recovery in the future. If these events occur, the parent company may, for tax purposes, write down the value of its original investment to the current value.

The parent company has the option of deducting a reserve for foreign investments from its taxable income. A reserve of 10 percent to 50 percent may be claimed in the initial year for investments in underdeveloped countries. A reserve of 50 percent to 100 percent is available in any country for companies organized to develop natural resources. After five years, the reserve is restored to income in five annual installments.

Foreign Tax Credits

Japanese law provides for an extensive system of granting relief through foreign tax credits where income is subject to taxation in Japan and another country. The requirements for claiming the credit are similar to the United States rules in that (1) the claimant must be a Japanese resident taxpayer, and (2) the foreign-source income must also be subject to Japanese and foreign tax. In addition, a Japanese resident company which owns at least 25 percent of the voting stock of a foreign subsidiary may claim a credit for taxes deemed to have been paid by the foreign subsidiary when a dividened is received from that subsidiary.

A limitation on the allowable foreign tax credits must be computed on the overall basis. For purposes of computing the overall limitation, any loss incurred by a foreign branch need not reduce other foreign-source income. This provision is referred to as the "modified" overall limitation.

The deemed foreign tax credit is allowed for taxes paid by a foreign subsidiary if the Japanese parent owns at least 25 percent of the issued and outstanding stock for an uninterrupted period of at least six months before the dividend is received. This credit is available upon receipt of a dividend from a "qualified" foreign subsidiary. To qualify, a foreign subsidiary must carry on an active business and may not be a tax-haven type corporation organized for the purpose of reducing income tax in Japan.

The mechanics for computing the deemed foreign tax credit are similar to those of the United States. The ratio of the dividend received to the foreign income (net of foreign taxes) is multiplied by the foreign tax to determine the tax deemed paid. The amount of foreign tax deemed paid is included in the Japanese parent's income and is included in foreign-source income when computing the overall limitation. The deemed credit is allowed only for taxes paid by directly owned subsidiaries; taxes paid by second or third tier subsidiaries do not qualify.

Japanese tax law does not require the taxpayer to substantially adjust a foreign subsidiary's earnings and profits to Japanese standards when computing the deemed credit. The profits to be used for computing the foreign tax credit are either the profits as shown by the foreign financial statements or taxable income as reflected on the tax return, whichever is greater. There are certain minor adjustments which must be made, however, regardless of whether financial statement income or taxable income is utilized. For example, if there is any income which is not subject to foreign income tax, it must be included in foreign-source income for purposes of the deemed credit calculation.

Unused foreign tax credits may be carried forward to the five taxable years following the year in which the foreign income taxes are paid or accrued. Also, the current year credit may be increased to the extent the foreign income limitation exceeded available credits during the five previous years. Thus, either the excess foreign tax credit or the unused limitation can be carried foward five years. Refunds of prior years' income taxes paid are not granted. Instead, the procedure is simply to increase the foreign tax credit in the current year by recomputing the Japanese taxes paid on foreign-source income including that of prior years.

The Excise Tax

Japan imposes an excise tax (so-called "commodity tax") on manufacturers, importers, or retailers on the sale of 17 types of commodities. Food, medicines, and other essential consumer goods and food products are outside the scope of this tax. The tax ranges from 5 percent for beverages and motor vehicles with two or three wheels to 30 percent mainly for luxury items. Commodities exported are exempt from the tax. If the product is exported after being taxed, the tax is returned and there are special provisions authorizing an exemption or repayment for component parts of exported products. Imports are taxed at the same rate as similar goods on the home market.

Specific Export Tax Incentives

Japan's concern for encouraging exports has led to the adoption of various export tax incentives to domestic companies. These incentives include:

(1) Allowances for overseas market development which permit firms to deduct a percentage of their export profits from taxable income. These transactions include export of goods to an exporter and processing of goods to be exported, provided payment is in foreign currency. The deductions may go from 1.0 percent to 1.7 percent of the export value of goods purchased from others, depending on the amount of the corporation's capital and may go from 1.5 percent to 2.3 percent for all other overseas transactions. One-fifth of the amount credited to the reserve must be returned each year to income in the five years immediately following the creditation.

(2) Deduction of overseas investment losses. Corporations acquiring and holding 10 percent or more of particular shares of a "Specified Overseas Enterprise Juridicial Person," or 1 percent or more of particular shares of a "Specified Investment Juridical Person," can deduct amounts credited to a reserve for losses from such investments up to a specified ratio of the acquisition cost of the shares. A "Specified Overseas Enterprise Juridical Person" is a corporation or other legal entity whose head offices is located outside Japan for purposes other than avoidance of taxes which conducts any kind of business except the investment business. A "Specified Overseas Investment Juridical Person" is a domestic corporation that mainly invests in, or makes long term loans to, a specified overseas enterprise juridical person. These juridical persons are specified where their head office is

located in a specified statutory geographical area, mainly developing areas or where they deal with such juridical persons. Amounts deducted must be added back to taxable income over a five-year period commencing five years after the current taxable year of the deduction.

(3) Deduction for foreign exchange losses. A domestic corporation can establish a deductible reserve for foreign exchange losses on its net long-term receivables. Amounts deducted must be added back to taxable income in the next accounting period.

(4) Entertainment expenses related to export activities. There is generally a severe limitation on the deductibility of entertainment expenses for tax purposes in Japan. Ordinarily a deduction is limited to about U.S. $13,333 per corporation plus 1/4 of 1 percent of capital. The deduction for entertainment expenses in excess of this is limited to 25 percent of the expenditures.

(5) Export Allowances. Domestic corporations are allowed substantial special deductions for certain overseas transactions. The eligible transactions, provided payment is in a foreign currency, are as follows: (a) Sales or licensing of industrial property rights and the furnishing of technical knowledge such as know-how. The amounts deductible are 70 percent of the proceeds from the transaction limited to 50 percent of the total ordinary income. (b) Sales of copyrights. The amount deductable are 30 percent of the proceeds from the transactions, also with a 50 percent limit. (c) Sonsulting or rendering technical services such as research and planning with respect to the manufacture or construction of production facilities, or technical guidance regarding agriculture and fishing.

The amounts deductible are 20 percent of the proceeds from the transaction also with a 50 percent limit.

(6) Accelerated depreciation in case of export sales. In 1961, Japan enacted a law to provide for accelerated depreciation in case of export sales, but repealed it in 1972. It was originally enacted as a means of stimulating exports by providing tax relief, but by 1969 Japan began experiencing a favorable international balance of payments because of greatly increasing exports.

GLOSSARY

ITIC — International Trade Information Center

JETAC — Japanese International Trade Information Retrieval System

JETRO — Japanese External Trade Organization

MAF — Ministry of Agriculture and Forestry

MITI — Ministry of Finance

MOFA — Ministry of Foreign Affairs

JODC — Japan Overseas Development Corporation

Yen — Unit of Japanese currency. Exchange rate (1976) U.S. $1 = 300 yen.

Note: From April 1949 to August 1971 the official exchange rate was U.S. $1 = 360 yen. Between December 1971 and February 1973 the rate was 308 yen per dollar. Since February 1973 the yen has been allowed to float, though the exchange rate was maintained at around 265 yen to the dollar until November 1973.

CHAPTER IX

EXPORT STIMULATION IN THE NETHERLANDS*

INTRODUCTION

Though it is heavily dependent on foreign trade for the health of its national economy, the Netherlands has a relatively small government program for stimulating exports. The country relies mainly on the private sector to promote and finance Dutch international sales. The government's efforts in promoting exports mostly involve the provision of basic market information, through its Economic Information Service, and encouragement of private organizations like the Netherlands Council for Trade Promotion and chambers of commerce at home and abroad through subsidies that help support their operations. The Dutch Government has no agency to provide direct official export credits or insurance, but it does offer some incentives through the central bank to encourage private loans and guarantees in this area. Because of the lingering effects of the international recession on the country's economy, the government has been considering some additional efforts to bolster existing government

---

* Prepared by John Costa, Analyst in International Relations, with the assistance of Jaap Dingemans, Consultant. Information on specific programs and agencies was derived or condensed from U.S. State Department Airgram "Competitor Nation Export Expansion Programs," by the U.S. Embassy, the Hague; The Export Credit Financing Systems in OECD Member Countries, a 1976 survey by the Organisation for Economic Co-operation and Development; and Arthur Anderson & Co., Statement on U.S. Companies in International Markets--the Competitive Factor in Tax Policy. Submitted to the U.S. Senate Finance Committee in conjunction with public hearings on H.R. 10612, 94th Congress, 2d Session, April 20, 1976.

and private programs in suport of exports. The total government program is still limited, however, as the Netherlands continues to depend primarily on the private sector for efforts to encourage the growth of its international trade.

THE DUTCH ECONOMY

Holland has few natural resources and, like other small populous countries, it depends heavily on exports and imports for its continued economic health. The central role of exports in the Dutch economy can be illustrated by a few basic statistics. Foreign sales of goods and services account for about 47 percent of Holland's total GNP. Approximately 38 percent of the Netherlands industrial output and 18 percent of the agricultural, forestry, and fishery production is sold abroad. The total volume of exports has multiplied eight-fold in the 1952-1976 period. Almost two-thirds of all the Netherlands' exports go to the other member countries in the European Economic Community. For some industries, exports are a vital element of total demand. The metalurgical industry gets 42 percent of its total turnover from foreign sales. For the chemical and related industries it is 63 percent, and for the textile industry it is 45 percent. Though the country has one of the world's largest natural gas fields and counts sales of natural gas to neighboring states as a major source of export earnings, the Netherlands must import almost all its petroleum. Industrial goods still account for almost 70 percent of all Dutch exports.

Manufacturing is probably the most important single sector of the Netherlands' economy, accounting for roughly 40 percent of all production and 35 percent of total employment. In turn, the metalurgical and electro-technical industries are particularly prominent, as they employ a third of the industrial workforce. The production of steel and aluminum products along with other metals like zinc and molybdenum (for steel production) is especially significant. The country's sophisticated electrical industry is dominated by Philips, the Dutch multinational company, which produces products like transformers, computers, scientific and optical equipment, communications apparatus, and lighting equipment for sale both at home and abroad. The chemical industry is the largest manufacturing sector in terms of the value of its production. Dutch chemical output has grown enormously in recent years with the establishment and expansion of oil refineries and petro-chemical industries. Almost two-thirds of the 9 billion guilders ($3.6 billion) turnover in 1970 for this industry was exported. The transportation industry has also been quite important for the Netherlands' exports--the Fokker company's F-27 "Friendship" has become the most-exported European aircraft; shipbuilding is a prominent activity in this maritime nation; and Dutch trucks, bicycles, and mopeds are finding significant markets outside the country.

Even though agricultural production has declined in importance in the last fifty years as the Netherlands has beoame increasingly industrialized, food processing has grown more important. Major export items include dairy products, meats, spirits and beer, tobacco products, vegetable and fruit preservatives, cacao products, and potato flour.

The Dutch have experienced a drop in their international competitiveness in recent years, due to the upward revaluation of the guilder and rising domestic production costs. The latter has been due largely to very high wage cost increases. To retain markets, Dutch industry has had to trim its profit margins substantially. According to the OECD, the Netherlands experienced a substantial recovery in exports in 1975 which helped the country recover from the serious international recession of 1973-4. Export growth was slower in 1976, but a carryover from the previous year brought a general expansion in international trade for the year. The Dutch trade surplus rose in 1976 by roughly $1.2 billion. However, the net surplus on invisibles continued a shrinkage which began in 1974, while the tourism deficit expanded substantially. While the overall balance-of-payments remains strong, particularly in comparison to the Netherlands' neighbors and other major industrial states, the relative deterioration in some areas has generated new concern over the Dutch economy.

Many economic analysts in the Netherlands are advocating new government efforts to shift production to higher grade industries and to promote exports of Dutch goods. For the most part, however, Holland continues to rely mainly on the private sector to promote and finance its exports, though the Dutch Government has been considering some new efforts to encourage international trade.

EXPORT PROMOTION PROGRAMS

In the Netherlands, government activity in trade promotion is mainly concentrated in the Economic Information Service of the Ministry of Economic Affairs, Dutch Diplomatic and Consular posts abroad, and the Foreign Agricultural Service Directorate of the Ministry of Agriculture and Fisheries.

The Economic Information Service

The Economic Information Service's principal task is to promote the economic development of the Netherlands in general and the exchange of goods and services between the Netherlands and other countries, by means of disseminating information. The Ministry's responsibilities include: supplying economic information to government and industry by reporting on economic developments in other countries, providing general and specific data on marketing opportunities abroad, furnishing trade information on exports through publications as well as in response to specific inquiries, providing other countries with economic information on the Netherlands and most important, granting support to private Dutch institutions and organizations active in the export promotion and economic information field.

The Economic Information Service is divided into four groups, which are in turn divided into several units. The groups include a sub-directorate of economic research and export information, which has seven divisions; a sub-directorate of publicity, which has five divisions; a sub-directorate of information organization, which has three divisions; and a library and documentation division.

Overseas Activities

There are 37 regional chambers of commerce and Industry throughout the Netherlands, semi-official organizations established by law to promote and coordinate the interests of Dutch industry, trade, and small business. While the government does not grant any subsidies to these organizations, it cooperates closely with them and extends to them non-monetary assistance when needed. Seventeen of the 37 chambers of commerce in the Netherlands have on their staff an export consultant whose main activity is to offer assistance to small businesses.

Outside the Netherlands, export promotion activities are aided by fourteen Dutch chambers of commerce, mostly in countries of the greatest export interest to the Netherlands. These countries include Argentina, Belgium, Luxembourg, Brazil, France, Great Britain, Italy, Austria, Spain, Venezuela, United States, Switzerland, and West Germany. It should be noted that the overseas chambers of commerce were organized mainly on the initiative of private business as non-profit organizations for the purpose of promoting Dutch foreign trade. The Dutch government subsidizes them in the belief that the services rendered by such private organizations are of definite value to Dutch businessmen. The subsidies are supposed to cover the costs of chamber of commerce services provided to non-Dutch businessmen and companies, for which no charge is made.

The chambers of commerce abroad have mixed memberships of Dutch and non-Dutch firms from which they collect annual fees. Furthermore, they have specific fee schedules for the variety of services they make available to Dutch businessmen for which they charge specific fees.

The Netherlands Council for Trade Promotion falls within the operating jurisdiction of the chambers of commerce. Like the chamber of commerce, this private international trade organization is financed by a combination of fees from Dutch businessmen and subsidies from the government. Besides supplying information, it also coordinates and handles Dutch commercial participation in trade fairs abroad as well as private economic missions to foreign countries. For these two activities, the entire costs are borne by the participants.

Diplomatic and consular posts also participate in trade promotion work, particularly in those countries in which there are no Dutch chambers of commerce. If officials in the embassies and consulates are unable to provide the desired information, they will call upon the services of the Netherlands Council for Trade Promotion.

Budget

In fiscal year 1976 the Dutch Government reported that expenditures for export promotion totaled Nf 50.21 million ($18.66 million: $1=Nf 2.69) in contrast to Nf 46.76 million ($19.12 million; $1= 2.44) in fiscal year 1975. Budgetary allocations were identified for the following programs: Economic Information Service personnel costs, commercial library, support of quasi-government trade promotion organizations, publicity and propaganda abroad trade fairs and exhibitions, other costs at home and abroad regarding export promotion, international organization for the publication of tariffs in Brussels, Foreign Ministry commercial officers and information services, and Agricultural Ministry programs to promote Dutch farm exports. The U.S. State Department estimates that expenditures by the Dutch Foreign Service in 1976 for export promotion were about Nf 30 million ($12 million), or about 65 percent of the total.[1/] The Economic Information Service in the Ministry of Economic Affairs spent about Nf 15 million (35 percent of the total.) About Nf 8.95 million of this was for personnel costs and Nf 5.41 million for subsidies to trade promotion organizations. The U.S. State Department reports that the Dutch Agriculture Ministry's outlays for promoting agricultural exports was about Nf 4.5 million in 1976.

THE DUTCH EXPORT FINANCING SYSTEM

Export Credits

The Netherlands has no special government institution or program for extending official export credits to foreign purchasers of Dutch goods. Exporters normally rely on the private market to provide most of the export credits needed to finance Dutch foreign trade. Government intervention in export credit has been generally limited to the shipbuilding industry, though the Netherlands Central Bank does encourage Dutch exports by

1/ This estimate may be too high, for it seems unlikely that 73 professsionals and support staff would cost roughly $12 million.

offering discount and relending facilities (on a non-preferential basis) to expand the amount of commercial credit available from private banks for international trade.

Most medium and long-term private credits are financed by the NV Export Financiering Maataschappil (EFM), a specialized commercial institution created in 1951 by the Nationale Investeringsbank (Herstelbank) N.V. The Herstelbank now owns over half the EFM stock while the rest is held by other Dutch commercial banks. The EFM gets most of its lending resources through borrowings from the Dutch capital market and, to a lesser extent, deposits in the participating banks. As indicated, its resources may be supplemented by the rediscounting facilities of the central bank, up to a ceiling which varies from time to time.

The Netherlands Central Bank provides loans and discount facilities in order to let the EFM (and other private banks, to the extent that they make medium and long-term export loans) finance international transactions at interest rates lower than might be otherwise expected in the commercial market, sometimes as much as 2% below the prevailing rate. Its facilities are available for bills and promissory notes to finance the export of Dutch goods drawn to the order of a Dutch bank by foreign buyers for a period of at least three years. The Netherlands Bank may declare these bills and promissory notes acceptable security for a loan of its own, providing the terms are no longer than five years, or it may deem them discountable, if the remaining term is less than 105 days. There is a ceiling of Nf 1,500 million (about $500 million) on the amount of these private credits that is available from the discounting facility. An additional Nf 100 million is also available to refinance medium-term credits on exports by medium and small scale enterprises. Transactions financed outside the official export financing process are not subject to these ceilings.

Until recently, the government provided assistance to its shipbuilding industry through a system of "transition interest benefits," introduced in 1967 in order to provide a maximum 2 percent interest subsidy that would make up the difference between the Dutch and the OECD-average rate for money to finance sales of ships. Adjustments in early 1972 changed the internal mechanism for calculating the interest differential but not the basic thrust of this ship interest subsidy program. The OECD reports that about 1 1/2 percent of all Dutch exports benefited from this arrangement in 1973.

Export Insurance

The Nederlandsche Credietverzekering Maatschappij NV (NSC), a privately owned insurance company, has provided export credit insurance since 1925. The NCM has had a standing arrangement with the Dutch Government since 1932, broadened in 1946 and renewed in 1961, in which the government pledges to reinsure certain non-commercial and commercial risks which fall outside the scope of the NCM's normal private insurance. Under terms of this agreement, NCM is authorized by the Minister of Finance to accept commitments up to Nf 5 million ($2 million) the "Dagelijkse Commissie voor Exporten Importgaranties" (Executive Committee for Export and Import Guarantees) which is comprised of five officials of the Nederlandsche Bank (Central Bank) is authorized to commit the government. For any other commitment including those involving credit lengths exceeding five years the decision is referred to the Minister of Finance. There is also a "Rijkscommissie" (Governmental Committee) to advise the Minister on policy questions. Its members include persons named by the Ministers of Finance, Economic Affairs, and Agricultural and Fisheries and the Nederlandsche Bank as well as experts from agriculture, industry, trade services, banking, and insurance. The Chairman and Secretary are the representatives of the Nederlandsche Bank and are among those who make up the Executive Committee.

NCM's commercial activities are supported by its own share capital and reserves. NCM maintains separate accounts for risks reinsured by the government, and any surpluses on operations after deduction of administrative expenses and claims are paid into the Treasury. The Ministry of Finance remains liable for any claim exceeding this reserve. In 1975, about 90 percent of the total premiums on NCM insurance were reinsured with the government, with the government covering a risk totalling Nf 10 billion (over $3 billion) at that time. Some of this insurance involved potential orders under negotiation which were never completed, however, so the final level of risk assumed by the government was somewhat lower.

Short-term coverage is available on a global or specific policy basis. The former is not obligatory but is necessary if preshipment coverage is required. The exporter may choose to cover commercial and/or non-commercial risks. Medium-term coverage is provided on a specific policy basis from date of contract or shipment with combined or separate commercial and non-commercial risks. Most cover is provided for combined risks for both short and long-term policies. There are no specific limits on the foreign content of goods to be financed, although a 30 percent limit on the basis of reciprocity is the general practice. Trade among third countries also can be eligible for cover in certain instances.

Even if the exporter submits data as to the credit-worthiness of the buyer/country, NCM carries out its own independent investigation in the field, which is particularly thorough for developing countries. Exceptions to normal credit terms depend on the existence of officially support competition.

Premiums payable for policies covering risks reinsured by the state are determined by NCM according to guidelines set by the government. The exporter then pays a flat rate premium on the contract amount. Rates vary according to risks, credit terms, the destination, and securities and are composed of a basic premium supplemented by a variable non-related supplementary premium. Although private banks usually do not require exporters to secure NCM insurance as a precondition for their export financing loans, the presence or absence of this coverage often will be reflected in the interest rate charged by the commercial banks.

Proceeds of policies can be transferred to the financing institution and NCM can issue unconditional bank guarantees for medium-term credits. These guarantees provide for the same percentage as the underlying insurance policy and become effective from the moment the exporter has fulfilled his contractual obligations. Credits benefitting from the refinancing arrangement with the Nederlandsche Bank must be insured with NCM.

The policies and guarantees issued by NCM provide for coverage ranging from 75 percent to 90 percent of the risk on credits extended on a combined commercial, non-commercial risk basis. For financial guarantees of loans extended under government promises within the framework of consortiums the insured portion can be up to 95 percent.

NCM can insure credits offered by the data banks to a given country (either to the government or a government institution such as a development organisation or the country's national bank) even if at the time the credit is offered and insured it has not yet been decided what capital goods will be brought in the Netherlands.

In 1973 NCM began to issue insurance to cover losses resulting from exchange rate fluctuations on export sales of capital goods for terms of two years or more. Compensation is payable on losses of 3 percent or more, with premiums of 2 to 2.5 percent for the first two years and 0.7 percent thereafter. Coverage is 100 percent.

DUTCH EXPORT TAX INCENTIVES

Foreign Source Income

A company resident in the Netherlands, which conducts business operations through a branch in another country, is subject to Dutch taxation on the foreign branch profits on a current basis. However, a foreign tax credit, for taxes paid in another country, is allowed; the credit can effectively make the branch profits tax exempt. Conversely, losses sustained by the branch are currently deductible against the other income of the company. However, to the extent branch losses reduce current taxable income from Dutch sources, the losses can be recaptured against future branch profits for the next 6 years which might otherwise not be taxed because of the credit. If foreign branch income exceeds the total net income of a Dutch corporation, the excess may be carried forward as excludable foreign income during the following 6 years.

If the Dutch company operates in another country through a subsidiary, the profits or losses of the subsidiary are normally not taxable nor deductible. Any dividends received by the parent corporation are exempt from taxation, provided the parent corporation owns at least 5% of the share capital of the foreign subsidiary and the subsidiary is subject to foreign income tax of some kind. If the subsidiary's income is not subject to foreign taxation, the dividends it pays are not exempt from Dutch taxation.

The Netherlands has entered into numerous bilateral income tax treaties in order to avoid double taxation of income. Normally, foreign tax credits are granted in the Netherlands in accordance with the provisions of these treaties. Should no treaty exist, Dutch law includes unilateral provisions for the avoidance of double taxation.

In theory, a Dutch corporation is subject to Dutch corporate taxation on its worldwide income. However, if, in accordance with a tax treaty, an item of income is excluded from Dutch taxation, a tax credit is granted in order to comply with the provisions of that treaty. In general, the Dutch tax credits are limited to Dutch tax due on foreign source income. Under most Dutch treaties, the foreign tax is determined by multiplying the total Dutch tax due on worldwide income by a fraction, the numerator of which is the foreign source income and the denominator of which is worldwide income.

In cases where no tax treaty has been negotiated with a particular country, a Dutch corporation may claim a foreign tax credit only on certain specific types of foreign income, including profits from a foreign branch or partnerships, income from real estate located outside the Netherlands, and income from loans secured by mortgages on real estate located outside the Netherlands. Again, the foreign tax credit would be computed as described above. In determining the allowable foriegn tax credit, an overall limitation is utilized permitting a taxpayer to group all foreign source income together, including overall losses.

A foreign tax credit is granted to a resident corporation against tax due on interest and royalties received from a debtor in a developing country, whether or not a treaty exists, if the interest and/or royalties are subject to income tax in the developing country. This tax credit is limited to the lower of the tax levied in the developing country or the Dutch corporate income tax due on the income. There are presently about 80 qualifying developing countries.

Foreign taxes paid on any other type of foreign income are not allowed as foreign tax credits in the absence of treaties. Where foreign income is included in taxable income and no tax credit allowed, any foreign taxes paid on the income can be claimed as a deduction. All direct and indirect expenses of earning foreign source income must be allocated against that income in computing the applicable foreign tax credit limitation unless an applicable tax treaty specifies otherwise. There are no specific statutory guidelines on the mechanics of allocating indirect expenses.

Unlike other national laws, Dutch law does not provide for the deemed foreign tax credit, particularly since dividends involved are not taxed.

The Dutch Government enforces intercompany pricing rules more strictly than is the case in most other countries. The taxpayer may negotiate advance agreements on pricing for exports, and at least a 10 percent margin over costs is required. These reallocation rules are instrumental in determing the extent to which income from exports can escape completely or partially, liability. Foreign source income is often tax-free under the reallocation rules, and companies usually find they can reduce their overall tax liability if they can realize more of their income from foreign operations and less from domestic processes. If the reallocation rules are so strictly enforced that only a small part of their income is considered foreign-source income, on the other hand, the benefits from the exemptions or low tax rates on that income are much less significant.

Value Added Tax

In 1969 the Netherlands introduced the value added tax, or VAT. The applicable VAT rate is 16% although a reduced rate of only 4 percent is levied on most food products. The Netherlands also utilizes the so-called zero rating system, whereby exporters may recover the entire amount of taxes levied upon purchases and services made in connection with the manufacturing or sale of goods to be exported. The zero rate is also available if a product is exported directly by a Dutch manufacturer on behalf of the Dutch exporting company provided the latter gives the manufacturer or supplier a written export instruction.

NEW GOVERNMENT INITIATIVES

Since February 1977, the Dutch Government has been considering several new proposals to strengthen and expand the program for stimulating the country's lagging exports. Continuing disagreements among the major political parties have hampered efforts by the Crown and Parliament to form a new government following the May 1977 elections. The interim caretaker government has been unable to take action on the new export stimulation proposals, the Dutch embassy indicates. The issue is not controversial, however, and there is a general consensus in Holland that something needs to be done to encourage exports.

The new policy asked for by the the Minister of Economic Affairs incorporates three methods to promote exports: (1) The proposed 1978 budget would allocate additonal funds for the chambers of commerce, to be used primarily to help create new products for new markets, especially in situations where exporters are unsure about future revenues and big risks are involved. (2) As the result of the recent success of the Dutch delegation to the International Trade Fair in Moscow, additional funds would be allocated for national exhibits and combined international trade fairs. (3) Undertakings such as "turnkey projects" involving banks, consultants and contractors would also receive additional support from the government.

The following changes were also proposed in the export finance area. (1) The "matching fund," Nf 50 million ($20 million) in 1976 would be enlarged in 1977 to Nf 100 million ($40 million). Companies will receive money from the funds when they can show their foreign competitors receive abnormally levels of support from our national governments. (2) For the export financing arrangment between the Netherlands Central Bank and the EFM and other commercial banks, the parties involved are negotiating an expansion of funds form Nf 2.7 billion ($1.08 billion) to Nf 3.5 billion ($1.4 billion). The present ceilings of Nf 200 million ($80 million) for global loans and Nf 1.5 billion ($0.6 billion) would also be enlarged. (3) The ceilings would also be raised for small and medium sized companies and loans for more than of Nf 100 million ($40 million) over three to five years would also be available for an additional two to five years, allowing more companies to take advantage of the central bank's export financing arrangement.

The government is also considering a fixed interest rate of 7 1/2%, in combination with EFM and matching funds, for companies insured with NCM. Following a request from industry, the government also said it might be willing to create a fund for "mixed credits," under international guidelines established by the OECD, whereby regular commercial credits could be mixed with subsidized government funds in order to expand lending opportunites in the developing world.

Abbreviations

EFM — Export Financiering Maatschappoj N.V., a private banking institution specializing in export credits.

Nf. — guilder. (Nf.1= $.41)

OECD -- Organization for Economic Cooperation and Development

NCM -- Nederlandsche Credietverzekering Maatschappij N.V., a private insurance company specializing in export insurance.

CHAPTER X

EXPORT STIMULATION IN SWITZERLAND*

INTRODUCTION

Switzerland has traditionally had a free market economy with little direct governmental participation in its commercial affairs. In recent years, though, with the world energy crisis and the international recession of 1973-1974, the government and the Swiss National Bank have taken a larger role in managing Swiss economic affairs. For the most part, they have resorted to a conservative posture in order to facilitate a recovery of Swiss exports and a gradual expansion of economic activity. The government is determined to retain present low interest rates (5 to 6 1/4 percent) and the open Swiss capital market. Its policies, though, have produced a very low rate of expansion (less than 1 percent last year) in Switzerland's GNP.

Despite a slackened world demand for Swiss exports due to continuing effects of the recent recession, the government relies mainly on the private sector to promote exports. It does have a small government office to facilitate trade, but the Swiss Office for the Development of Trade (SDOT)—a semi official organization—

---

* Prepared by John A. Costa, Analyst in International Relations, with the assistance of Jose Fiallo, Consultant. Information on specific programs and agencies derived or condensed from U.S. State Department Airgrams in Competitor Nation Export Expansion Programs: Switzerland, "July 28, 1976, and "Export Financing," January 6, 1975, by the U.S. Embassy, Bern, and from Price Waterhouse Information Guide <u>Doing Business in Switzerland</u>, July 1976.

is the primary vehicle for coordinating industry participation in trade events and supplying marketing information about foreign economies. It promotes Swiss exports and sponsors and organizes Swiss expositions and participation in foreign trade affairs.

Switzerland has no official organization to finance exports. The private sector is solely responsible for such support. However, the Swiss Government does negotiate inter-governmental agreements with developing countries on transfer credits. These provide for the combination of a government loan with a bank loan of a similar amount. Transfer credits are considered part of a program of assistance to developing countries.

The continued appreciation of the Swiss franc has had its impact on foreign demand for Swiss products. The higher value of Swiss currency in comparison to other currencies has made Swiss goods less competitive in the world market. The Swiss National Bank, aware of the adverse effects of this appreciation, is intervening in the foreign exchange market in order to help curb further appreciation of the franc. The Bank is recycling investments, placing lower ceilings on levels of savings deposits by nonresidents, limiting the number of accounts a family may hold, reducing the volume of Swiss franc sales to foreigners and restricting the importation of foreign bank notes to smaller amounts in order to achieve this end.

The Swiss Government's major intrusion into the private sector is in the agricultural sector. The government supports agricultural production through compensatory payments, price supports, preferential credits, and supplementary imports. The supports are geared to assure the farmers an income equal to that earned by people doing non-farm work in similar skills.

The Government does provide official export credit insurance against non-commercial risks through the Office of Federal Export Risk Guarantee (FERG), while two commercial companies insure commercial risks. The former generally insures exports to developing countries, while the latter insures exports to developed countries.

SWISS ECONOMIC CONDITIONS

The Swiss economy is highly dependent on external forces. Switzerland is a resource poor country lacking many basic raw materials for its industries. Its agricultural sector is unable to feed more than half of the population. Since the small Swiss domestic market can only absorb a small fraction of its highly sophisticated manufactured goods production, foreign trade plays a vital role in the country's prospertiy. In 1974, Swiss exports of goods and services accounted for 26 percent and 14 percent of GNP, respectively.

The country's major trading partners are other European countries and the United States. The nine EEC countries supply 67 percent of Swiss imports and take 44 percent of Swiss exports.

Switzerland's major exporting industries are machine manufacturers, chemicals, pharmaceuticals, textiles, and watching-making. The first three export about 75 percent of their total production. The textile and watch-making industries export about 50 percent and 95 percent, respectively, of their output. These five industries account for over 60 percent of the country's total industrial production. Switzerland also derives a good deal of its foreign revenues from tourism, banking, insurance, and other services.

EXPORT PROMOTION PROGRAMS

Official Agencies

The Swiss Federal Department of Public Economies in Bern is responsibe for overseeing the interests of Switzerland in the international economy. Its Division of Commerce negotiates bilateral and multilateral trade agreements, develops investment and trade policies, allocates financial assistance to developing countries through international institutions, and makes and carries out policy and related matters. One of its subunits, the Export Promotion, Foreign Image and New Markets Office (Handelsfoderung, Imagewerbung und Erschliessung neuer Markte) deals with export promotion issues. It has a staff of three: an ambassador, a minister, and a chief of section.

Semi-Official Activities

Most Swiss export promotion activities are managed by a semi-official institution, the Swiss Office for the Development of Trade (SODT), an institution formed in 1927 out of the merger of the Central Office for Expositions and the Office for Buying and Selling Information in Zurich with the Swiss Industrial Office in Lausanne. The SODT still has two separate offices, one (with 45 people) in German-speaking Zurich and another (with 50 people) in French-speaking Lausanne. The SODT is a semi-official entity, entrusted with the task of promoting Swiss exports and sponsoring or organizing Swiss participation in foreign trade fairs. While the Swiss Government channels its official export promotion activities through the SODT, the major portion of Swiss action in this area is still conducted by the private sector, through individual companies and private associations.

The SODT has a Supervisory Board consisting of: (1) two members of the Division of Commerce; (2) eight delegates appointed by the Swiss Government from private industry and small business; (3) three delegates from the Swiss Union of Trade and Industry, commonly known as the Vorort; (4) two delegates from the Swiss

Union of Small Trade; (5) two delegates from the Swiss Farmers Union; and (5) twelve delegates appointed by the General Assembly of SODT members representing various industrial, service, and banking organizations. Management is under a General Director, a General Secretary, and two Directors, one each for the offices in Lausanne and Zurich.

Other institutions contributing to export expansion are: (1) the Swiss Union of Trade and Industry (or Vorort), an umbrella association for Swiss industry and trade with 132 member organizations. The Vorort is the Division of Commerce's main private sector partner in shaping Swiss Government trading policies; (2) the cantonal chambers of commerce, private associations which deal with export inquiries received from members and handle export documents such as certificates of origin, carnets de passage, and certifications of origin; (3) professional organizations, such as the "Deration horlogere" (watchmakers' guild) or "Verein schweizerischer Maschinen-Industrieller," (Associatia of Swiss Machine Industralists), which coordinates promotion campaigns abroad; and (4) the Union of Swiss Chambers of Commerce abroad, an association of private Swiss trading organizations in 13 countries. The Swiss Chambers carry out work for the SODT for which they are modestly compensated in a lump sum fee annually. Most of their income, however, is derived from membership fees and other payments from their user organizations.

There is a division of responsibility for the execution of these various export promotion programs. National-level programs are carried out by the SODT. Cantonal chambers of commerce, depending upon the initiative of their boards of directors or of their staff, offer limited assistance to Swiss exporters. For example, as part of an effort to assist the industries worst hit by the recession, certain cantonal and municipal economic development agencies have taken a more direct interest in promoting exports either through existing agencies or their own programs. A typical local drive is the program now under consideration in the Canton of Geneva whereby the cantonal government channels subsidies to the "office pour la promotion de l'industries de Geneve." This office is actively searching for new markets and customers.

Programs and Techniques

Elaborate, targeted, or sophisticated programs other than basic export information assistance do not exist, except for the sporadic organization of large industrial expositions in potential markets. (Examples of these include Moscow, Sao Paulo, and Peking, at intervals of about two years in the past six years, and the Swiss Industrial and Technological Exhibition held at Guezira Exhibition Grounds, in Cairo, in late 1976. Unlike other European nations, the Swiss Government and SODT do not concentrate their resources or programs on particular types of exporters, customers, industries, or products.

The views and wishes of selected export firms, most of which have extensive experience and great expertise in export promotion, play a significant role in the formulation of SODT policy. Advice and criticism from individual firms and organizations are voiced through the Supervisory Board of the SODT and in Parliament.

One successful program of the SODT is the organization of Swiss single country industrial expositions abroad. In addition, the SODT coordinated the participation of Swiss industries in 22 international fairs in 1976. At its head office in Zurich, six staff members operate the fair development. Collapsible, prefabricated booths are made available at a reasonable cost to Swiss exhibitors. The Lausanne Office maintains an extensive library on foreign markets, engages in limited market research, and operates a publishing department. The Zurich office is the seat of the General Director and the General Secretary and is responsible for organizing Swiss exhibitions and participation in foreign trade fairs, answering trade inquiries, and publishing the Swiss export director. More recently, the Lausanne office started a program of educational seminars for small and medium-sized prospective exporters to provide information on access to specific markets and on some specific problems encountered by exporters (e.g., the preparation of contracts with agents).

Other SODT programs include: (1) information on foreign markets; (2) agent/distributor service which provides information on possible trade leads; (3) an indirect referral system by which foreign inquirers receive names of Swiss suppliers; (4) publishing the Swiss Export Directory from which most addresses are derived that are used in reply to foreign trade inquiries; (5) publishing the Swiss Economic News (a monthly bulletin for the economic press, published in French, German, English and Spanish); and (6) publishing a bi-weekly journal circulated to SODT members and to trade associations in Switzerland.

The Division of Commerce became more active in opening new markets to Swiss firms during 1977. Its director and other staff travelled to OPEC countries. The Federal Councilor who heads the Department of Public Economy visited Iran and Saudi Arabia to look into new opportunities in those areas. In addition, the Swiss Government also took a direct interest in creating four new positions for commercial delegates in emergent markets. Apart from Swiss Government involvement within emerging markets, export promotion programs are normally carried out by the SODT or by individual firms or associations in the private sector. SODT has entered into agreements with chambers of commerce in several Eastern European countries. Similarly, it occasionally assists Eastern European countries and LDC's in the promotion of their exports into Switzerland with a view to adjusting the Swiss balance of trade with those countries.

The private sector, through individual companies and private associations, assumes a far greater role in promoting Swiss exports than the SODT could with its limited means.

Budget

SODT derives its income from fees charged to inquirers, contributions from its 1,641 members (companies and business organizations) as well as from Swiss Government subsidies, which amounts to 30-40 percent of the total budget. In view of the mixed activities of the SODT, its operations and budget are supervised jointly by the Swiss Government and the private sector through the SODT Supervisory Board. SODT policies undergo close scrutiny by the Swiss parliament each year at the time of voting on its budget (the Swiss Government subsidy). Over the last few years there has been discussion about the level of SODT funding. During a period of economic expansion there were attempts to limit SODT activity, as well as discussion in parliament of an export tax. In fact, however, the Swiss parliament has responded favorably to government advocacy of increased SODT activity and has enacted an increased SODT subsidy, and special allocations to establish special commercial delegations abroad. The SODT's small budget ranks last among those of all Western Europeans export promotion agencies surveyed in this paper.

While information on Swiss Government subsidies to the SODT are available, these funds are contributed in a lump sum, and a breakdown by type of activities or programs is not obtainable. In 1976, the Swiss Government subsidy to the SODT totaled 4.9 million Swiss francs ($1.88 million), in contrast to 3.5 francs ($1.3 million) for 1975. The Swiss Government categorized 3.9 million of the 4.9 million francs spent in 1976 as an ordinary contribution, while the remaining 1 million francs was termed an emergency donation required because of the recession.

EXPORT FINANCE

Export Credits

Unlike other countries reviewed in this study, Switzerland has no official organization to finance exports. The financing of export credits is the sole responsibility of the private sector. As part of a program of assistance to developing countries, though, the Swiss Government has concluded some inter-governmental agreements with developing countries on transfer credits providing for the combination of a government loan with a bank loan for a similar amount. The interest rates on government loans in recent years have been a 1 percent to 5 percent, with a grace period of up to 10 to 12 years, and a duration of 15 to 18 years. The bank loans have been made on the same terms.

The Swiss capital market has always satisfactorily fulfilled its role as supplier of funds to exporters. In 1977, short-term credit (i.e., one year) cost 5.0 percent, plus a .94 percent premium to cover credit insurance guarantees from FERG. As of October of 1975, the following typical interest rates were reportedly paid by borrowers under the Swiss commercial banks export credit terms.

Maturity of Credit	Average Rate
3 years - 10 yrs	5-6 1/4%
6 years - 10 yrs	5 1/2 - 6 3/4%

Swiss Export Insurance and Guarantee Program

While the Swiss Government does not provide official export credits, it does provide a government credit insurance scheme against non-commercial risks. Two commercial companies insure commercial risks. In 1934, the Swiss Government introduced the insurance system although it is at present governed by a 1958 law and an order of 1969. The Office for Guaranteeing Export Risks (FERG), whose headquarters are in Zurich, acts on behalf and at the direction of the Swiss Government. The Federal Council appoints a Guarantees Committee consisting of three federal civil servants (one from the Trade Division of the Department of the Economy, one from the Federal Office for Industry, Crafts and Labour of that Department, and one from the Finance Administration of the Department of Finance and

Customs) and three representatives of business and industry (one from the Societe Suisse des Constructeurs de Machines, one from the Societe Suisse des Industries Chimiques, and one from the "Vorort" or the Union Suisse du Commerce et de l'Industrie).

The proposals of the Guarantees Committee require the approval of the Trade Division of the Economy when the guarantee requested does not exeed 1 million Swiss francs, and the Department of the Economy must in turn obtain the consent of the Finance and Customs Department for amounts over 2 million Swiss francs. When the requests involve a matter of principle or are of special importance, the Federal Council itself must decide on the recommendation of the Guarantees Committee.

The FERG program is relatively significant, guaranteeing over $695 million of Switzerland's $15.1 billion exports in 1976, and its outstanding guarantees totalled $4.08 billion at the close of the year. Policy rates are based on presumed risks. The FERG has no funds of its own, and its fees are paid to and payments received from the Swiss Government treasury. Any surplus income, after deductions for current expenses and losses, is paid to a fund for export risk gurantees, whose reserves cover future claims and currently stand at 170 million Swiss francs.

The FERG serves to promote exports and thus maintain a high level of employment. It provides guarantees against political risks of non-payment of credits arising out of Swiss exports. Exceptionally, the guarantees may cover exports that are partly of foreign origin if the requirements of a contract could not be met in Switzerland or if there are reciprocal agreements with the country in which the products originate.

While the Swiss Government does not guarantee commercial risks, two private companies do: the Eligenoessische Versicherungs Aktiengesellschaft (Eligenoessische Insurance Company) and the Swiss subsidiary of the Gerling Konzern of Cologne. These two companies insure exports to developed countries. In the case of exports to developing countries, the Swiss banks usually seek to obtain the guarantee of the government of central bank in the developing country concerned. Under such a guarantee the transaction is considered to be with a public buyer, and the risk of default is thus covered as a political risk.

Guarantees are granted only for exports of Swiss products, although exceptions are occasionally made for complementary equipment which cannot be obtained in Switzerland. Guarantees may also be granted for transactions involving the rental of Swiss equipment, the assembling of equipment, engineering services, or the transfer for a fixed sum of patents or technical processes. Global policies are available for short term credits, exporters being free to choose their markets. Individual policies are also available for short term and medium term suppliers' credits and buyers' credits granted within the framework of bilateral agreements between the Swiss Government and developing countries.

Guarantees cover pre-delivery and post-delivery risks caused by such events or circumstances as: (1) transfer difficulties; (2) insolvency or refusal to pay on the part of states, municipalities or other public entities acting on behalf of a government; (3) insolvency or refusal to pay on the part of states, municipalities or other public entities or central banks guaranteeing a credit; and (4) special measures taken by foreign states, or political events abroad which prevent debtors from fulfilling their obligations, leading to the confiscation or deterioration of goods belonging to the exporter or preventing their re-exportation. The maximum indemnity that can be paid is 85 percent of the loss plus interest on the credits. Insurance premiums are fixed by decree and determined according to the amount of the credit and duration of the guarantee. Specific coverages may be limited to specific phases of the pre-shipment and post-shipment periods.

TAX INCENTIVES FOR EXPORTS

Foreign Branch and Subsidiary Operations

Swiss treatment of foreign business income depends on the form in which the operations are conducted. All income and assets of a Swiss company are theoretically subject to taxation, but the law provides exceptions in certain cases.[1/] Income and net assets attributable to foreign permanent establishments or net income on the appreciation of real property situated outside Switzerland are not subject to tax until transferred to the Swiss parent company. Most income from foreign subsidiaries is also taxed only when received in dividends and taken up as income by the Swiss firm. The proceeds from any liquidation (in excess of the value of the investment and capital gains) are taxed separately in some cantons, at rates that are generally higher than those for Swiss income taxes. Income from interest, royalties, and licencing or service fees from foreign subsidiaries is also treated as ordinary income for the Swiss firm.

The Swiss have negotiated a number of tax treaties with foreign countries to avoid double taxation on foreign earnings. They do not normally allow credits for foreign income taxes except in those instances where tax treaties permit those claims on the unrelieved portion of foreign withholding taxes on dividends, interest or royalties or on similar fees originating in the foreign land.

1/ Corporate income, including capital gains, is taxed in the hands of the corporation. Profits distributed by way of dividends, are again taxed in the hands of the recipients, e.g., shareholders. Entities subject to the corporate tax system are the following corporate entities: corporations, companies, partnerships partially limited by shares and cooperative societies.

Turnover Taxes

The Swiss Government first imposed a turnover tax during World War II, and it now provides the federal government with one-quarter of its total tax revenue. A single step tax resembling a sales tax, the turnover tax is levied only on deliveries of goods and merchandise, not on services, and it applies only to final sales to the consumer. Export sales are exempt.

The Swiss had planned to replace their turnover tax with a value-added tax (VAT) after October 1, 1977, to bring their tax system into conformity with current practice in most Western European nations, but the initial proposal was rejected by the voters in a June plebiscite. The turnover tax remains in effect and it is not certain what the government's long-term plans are in this area.

34-201 O - 78 - 18

CHAPTER XI

EXPORT STIMULATION IN THE UNITED KINGDOM*

INTRODUCTION

The United Kingdom promotes its exports actively. The British Overseas Trade Board (BOTB) provides policy direction for export promotion programs, while the British Department of Trade performs budgetary, staffing, and other housekeeping functions related to export promotion activities. A British Overseas Advisory Council, composed of BOTB and business officials, advises the BOTB on trade promotion matters. Overseas trade fairs, particularly the Joint Venture program, stand out as the predominant form of U.K. Government export promotion activities.

The United Kingdom has one of the largest and most comprehensive export credit and insurance programs among the major trading countries. The Export Credit Guarantee Department, which administers the program, does not extend export credits directly. Instead, British clearing

---

*Prepared by Kenneth Durkin, Consultant, and John A. Costa, Analyst in International Relations. Information on specific programs and agencies was derived or condensed from U.S. State Department Airgrams "Competitor Nation Export Expansion Programs: United Kingdom," May 18, 1976, and "U.K.: Investment Incentives," May 31, 1977, by the U.S. Embassy, London; U.S. Department of Commerce, Bureau of International Commerce study "Competitor Export Promotion Programs: Selected Aspects and Techniques," July 1971, revised April 1974; U.S. Export-Import Bank Report to the Congress on Export Credit Competition and the Export-Import Bank of the United States, June 1977; and Arthur Anderson & Co., Statement on U.S. Companies in International Markets--the Competitive Factor in Tax Policy. submitted to the U.S. Senate Finance Committee in conjunction with public hearings on H.R. 10612, 94th Congress, 2d Session, April 20, 1976.

banks provide such credits, though, in exchange for ECGD unconditional repayment guarantees, interest rate subsidies, and limited portfolio refinancing. The support applies to medium and long term credits on both a supplier and buyer basis. Export credit insurance is available through the ECGD to cover commercial risks, political risks, and inflation risks.

The British economy remains quite depressed, and the government hopes a strong program for stimulating exports will help bring the country out of its slump by expanding production and stimulating new economic activity in other sectors of the national economy. The United Kingdom's export promotion program has met with some success, though exports alone are not likely to solve the U.K.'s economic problems. Inflation is running at over 15 percent and this could rise sharply in the coming year, if drastic wage escalation becomes the rule in coming months.

A wage agreement negotiated in June 1976, envisaged an average annual increase of 4.5 percent, which because of the high inflation rate meant an effective fall in real income. As of the end of July 1977, however, the minimum increase in wages demanded by the unions was 15-20 percent over the next year. In many cases it is higher. For example, the miners are demanding 90 percent more than they asked for last year and railway workers wanta 63 percent larger raise than before. Continued high rates of inflation almost inevitably increase imports and diminish export opportunities for national goods. Thus, in the view of many observers, the United Kingdom faces the unpleasant prospect of increasing its export revenues through pormotion programs only to see them dissipated by continuing inflation and its effects on British trade.

THE UNITED KINGDOM: A PROFILE

The United Kingdom provides assistance or incentives for a larger share of its manufactured exports than does the United States. The share of manufactured exports officially supported in the United Kingdom stands at roughly 45 percent compared with 15 percent in the United States. This reflects the greater government involvement in the United Kingdom as well as the government's willingness to provide subsidies for exports.

A major source of export promotion for the United Kingdom is its foreign service. Britain has long given top priority to its commercial relations and this is reflected in the personnel it allocates to export promotion—almost 400 foreign commercial officers and 1000 support staff at most U.K. overseas posts. Roughly 13 percent of these are in the EEC, 9 percent in the United States, 1 percent in Japan, and 11.3 percent in other OECD countries. The U.K. spent over £45 million ($91 million) on export promotion in 1975, more than was spent by any one of its major competitors.

The United Kingdom has expanded its exports of manufactured goods continuously in the 1970s but not fast enough to avoid running up large trade deficits. In 1970 and 1971, the U.K. trade balance was in surplus, but in 1973 it registered a trade deficit of £736 million ($1.7 billion). This deficit skyrocketed to £3.3 billion ($7.6 billion) in 1974, then fell to £1.6 billion ($3.2 billion) in 1975. Britain's share of world exports of manufactures declined from 10.1 percent in 1970 to 8.5 percent in the first three quarters of 1976. Its share of total world exports declined from 7.1 percent in 1971 to 5.2 percent in 1976.

Britain's main exports are machinery (25% of total exports), chemical (13%), transportation (11%), metals (10.5%), and other finished manufactures and semi-manufactures (18.5%). Together these account for almost 80 percent of total U.K. exports. The EEC is the United Kingdom's largest market. Table 1 gives a further breakdown for U.S. export markets.

TABLE I

Percentage Distribution of UK Exports (1974)

EEC	33.5
Rest of W. Europe	17.5
Sterling Area outside Europe	18.5
North America	13.5
Latin America	3.0
Soviet-Eastern Europe	2.5
Others	11.0
Total*	100

While the British do monitor some of their export promotion programs and tabulate results, this does not normally take place against a background of predetermined goals or cost benefit analysis. Export promotion is targeted on a product or geographical basis, with forty products and twenty countries receiving the bulk of promotional expenditures. These targets areas and products are determined by the British Overseas Trade Board (BOTB) based on reports and recommendations from British overseas posts and consultations with the Department of Trade (DOT) and the Department of Industry (DOI).

British export promotion programs are aimed primarily at the largest exporters and at traditional markets, although small and medium-sized exporters have not been ignored. The number of small, medium, and large firms participating in the export sector has increased in the 1970s.

* total may not add due to rounding

According to U.K. Department of Industry estimates, 89 companies accounted for half the country's exports in 1974, compared with 100 in the previous year. Two-thirds of total exports in 1974 were controlled by only 230 companies, compared with 300 in 1973. Despite this increasing trend toward concentration in the export sector, small and medium-sized companies are recognized as an important and substantial part of the export sector.

THE BRITISH OVERSEAS TRADE BOARD

In March 1972 the British government created the British Overseas Trade Board (BOTB) to stress the increased importance of two-way trade, overseas investment, and general British export promotion activities to the United Kingdom. The membership of the BOTB consists of ten members from banking and industry (both management and union levels) and four members from the government.

British export promotion activities are centered in the BOTB and the Department of Trade (DOT). The DOT is responsible for budget management and the staffing of government export promotion activities, while the BOTB is in charge of policy direction for the Department of Trade's export promotion machinery. The BOTB has broad powers and is subject to outside control only for purposes of coordinating general policy consideration with the government through the Minister for Trade or the Secretary of State for Trade.

The BOTB has three broad areas of responsibility. They are 1) the direction and administration of the existing services to exporters provided by the DOT; 2) acting as a bridge between government and industry in the consideration and resolution of specific overseas trade problems; and 3) discussing and resolving with industry the long term strategic approach to overseas trade expansion, including the establishment of priorities for products and markets. The Board also strives for effective deployment of the government's export promotion resources in support of the British industrial, service, and finance sectors. In essence, the BOTB places businessmen in charge of the United Kingdom's export and trade promotion machinery.

A government task force recommendation resulted in the establishment in 1975 of a new entity named the British Overseas Trade Advisory Council (BOTAC). This council, presided over by the Secretary of State for Trade, is made up of the members of the BOTB, the chairmen of its sixteen geographical area advisory groups, officers of certain associations plus members named by the Confederation of British Industry, the Trades Union Congress and the Association of British Chambers of Commerce. The council is designed to draw in a more varied group of advisors for the government's trade promotion program. Technically, it was not possible simply to broaden the membership of dhe BOTB because the latter's assigned role was as executive for the trade promotion program, while the new council was to have purely advisory functions. Nevertheless, BOTAC has had the effect of broadening involvement in the promotion of trade.

The BOTB has introduced various program innovations but there has been no change in the long standing priorities in trade promotion. The government continues to give primary emphasis to assisting firms which are already important exporters and to countries which are already major export markets for British products. There has been no new-to-export or new-to-market emphasis in the British program, nor has there been any concentration on smaller and medium-sized companies.

The techniques of government export promotion activities have varied depending upon the time and circumstances. The BOTB provides advice to exporters in the form of brochures dealing with tariff and nontariff barriers, exhibiting effectively abroad, conducting overseas seminars and symposiums, and participating in trade fairs. Trade fairs together with the Export Intelligence Service, the Export Marketing Research Scheme, and the Overseas Projects Group are the major export promotion programs of the BOTB.

Trade Fairs

Overseas trade fairs are emphasized in order to encourage firms to use them as a means of exploring, establishing, and sustaining themselves in export markets. The British Joint Venture Program is the predominant form of U.K. Government sponsored participation at international trade fairs. Cooperation between the BOTB and the private sector is of fundamental importance in actively mounting Joint Venture participation.

In 1976 the BOTB gave support to over 5,400 companies at over 270 specialized trade fairs abroad. It is BOTB policy to help defray expenses incurred by companies participating in these fairs. The BOTB pays up to half the round trip fares of two trade association representatives to man information stands. In the case of Joint Ventures outside Western Europe, the BOTB makes a similar contribution to the round trip fares for two representatives of each firm to man their stand at the event, and in addition, pays up to half the freight charges for returning unsold goods exhibited at the fairs, provided the goods are shipped back to the United Kingdom within twelve months of the close of the event. Joint ventures are claimed to be the cheapest and most effective way to introduce British manufactured goods to foreign markets.

The BOTB also organizes British pavilions at some international trade fairs, usually those where participation is organized on a national basis. A substantial part of the total cost of providing display facilities is borne by the BOTB. As a result space and a shell stand may be provided to participating British firms at attractive rates. Travel benefits available under the Joint Ventures program also apply to firms exhibiting in a British pavilion at fairs outside Western Europe.

Export Intelligence Service (EIS)

The Export Intelligence Service was initiated in June 1970 by the Department of Trade and Industry (since separated into two separate government departments). The EIS has a computerized information dissemination and retrieval system designed to aid firms in obtaining information relevant to their needs. The system supplies data in fourteen commercial information categories on specific export opportunities and other important export intelligence matched to a subscriber's individual needs and requirements.

A 1973 survey showed that for subscribers to the EIS, two-thirds had some type of response, and of those two-thirds approximately 14-20 percent of the contacts resulted in business. Information on trade leads (which is published for exporters in the Export Service Bulletin) is collected from the commercial staffs of 220 British embassies, high commissions, and consulates throughout the world. The information is then analyzed on the Department of Trade computer and broken down into nearly 5,000 product categories. EIS, information is also divided into 200 geographic areas or countries and various intelligence categories, including trade opportunities, tender reports reports, notification fo foreign trade fairs, and market data.

The initial cost of placing the EIS program into operation in 1970 was £502,000 ($1.2 million) and the annual cost of operating the program has been approximately £480,000. The BOTB had originally hoped to attract as many as 10,000 subscribers to this program so that it might break even. At the end of 1974, however, it had only 6,5000 subscribers covering firms responsible for 80 percent of British exports. In the four years from 1971-1974 the EIS attracted only 1500 new subscribers. Based on these figures it is probable that the EIS will continue to operate at a loss. In fact, in April of 1976 subscription fees were increased. These increases still did not bring the EIS program to the break even point. Rather than aiming at full cost recovery, the BOTB is striving for the recovery of such costs as the market will bear.

Export Marketing Research Scheme (EMRS)

Another export promotion service of the BOTB is the Export Market Research Scheme, established in 1969. The goal of this program is to encourage U.K. firms and trade associations to undertake marketing research overseas as a key part of their export efforts. Priority is given to applicants with little or no previous experience in exporting marketing research. The BOTB employs a professional consultant, the Export Marketing Research Adviser (EMRA), to advise firms on the best methods of conducting research in overseas markets.

EMRS offers a fifty-fifty cost sharing option for private firms' market research efforts. In all there are three categories of financial assistance under EMRS: 1) Individual company projects with up to one-third of the cost shared by the Department of Trade. This is the oldest and most popular arrangement to date. 2) Joint research by groups of two or more firms in related fields in the same geographic area, with the Department of Trade contributing up to one half of the costs. This option is rarely used since it is difficult to match the diverse interests of various companies. 3) Trade association sponsored research, with DOT absorbing up to two thirds of the costs. This is the second most popular arrangement under EMRS. The trade association is entitled to charge non-members a higher fee than members pay for the report. The price to be charged is negotiated beween the DOT and the trade association and usually runs about 50 percent higher for non-member firms. In theory, any profits from such additional sales are to be shared equally between the DOT and the trade association. On occasion the DOT will underwrite market research and then sell the information to interested firms at a nominal price.

EMRS research, no matter what the financial arrangement, can be one of three types 1) research by the DOT, 2) syndicated studies initiated by a market research firm and later sold to British firms, 3) research performed by private firms with a market research capability. If the work meets Department of Trade standards, the firm may be reimbursed at the scheduled rate. EMRS also provides firms interested in exporting with general information and market research and helps them define their market research objectives. The Export Market Research Scheme assumes a high level of export awareness on the part of the firms and relies on the firms to take the initiative.

Overseas Project Group (OPG)

The Overseas Project Group coordinates official support for British consultants, contractors, manufacturers, and bankers and helps assure that U.K. business participation in a project is optimized. The group's primary objective is to help British industry win major contracts overseas. In selecting projects to finance, OPG looks for projects which offer the opportunity for earning at least £5 million of foreign exchange for British goods and services. Another important factor in choosing projects is their ability to generate additional business in the future. Once a project is chosen (after considering technological, financial, and political factors as well as price and delivery terms), the OPG makes contacts with interested companies and stimulates interest in the proejct where this is lacking. There is close cooperation between the OPG and all interested Departments at home and foreign service posts abroad.

The OPG has power to provide a limited amount of financial assistance from the Overseas Projects Fund. The purpose of this fund is to increase the British share of contracts for goods and services for major projects abroad. It is designed to encourage firms that are capable of an overseas undertaking, but which would not otherwise be capable of winning the contract without financial assistance. Provided that the assistance does not exceed £50,000 per project or one half percent of the gross value of the contract being sought (whichever is lesser), OPG can contribute up to 50 percent of the precontractual expenses of firms pursuing major projects overseas.

In the period January 1973 to September 30, 1974, British firms assisted by OPG won contracts abroad worth £250 million (about $580 million). It has been estimated by British sources that every £1 of public funds spent by the OPG helped stimulate British exports worth £400. Of the 155 projects in which OPG became involved in the period 1973-1974, 120 were in countries which had been designated as major markets for projects. Almost all of these were in sectors which had been given special priority because the projects appeared promising as a result of high U.K. capability in the project fields.

Other Programs

Trade drives, initiated in 1969, are designed to stimulate the exports of British products in a target foreign market over a relatively long period of time. During such a period, the DOT steps up all forms of officially sponsored and financed promotional activities. The BOTB declared 1977 an official U.K. Export Year, which meant in essence that a large scale trade drive was under way in many parts of the world all year.

"Store promotions" of British goods involving a substantial volume of new or additional items are put on by overseas department stores. The BOTB assists the store by providing display material, arranging for special supporting features to be sent out either wholly or partly at the store's expense, and in certain cases providing financial assistance towards paid advertising. The BOTB's contribution to the store promotion is directly related to the volume of special buying of British goods.

Another program technique is supervised by the Committee on Invisible Exports. Invisible exports refer to income generated from selling abroad any of a number of services or other income producing ventures (e.g., insurance, engineering and construction consulting, financial services, investments abroad, proprietary knowledge, leasing motion pictures). The chairman of the Invisible Exports Committee sits on the BOTB. The committee role became important when the United Kingdom consistently showed a strong surplus in this category of export earnings.

TABLE 2

The U.K. Current Account Deficit, 1974-1976
(£ or $ = millions)

Year	Visible earnings	Invisible earnings	Trade Deficit
1974	£5,220($12,214)	£1,873($4,382)	£3,347 (-$7,832)
1975	£3,204($6,472)	£1,531($3,092)	£1,673 (-$3,280)
1976	£3,590($6,103)	£2,170($3,689)	£1,420 (-$2,414)

Source: U.S. Department of State

For each of the years listed in Table 2, invisible earnings were in surplus while visible earnings accounted for huge deficits. The disparity demonstrates the vital role of invisibles in helping control the overall size of the U.K. current account deficit. The Committee on Invisible Exports plans its promotional activities for specific geographic areas determined to have potential for increased earnings. The invisible promotion campaign is directed towards firms and industries that have proven their ability to succeed in international markets.

Another service to increase exports offered by the BOTB is financial support to outward trade missions (U.K. businessmen going overseas to sell). Missions must be collective and must be sponsored by chambers of commerce or similar non-trading organizations. The BOTB also operates a large reverse mission program designed specifically to encourage key, high level foreign businesses or government officials in specific fields to visit the United Kingdom. The program has the clearly stated objective of influencing purchasing decisions. The British have found reverse trade missions a particularly valuable export promotion tool for LDC markets.

In recent years the BOTB has become involved in giving financial assistance to British trade associations or other non-profit groups conducting technical seminars and symposia overseas. In addition, the BOTB as of 1975 has coordinated the development of a new "Foundation Course in Overseas Trade," which is offered in colleges and polytechnical schools. This is a part-time, one-year course, conducted in conjunction with the Institutes of Export Freight Forwarders and Marketing. The response of the educational institutions reportedly has been very good.

Budget

In fiscal year 1976 (April 1975-March 1976) the United Kingdom reported its export promotion expenditures totaled £46.4 million, up considerably from the £37.7 million spent in fiscal year 1975. By far the two largest areas of budget support in the fiscal year 1976 period were information services and trade event support, which accounted together for over 65 percent of total government export promotion expenditures. A more detailed breakdown of the United Kingdom's export promotion expenditures can be found in Table 3 below.

TABLE 3

United Kingdom Official Government FY 1976 Export Promotion Expenditures
(L and $ millions)

Program	FY 1976 £	FY 1976 $	% of total gross costs
Support of quasi-government trade promotion organizations	1.4	2.8	2.9
Market Research	0.5	1.0	1.0
Information Services	16.4	33.1	34.0
Trade Event Support			
Trade Center-Tokyo	0.6	1.2	1.2
Trade Fairs*	13.1	26.4	27.2
Trade Missions	2.1	4.2	4.3
Overseas Export Publicity	6.1	12.3	12.5
Joint export Associations and other Private Sector Support	-	-	-
All Other**	7.3	14.7	15.1
Total Gross Costs	47.5	95.7	100***
Less Trust Funds	1.5	3.0	
Less Reimbursable Funds	-	-	
Total Net Costs	46.0	92.7	

*Includes in-store promotions; £1 million.
**Includes general administrative backup to export.
***Totals may not add due to rounding.

THE EXPORT CREDITS GUARANTEE DEPARTMENT

The United Kingdom has one of the largest and most comprehensive export credit programs among the world's major trading nations. The U.K. export financing and insurance support programs are administered by the Export Credits Guarantee Department (ECGD). The ECGD was established as an executive agency of the British Government responsible to the Secretary of State for Trade. All ECGD transactions also require the approval of the British treasury, though, in practice, only those that set precedents or involve extraordinary risks or terms are formally referred to the treasury for review. Advisory councils of bankers and businessmen are consulted on transactions underwritten on commercial account and on country conditions and exposure.

The ECGD operates within an overall budgetary ceiling set by parliament and has discretionary power to allocate funds to each of its support programs. Basically the ECGD operates as a commercial enterprise and is self supporting. Commercial banks provide the actual credit with the ECGD refinancing sterling credits. In theory, any profits earned are returned to the exchequer. In practice the ECGD maintains $400 million worth of reserves for accounting purposes.

Export credit insurance activity registered large increases during the fiscal year ending March 31, 1977. ECGD insurance and guarantee authorizations increased from approximatly $9.6 billion (£4.7 billion) in 1975/1976 to approximately $10.5 billion (£6.1 billion) in 1976/1977. Export credit authorizations, in contrast, declined about 18 percent, from $1.4 to $1.2 billion. This decline reflected, in part, a growing attempt in the United Kingdom to curtail public sector expenditures. Twelve percent of the 1976/1977 insurance and guarantee authorizations also received preferential financing from the ECGD.

The five basic services offered by the ECGD are 1) preferential fixed rate financing, 2) inflation indemnity coverage, 3) insurance and guarantees, 4) credit insurance for political and commercial risks, and 5) performance bond guarantees.

Preferential Fixed Rate Financing

British exporters may benefit from medium and long-term credits under the ECED direct lending preferential fixed rate financing program. Credits are extended to British exporters (suppliers credits) or foreign buyers (buyer credits) by London and Scottish commercial banks at rates set by the ECGD. The ECGD guarantees repayment of the full amount of the credit including interest. It also provides the banks with interest rate subsidies and refinances a portion of their export obligations.

Buyer credits are intended to encourage foreign buyers to place orders with a number of unrelated British suppliers. The terms of an individual credit under a particular line are set when the credit is arranged. Buyer credits have been very successful, as 80 to 85 percent of the over $1 billion in credits arranged since 1968 have been utilized.

Under the export financing scheme, a commercial bank receives a subsidy from the government on each export credit equal to the difference between the preferential rate set by the ECGD for that credit and an agreed upon rate of return. This agreed upon rate of return is the simple average of the treasury bill rate and the rate on lending to the nationalized industries on the date of authorization, plus a margin of 0.5 to 1.25 percent. Thus, the level of the interest rate subsidy varies with changes in relevant market rates and in the ECGD preferential fixed export credit rate. During 1975, for example, credit conditions were somewhat more relaxed than they had been in the past, and market interest rates declined. Consequently, the amount of government funded subsidy was reduced. Commercial banks may also refinance medium and long-term export credits with the ECGD when these credits exceed 21% of the bank's current account deposits. Many have taken advantage of this option, even though the refinanced loans are no longer subsidized.

In 1976, the basic preferential interest rate set by the ECGD ranged from 7.25 to 8.5 percent fixed for medium term credits (2-5 years) and from 7.5 to 9.0 percent fixed for long term credits (over 5 years), although the upper limits were not firm. These rates are exclusive of insurance premiums or other charges. Including these changes in the cost of funds to the borrower would mean an effective rate of interest on long term credits of 8.9 percent. At the time, this rate was higher than comparable figures for France, West Germany, and Japan, but lower than similar rates in Canada, Italy, and the United States.

Most credits in the two to five-year credit category were extended in 1976 at the minimum rate of 7 percent. For credits over five years, the most typical rate was 8 percent, although many credits were extended at rates between 7.5 and 8.5 percent. The actual rate charged is determined by the ECGD on the basis of the borrower's ability to pay, including the per capita GNP of the country, the competitive situation, and in some cases, the length of credit. ECGD will attempt to match each aspect, including interest rate and maturity, of a foreign officially supported export credit if the terms have been confirmed through the Berne Union or OECD information exchange systems. In addition to the basic interest rate, the commerical banks impose a commitment fee, negotiation fee, and management fee, which together add roughly 0.5 percent annually to the cost of credit.

The ECGD charges a guarantee premium which ranges from less than one percent to more than 5 percent flat and varies with the length of the credit and the credit risk. The premium adds approximately 0.6 percent annually to the cost of a ten-year credit for a good credit risk and 0.9 percent annually to the cost of a ten-year credit for a poor credit risk. These rates are somewhat higher for credits with shorter terms.

Short-term export credits are available from British commercial banks at market rates of interest. Such credits are often provided only on the condition that they will be guaranteed by the ECGD. As of the end of the first nine months in 1976, short-term export credits were advanced by the commercial banks at their base lending rate of 10.5 percent, plus 0.5 percent increase over the short-term rates available in December, 1976.

As of the end of 1976 the following typical interest rates were reported as paid by borrowers under the British export credit system. As expected, the interests vary with the maturity of the credit according to the following schedule:

Maturity of Contract	Range of Basic Rates	Typical Basic Rate	Most Typical Rate Including Fees and Premiums	
			Good Credit Risk	Good Credit Risk
Up to 2 years	Market Rate	Market Rate	12.5*	13.0
3 to 5 years	7.25-8.5	7.5	8.7	9.0
Over 5 years	7.5-9.0	8.0	8.9	9.2

*Variable

Medium and/or long-term credits with lower than normal interest rates may be extended in special circumstances in order to match foreign financing competition. For example, in February, 1975, the ECGD provided a $1.8 billion line of credit to the Soviet Union. In order to match French official financing competition, interest rates extended under this line of medium and/or long-term credits to the Soviet Union for major projects may be as low as 7 percent. For several years, the ECGD has also had authority to extend export credits on highly concessional terms, where necessary, to match foreign mixed-credit competition. However, almost no use has been made of this authority since it was granted in 1970.

Other key features of the British preferential fixed rate financing program are summarized below:

Percent of contract value preferentially supported:		80-85	
Are insurance or guarantees required?		Yes	
	FY 1975*		FY 1976*
Annual statutory or budgetary ceiling		-None-	
Outstanding Credits	6,417		6,393
Credit Authorizations	1,402		1,152
Credit disbursements (excluding discount loans)	2,649		2,256
Credit disbursements as percentage share of capital goods (excluding discount loans)	21.5		15.8
Outstanding lines of credit guarantees	836		966

*British fiscal year, April-March
Source: U.S. Export-Import Bank

As of the start of 1977 the U.K. Government began to encourage a basic shift in ECGD's program emphasis from sterling credits to guarantees in foreign denominated credits. Buyer credits and supplier credits are both eligible for foreign currency denominated credits. The ECGD will require foreign currency financing on new export credit applications exceeding £20 million. The foreign currency denominated credits are eligible for ECGD interest rate subsidies but not for refinancing. The elimination for refinancing should eventually result in a sharp reduction in direct public sector export credit outlays.

To the extent that buyers welcome sterling denominated contracts because of their expectation that sterling will decline in value, the shift to foreign currency denominated contracts will reduce somewhat the competiveness of the British export credit system. Its competitiveness will also be reduced because official support will generally be reserved for export credit contracts denominated in relatively strong currencies such as the deutschemark.

Inflation Indemnity Coverage

The inflation indemnity coverage program became effective in March, 1975. The program is designed to compensate British exporters for cost increases which arise during the production of major capital goods and thus enable the exporters to offer fixed prices or limited escalation contracts despite the high British inflation rate. Coverage is available only on fixed price contracts of £2 million or larger with non-EEC countries and involving capital goods requiring at least two years to manufacture.

The ECGD offers this insurance at 1 percent of the value insured per year. The exporter must bear all inflationary cost increases up to 7 percent and above 17 percent. Since cost increases must be at least 8 percent (7 percent plus the 1 percent premium) for benefits to be paid, the actual inflation rate must be at least 12-13 percent before exporters are eligible to make claims. If claims are paid, the ECGD supports up to 85 percent of the contract value.

As of Mid-1977, only two guarantees had been granted, on contracts totaling £60 million, even through the ECGD has approved over 30 applications for this type of coverage. No indemnifications have been paid out, so it is not possible to make any comparison of premiums vs. costs. The British estimated that the net cumulative cost of the program eill be £3 million ($5.1 million) in the 1975-1979 period. Domestic sales of ships are covered under a separate scheme. In this scheme eight guarantees have been issued covering contracts worth about £42 million ($71 million).

The ECGD export inflation program has not been as successful as was first anticipated. The reason for this appears to be that exporters have found it easier to insert escalation clauses into contracts to or to cope with inflation in other ways.

Insurance and Guarantees

The ECGD offers a number of other insurance programs aside from the inflation indemnity coverage for exports. One type of guarantee includes comprehensive coverage on routine exports, mostly for short credit term periods. This coverage is very popular and accounts for about 80 percent of ECGD total support. Products covered include raw materials, consumer products, and light engineering goods. Insurance covers 90 to 95 percent of the credit amount for a broad spectrum of risks. The exporter normally provides whole turnover insurance on an acceptable spread of insurance risk. He may choose whether coverage starts at the contract or shipment date and generally has some discretionary authority. The premium for this coverage is low since the risk is spread among good and bad markets.

A second type of guarantee provides coverage for specific exports for periods anywhere from two to five years. Products covered include capital goods and construction projects. Insurance generally covers 90 percent of the credit value, although in some cases full coverage may be provided. Individual policies must be negotiated for each contract. Premium rates are higher than in the case of comprehensive coverage because there is little spreading of risk.

A third type of guarantee provides coverage for specific exports for periods over five years. Under this type, a commercial bank may offer fixed rate preferential financing. Products covered include major capital goods and projects. Guarantees are also extended on lines of credit set up by British banks with banks overseas to facilitate placing orders with several unrelated British suppliers. This coverage is usually unconditional and for 100 percent of the credit value. It applies to both supplier credits (where the exporter grants credit to the overseas buyer and subsequently receives financing from his own bank) and buyer credits (where British banks supply credit directly to the purchaser abroad so that the exporter may be paid in cash.)

In addition to these types of guarantees, the ECGD offers special policies covering: 1) buyer default in trade between two other countries when the trade is arranged and financed by British merchants; 2) dealer to end-user sales of overseas stock made by foreign subsidiaries of British firms, and 3) sales through export merchants and confirming houses.

Under each plan, the ECGD may cover: 1) local costs for up to one-third of the credit value and foreign content for up to one-third of the credit value; and 2) subcontracts placed by British firms in other European Community countries for up to 40 percent of total contract value. Insurance and guarantee premiums are stated as a percentage of the credit and associated interest insured, the percentage varying with the credit terms and market involved. Premiums range from 0.6 to 0.9 percent per annum in most markets.

Political and Commercial Risk Insurance

Specific guarantees for commercial risk cover pre-delivery and post-delivery risks caused by major events or circumstances such as: 1) insolvency of the buyer; 2) arbitrary non-acceptance by the buyer not due to the fault of the seller; and 3) protracted default. The maximum indemnity that can be paid is 90 percent of the loss.

Guarantees for political and other risks cover pre-delivery and post-delivery risks caused by major events or circumstances such as: 1) cancellation of an export license not due to the fault of the exporter, 2) cancellation of a contract by a public buyer, 3) cancellation of previously valid import authority or the imposition of other government restrictions rendering importation impossible, 4) excessive transport or insurance charges arising from two diversion of a shipment caused by political events, 5) currency inconvertibility (Eastern Europe) and transfer delays, 6) outbreak of war, hostilities, civil commotion, or other similar events which prevent repayment by the buyer, and 7) requisition, expropriation, or other government intervention which prevents payment. The maximum indemnity that can be paid under this program is

90-95 percent of the loss. It should be noted that specific coverages may be limited to specific phases of the pre-shipment and post-shipment periods.

Performance Bond Guarantees

The performance bond guarantee program is designed to aid U.K. contractors competing for internationally tendered construction projects, particularly in the Middle East. The program is intended to supplement rather than replace the commercial bank guarantee market and is being carried out as a commercial insurance venture. Guarantees are issued to performance bond sellers usually for 100 percent of the bond. Contracts exceeding L two million are eligible for performance bond guarantees. As of the end of 1976 the total value of performance bond guarantees issued by the ECGD was $475 million. Applications for this program continue to be heavy.

U.K. EXPORT TAX INCENTIVES

Foreign Source Income

A company resident in the United Kingdom which conducts its business operations through a branch in another country, is subject to the U.K. tax on the foreign branch profits on a current basis. A foreign tax credit for taxes paid in the other country is allowed. Conversely, losses sustained by the branch are currently deductible against the other income of the U.K. company.

Assuming that the U.K. company operates in another country through a subsidiary which is a nonresident U.K. company rather than a branch, profits are currently taxable and losses are not currently deductible. Tax at the normal corporate rate is imposed when dividends are distributed from the subsidiary. However, the U.K. parent company may select foreign subsidiaries with high foreign tax credits from which to pay dividends, thereby decreasing the total tax due the U.K. government. The exchange control rules of the Bank of England require annual repatriation of at least two-thirds of the profits of overseas subsidiaries.

British law grants relief from double taxation through foreign tax credits in those cases where income is subject to taxation in both the United Kingdom and another country. The requirements for claiming the foreign tax credit are 1) the claimant must be a U.K. resident taxpayer, and 2) the foreign income must also be subject to U.K. taxes. In addition, a U.K. resident company, directly or indirectly controlling at least 10 percent of the voting power of a foreign subsidiary, may also claim credit for the corporate income tax the foreign subsidiary pays its host government when a dividend is paid to the parent.

If a foreign tax credit is not allowable or not claimed, a deduction for the taxes may be claimed. The foreign tax credit is limited to the greater of the foreign tax or the U.K. tax payable on that particular source of income. The limitation must be computed on each separate source of foreign income. The income from each separate susidiary or branch is considered a separate source of income. Because of this separate source rule, there is no overall limitation under U.K. law on the amount to be claimed. However, U.K. companies with varied interests overseas commonly incorporate an overseas holding company to receive all foreign dividends from the subsidiaries and thereafter pay a single dividend to the U.K. parent company. Thus, there is only one source of income for U.K. tax purposes. The effect of these rules is the averaging of foreign taxes with U.K. taxes.

As mentioned above, a foreign tax credit is allowed for the underlying tax incurred by a foreign subsidiary, provided that the U.K. parent company owns at least 10 percent of the voting power of a subsidiary for which the underlying tax credits may be obtained and provided that 10 percent ownership exists at each level of the chain of ownership. Unlike the United States, the ownership requirement is examined directly at each level and the law is not concerned with the effective percentage of ownership. For example, if a U.K. resident company owns 10 percent of foreign company B which, in turn, owns 10 percent of company C, company A can receive a credit for its proportionate share of the underlying taxes paid by companies B and C, provided dividends are paid through the chain of ownership.

The mechanisms for computing the underlying tax credit are generally similar to the U.S. method of computing the deemed credit for a developed country corporation. The taxes in the underlying tax credit are normally computed on an accrual basis and adjusted to the amount actually paid. British tax tax does not require the taxpayer to adjust the foreign subsidiary's earnings and profits to the British accounting standards.

Instead, the profits to be used for computing the foreign tax credit are defined as distributable profits as determined from the company's financial statements.

The impact of the rules involved varies according to the rates of overseas taxes, the ratio of overseas to U.K. sources of income, and the level of dividends paid. Where the U.K. business has significant foreign source income subject to high foreign taxation, part of all of the foreign tax credits will be lost.

The income of a nonresident company is not taxed in the United Kingdom until distributed as dividends (even though use may be made of tax havens). Thus, the tax advantages of establishing a foreign based sales company depend upon how intercompany pricing rules are applied by the U.K. Inland Revenue. The experience so far has been that intercompany pricing rules have not been rigorously enforced.

As in the case of other countries, the reallocation rules are instrumental in determining the extent to which income from exports can escape tax or reduce tax liability. Because of the British rules on foreign source income, firms often enjoy a lower tax liability than might otherwise be the case. The benefits from the exemption or low rate on foreign source income would be much less, on the other hand, if reallocation rules are strictly enforced so that only a small part of the income is considered foreign source income.

Overseas Entertainment Deduction

The United Kingdom allows only one direct export tax incentive. This is the deduction of business entertainment expenses for corporation tax purposes, if the customer entertained resides overseas and carries on a trade or business. As an indirect incentive, however, highly favorable rates of depreciation are granted in connection with a general program of stimulating capital formation.

In 1973 the Value Added Tax (VAT) was introduced as part of the harmonization measures taken in conjunction with British entry into the Common Market. The standard rate was 8 percent for the United Kingdom. It was reduced to 8 percent (from 10 percent) on July 29, 1974. A rate of 12.5 percent applies to luxury items, with food and essentials not subject to the tax VAT all. Like all other EEC countries, the United Kingdom applies the zero rating system to exports. This means that exporters recover the amount of taxes levied upon purchases of goods and services made in connection with the manufacturing or sale of goods to be exported.

Investment Incentive Schemes

The United Kingdom has a wide array of investment incentive schemes. The U.K. Government prefers to make grants (usually interest rate subsidies) rather than loans to stimulate manufacturing investment. The investor company and Department of Industry (DOI) will negotiate an investment agreement which usually provides for a grant of funds.

34-201 O - 78 - 20

If the company receiving the grant does not carry through on its commitments in the agreement, there is no repayment required of funds disbursed, but future payments of the interest subsidy can be stopped.

The goal of these schemes is to provide official assistance to encourage companies to proceed with investment projects over which they might otherwise have hesitiated. In addition to increasing industrial capacity and the capacity to export, this investment is seen as helping to create more jobs for British workers.

The United Kingdom has allocated an initial amount of £100 million ($202 million) in 1976 for investment incentive schemes. Although inceased exports or import substitution are not a prerequisite for a grant, the DOI considers that in general some benefits along these lines will usually result from most of the projects approved. These schemes are considered "aid" rather than loans in that they are direct grants which increase cash flow.

There are three basic investment incentive schemes: 1) General Powers of Assistance. This program gives assistance to help companies overcome temporary difficulties. It is restricted to major industries which occupy a major position in the U.K. economy. 2) The Industry Scheme. This program promotes modernization of nine key sectors of industry in the United Kingdom economy: machine tools, clothing, textile machinery, wool textiles, red meat slaughtering, nonferrous foundries, paper, board, and electronic components. Grants of 15-20 percent of the investments are not unusual.

3) The Selective Investment Scheme. This is limited to projects that cost at least half a million pounds. It is directed toward the manufacturing sector, with particular emphasis on the engineering sector.

Another important investment incentive is the ability to depreciate the whole cost incurred for plant, machinery, and equipment in one year. This is known as the "first year allowance." If the first year allowance is only partly used, a high annual depreciation rate (25 percent) is allowed on the same items. Since 1974, the initial depreciation rate on the construction of industrial buildings has been 50 percent of the cost (40 percent prior to 1974), with an annual writing down of 4 percent.

CHAPTER XII

EXPORT STIMULATION IN THE UNITED STATES*

INTRODUCTION

Only those programs which have as their primary purpose increasing U.S. export performance are discussed here. Programs which have primary goals other than export promotion (e.g., military objectives, foreign investment or economic assistance) but which, nevertheless, increase U.S. exports, are not covered by this report.

The United States promotes exports by the use of tax incentives, credits, and marketing-information services. The Domestic International Sales Corporation (DISC), the Western Hemisphere Trade Corporation (WHTC) and the China Trade Act Corporation (CTAC) are the principal tax devices designed to make exporting more profitable, basically by lowering corporate income taxes. The Export-Import Bank of the United States (Eximbank) and the Commodity Credit Corporation (CCC) promote exports through their export financing activities. The Departments of Commerce and Agriculture promote exports through marketing activities and the provision of information.

1/ Prepared by Kent H. Hughes, Analyst in International Trade and Finance, and George D. Holliday and Raymond Ahern, Economic Analysts.

EXPORT PROMOTION PROGRAMS

Commerce Department Programs

1. International Marketing The Commerce Department's export promotion activities are managed by its Industry and Trade Administration (ITA). ITA's international marketing program promotes export salev by furnishing market information, providing overseas exhibition facilities, and organizing and conducting overseas sales events, trade missions and promotions in the non-communist nations of the world. The goal of the international marketing program is to assist new-to-export and new-to-market firms to become established in overseas markets and to assist established exporters in expanding their share of world markets.

Specific activities of the international marketing program are:

(a) Market research and operational planning. In this area of activity, major anticipated developments in the United States and world economies are analyzed in terms of their impact on U.S. export prospects and programs. Also, the products and services in which the United States can most effectively compete internationally are identified. And finally, the foreign markets which offer the greatest sales potential for those American products or services are singled out. U.S. commercial programs are also included within this line item. These are integrated marketing plans developed cooperatively between the Departments of State and Commerce which lay out, for each of selected overseas markets, all the activities to be undertaken by the U.S. Foreign Service in those countries in support of U.S. commercial objectives.

(b) Developed and emergent markets' export promotions. A wide range of promotional events are maintained to help broaden the U.S. export base and enhance the role of U.S. business in world markets, ITA provides informational and promotional techniques to aid United States industry in this endeavor. The techniques available for export promotion are: trade and industrial exhibits, trade centers, trade missions, and special techniques.

(c) Information services. ITA gathers market information from available sources, including reports from U.S. commercial offices overseas. It analyzes this information and disseminates data to U.S. businessmen through direct mailings and through network of information services.

(d) Overseas commercial representation. By authority of the Reorganization Act of 1939 and the Foreign Service Act of 1946, the Department of Commerce maintains a direct working relationship with the Department of State in such areas as recruitment, assignment, evaluation, and training of Foreign Service Officers for commercial

Budget:

International marketing

	1977 Appropriation Enacted To Date		1978 Base		1978 Estimate		Inc. (+) or Dec. (-)	
	Perm. Pos.	Amount	Perm. Pos.	Amount	Perm. Pos.	Amount	Perm. Pos.	Amount
Market research and operational planning.....	38	$1,716	38	$1,721	38	$1,721	...	...
Developed market programs:								
Export promotions:								
Trade and industrial exhibits............	25	1,129	25	1,167	25	1,167	...	...
Trade centers............................	95	2,490	95	2,661	90	2,406	-5	-$255
Trade missions...........................	4	125	4	131	4	131	...	...
Special techniques.......................	4	175	4	112	4	112	...	...
Subtotal..............................	128	3,919	128	4,071	123	3,816	-5	-255
Information services.....................	37	2,956	37	3,071	34	2,901	-3	-170
Total developed.......................	165	6,875	165	7,142	157	6,717	-8	-425
Emergent market programs:								
Export promotions:								
Trade and industrial exhibits............	51	2,333	51	2,409	51	2,249	...	-160
Trade centers............................	58	1,867	58	1,903	58	1,903	...	...
Trade missions...........................	7	299	7	313	7	313	...	...
Special techniques.......................	6	263	6	167	6	167	...	...
Subtotal..............................	122	4,762	122	4,792	122	4,632	...	-160
Information services.....................	58	2,310	58	2,410	58	2,410	...	...
Total emergent........................	180	7,072	180	7,202	180	7,042	...	-160
Overseas commercial representation...........	15	510	15	532	15	532	...	...
Total requirements...........................	398	16,173	398	16,597	390	16,012	-8	-585

SOURCE: U.S. Congress. House of Representatives. Committee on Appropriations. 95th Congress, 1st session. Hearings. Department of Commerce, part 3, p. 318.

Employees:	1976 Appropriation	1977 Estimate	1978 Estimate
	418	398	390

activities to assure that U.S. efforts in overseas commercial representation are active, precisely targeted, and effectively managed. Both the overseas American business community and the Department of Commerce rely heavily on the Foreign Service for support provided by economic/commercial specialists who (1) develop and transmit economic and commercial information required for Commerce programs, such as Trade Opportunities and World Traders Data Reports; (2) negotiate arrangements and agreements for a more liberalized flow of American products and services to American markets; (3) provide direct assistance to American trade missions; and (4) direct and/or support trade promotion officers located at trade centers, trade fairs, and other promotional exhibits.

2. Export Development. ITA's activities in this area are designed to expand the scope and size of U.S. exports by stimulating greater awareness of and interest in exporting on the part of U.S. business, and by providing direct assistance to specific exporters and potential exporters in the form of information and marketing services to facilitate their overseas market penetration and sales expansion efforts. This activity has the following foci:

(a) Major export projects. The major export products and systems program seeks (1) to encourage and aid American firms in competing for specific

Budget: Export development

	1977 Appropriation Enacted To Date		1978 Base		1978 Estimate		Inc. (+) or Dec. (-)	
	Perm. Pos.	Amount	Perm. Pos.	Amount	Perm. Pos.	Amount	Perm. Pos.	Amount
Major export projects:								
Major export products and systems..........	44	$1,225	44	$1,300	44	$1,300	...	...
Trade opportunities........................	10	294	10	311	10	311	...	...
Total major export projects..............	54	1,519	54	1,611	54	1,611	...	...
Export information	41	917	41	929	41	929	...	...
Domestic export stimulation activities.......	15	521	15	547	15	547	...	...
Foreign buyers program......................	11	361	11	380	3	72	-8	-$308
Total requirements..........................	121	3,318	121	3,467	113	3,159	-8	-308

SOURCE: U.S. Congress. House of Representatives. Committee on Appropriations. 95th Congress, 1st session. Hearings. Department of Commerce, part 3, p. 328.

major overseas systems and construction projects, (2) to insure that American firms are given fair opportunity to compete for such systems and products by the foreign entities concerned, and (3) to provide information and assistance, as requested, on licensing and investment opportunities in emerging markets.

(b) Export information. The provision of foreign marketing information to U.S. business is a basic function of ITA and is part of ITA's overall effort to convince U.S. firms that significant profits are available to them through exporting. This program provides three elements: (1) basic market information, (2) trade data, and (3) counseling services for stimulating potential U.S. exporters and assisting both new and established ones.

(c) Domestic export stimulation and activities. Activities designed to accomplish these objectives include the President's Export Council, which works with a network of regional and district councils to increase exports by providing advice and guidance to the Executive Branch on export expansion; the President's "E" and "E Star" Awards program, which recognizes U.S. business for outstanding contributions to export expansion; the Export Multiplier program, which stimulates exports through cooperative activities with export-related organizations, such as banks, state development agencies, etc.; and the Publication Program.

Budget: East-West Trade

	1977 Appropriation Enacted To Date		1978 Base		1978 Estimate		Inc. (+) or Dec. (-)	
	Perm. Pos.	Amount	Perm. Pos.	Amount	Perm. Pos.	Amount	Perm. Pos.	Amount
East-West trade analysis....................	30	$808	30	$841	30	$841	...	...
East-West trade development..................	53	1,404	53	1,462	53	1,462	...	...
East-West trade promotions:								
Trade and industrial exhibits..............	6	594	6	1,023	6	1,023	...	...
Trade centers..............................	8	626	8	649	8	649	...	...
Special techniques.........................	3	260	3	263	3	263	...	...
Subtotal................................	17	1,880	17	1,935	17	1,935	...	...
Total requirements..........................	100	4,092	100	4,238	100	4,238	...	...

SOURCE: U.S. Congress. House of Representatives. Committee on Appropriations. 95th Congress, 1st session. Hearings. Department of Commerce, part 3, p. 336.

(d) Foreign buyers program. ITA facilitates the travel and contacts of foreign business visitors. By matching the interest of the foreign buyer with the appropriate U.S. suppliers and by facilitating negotiations between them, this program attempts to stimulate a greater interest in exporting within the U.S. business community, particularly among small and medium sized firms.

3. East-West Trade. ITA's Bureau of East-West Trade manages trade programs designed to expand and normalize U.S. commercial and economic relations with the U.S.S.R., Eastern Europe, the People's Republic of China, and with other centrally planned economy countries (CPE's) as changing circumstances warrant, consistent with the national security of the United States, in the interest of supporting detente and maintaining a favorable United States balance of trade with these countries. The objectives of the program are to resolve government-to-government problems that impact adversely on commercial relations; to increase the number of U.S. businesses involved in East-West trade; and to promote the sale of U.S. products to the centrally planned economies through increased participation in Commerce-sponsored exhibits.

The East-West trade activities most closely associated with trade promotion are as follows:

(a) East-West trade analysis. This program develops and formulates policies and activities to expand commercial relationships between the United States and centrally planned socialist economies. Studies and periodic publications attempt to assess the market potential for specific American products in socialist markets.

(b) East-West trade development. This program supports the entry of U.S. firms, products, and technology into the centrally planned economy markets. In order to increase exports, country specialists interpret business trends on a day-by-day basis and industrial specialists bring major business opportunities to the attention of U.S. firms interested in East-West trade.

(c) East-West trade promotions. The primary thrust of this program is the promotion of United States products and industrial expertise in the markets of CPE nations. The techniques used for trade promotions are: trade and industrial exhibits, trade centers, trade missions, and special techniques.

(d) Joint commission secretariat. Support for each joint commercial and trade commission established by the United States and individual CPE countries is provided by ITA, which supports the Department of Commerce in its role as a member of the commissions.

The joint commissions are principal mechanisms for government-to-government discussion on ways to achieve full normalization of commercial relations and resolution of basic commercial/economic issues with the CPE nations.

Department of Agriculture Programs

The Agriculture Department's main export promotion function is carried out by its Foreign Agricultural Service (FAS). FAS activities are authorized by the Agricultural Act of 1954 (P.L. 690) and the Agricultural Trade Development and Assistance Act of 1954, as amended (P.L. 480). The FAS program has two major export promotion activities.

1. Foreign Market Development. The object of the market development program is to promote and assist in the expansion of commercial export sales of American farm products. The workload of the program area is divided into program and evaluation and export trade services. Planning and evaluation duties include: (1) establishment of program policies and objectives, (2) formulation of market development plans and activities, and (3) coordination of program operations. Export trade services include: (1) maintenance of relationships and liaison with state departments of agriculture, private industry cooperation groups, and regional agricultural

Budget: Foreign Agricultural Service

Program and Financing (in thousands of dollars)

Identification code 12-2900-0-1-352	1976 act.	TQ act.	1977 est.	1978 est.
Program by activities:				
1. International trade	1,746	396	1,686	1,795
2. Foreign market development	16,738	7,128	22,719	22,776
3. Foreign commodity analysis	5,233	1,027	6,734	8,354
4. Agricultural attachés	9,385	3,307	10,250	11,553
Total program costs, funded [1]	33,102	11,858	41,388	44,478
Change in selected resources (undelivered orders)	3,347	−1,950	−1,288	−1,288
10.00 Total obligations	36,449	9,908	40,100	43,190
Financing:				
11.00 Offsetting collection from: Federal funds	−164	−100	−150	−150
21.00 Unobligated balance available, start of period		−785		
24.00 Unobligated balance available, end of period	785			
25.00 Unobligated balance lapsing		260		
Budget authority	37,071	9,283	39,950	43,040

SOURCE: 1978 U.S. Budget Appendix, p. 117.

Employees:

Personnel Summary

	1976 act.	1977 est.	1978 est.
Total number of permanent positions	726	730	780

SOURCE: 1977 U.S. Budget Appendix, p. 119.

trade councils, (2) operation of trade fairs and other FAS market development activities, and (3) coordination of market development programs with U.S. agricultural production planning. FAS spent $16.74 million in fiscal 1976 for foreign market development.

The Foreign Agricultural Service also maintains a market development relationship with 40 active cooperative organizations providing promotional activities in about 70 foreign countries. In addition, FAS conducts some 55 separate promotional events in 37 foreign countries.

2. Foreign Commodity Analysis. This section of the service has primary responsibility for the collection, analysis, and distribution of worldwide intelligence on the supply, demand, and trade of agricultural commodities. The program is divided into the following activities: (a) studies of foreign production and foreign markets for U.S. agricultural exports; (b) analyses of competition from foreign production and its effect on U.S. agricultural exports; (c) provision of U.S. exporters, trade groups, commodity associations, and U.S. Government agencies with current market data and intelligence; and (d) the use of automatic data processing systems to improve analysis of worldwide data. FAS spent over $5.23 million on foreign commodity analysis in fiscal 1976. That figure is not included in this study's total for U.S. Government expenditures for export promotion, however, because these basic informational services may be considered an "overhead" expense necessary for many other USDA activities.

3. Agricultural attaches. FAS maintains agricultural attaches at 64 foreign posts to aid in developing foreign markets for U.S. agricultural products. They work closely with various U.S. agricultural trade groups to promote greater market access for U.S. commodities and prepare reports on foreign agricultural production and marketing or trade developments. FAS estimates roughly one-quarter of the $9.39 million spent in fiscal 1976 for attaches (i.e., about $2.35 million) was directly for export promotion activities.

State Export Promotion Activities

Many states provide financial and nonfinancial incentives designed to attract export-oriented firms to locate in their jurisdiction and to expand sales by resident firms. Several of them exempt all receipts from sales outside the state from state taxation, regardless of whether sales occur at home or abroad. Included among other financial incentives are various exemptions from state and local taxes for specified time periods.

In addition to financial incentives, most states conduct seminars, workshops, and export education programs to familiarize mainly small and medium sized businesses with the procedures (documentation, licensing, etc.) and advantages of exporting. In this regard, each year the federal government grants $50,000 to each state to assist in expanding export development programs.

The National Association of State Development Agencies (Washington, D.C.) is a source of information on the export development activities of particular states.

34-201 O - 78 - 21

1976 Export Promotion Expenditures

In FY 1976, the United States spent approximately $64.42 million on export promotion programs, $32.34 million through the Commerce Department, $13.8 million through State, and $19.08 million through the Foreign Agricultural Service. The Commerce Department's Industry and Trade Administration spent $15.758 million for international marketing programs, $3.468 for export development activities, $3.888 million for East-West trade, $3.737 million on administration, and about $1 million (of the $6.396 million total) on export-related international policy research. (Most ITA international policy and research activities were not export oriented.) The State Department's $13.8 million outlay was for export-related activities by consular officers and reporting services by overseas commercial officers. As indicated before, the Agriculture Department devoted $16.74 through FAS for foreign market development and about $2.35 million for export-related duties by FAS agricultural attaches.

EXPORT FINANCING PROGRAMS

Export-Import Bank

The U.S. Export-Import Bank (Eximbank) is the primary official source of export credit assistance in the United States. Eximbank's legislative mandate is "to aid in financing and to facilitate exports and imports and the exchange of commodities" between the United States and any foreign country.[1] In practice, it finances only exports. Eximbank is an independent government agency that is administered by a Board of Directors appointed by the President with the advice and consent of the Senate.

Eximbank is self-sustaining, in the sense that it does not receive annually appropriated funds, and in fact, it has returned about $2 billion to the Treasury over the past 33 years. The capital stock of the Bank is $1 billion, all of which is subscribed by the U.S. Treasury. Eximbank is authorized to borrow up to $6 billion from the Treasury and to borrow additional capital from the private market. Its total lending authority—the amount of loans, guarantees and insurance that it can have outstanding at any one time--is currently set by law at $25 billion, though legislation is currently pending in Congress to raise this to $40 billion. Its annual lending authority is also set by law. The authorization for FY 1977 is $6.3 billion.

The major Eximbank export support programs are direct lending, discount loans, insurance, and gurantees. In 1975, Eximbank estimated that about 12 percent of U.S. exports were supported by its programs.

1/ 12 U.S.C. 635, Sec. 2(a)(1).

In the past, Eximbank has concentrated its resources in its direct lending program. Recently, however, there has been a shift in emphasis from lending to insurance and guarantees. Frequently, a combination of loans, guarantees, and insurance is used for a single transaction, although there is no requirement that guarantees or insurance be used. Discount loans are apparently also being de-emphasized.

Direct Lending. Eximbank provides direct credits to foreign purchasers of U.S. exports. The credits are generally long-term (over five years) and are extended primarily for purchase of U.S. capital equipment. They are almost always made in cooperation with private commercial banks. The typical Eximbank direct loan provides 30-45 percent of the total contract value, though as much as 85 percent financing may be available in rare instances. The purchaser is required to make a 15 percent down payment and obtain the balance in financing from a commercial bank. Eximbank interest rates for direct loans currently range from 8.25 to 9.50 percent, depending on the total terms of the transaction. Eximbank reserves the right, however, to go below these rates in order to meet competitive foreign financing terms. The maximum repayment terms for direct loans are 10 years for developing countries and 8 1/2 years for other countries.

Eximbank direct loans provide two major benefits to the borrower. First, they lower the effective interest rate because

Eximbank's rates are somewhat lower than market rates. Second, and perhaps more important, they stretch out the repayment period for the borrower. Long-term export credits are virtually non-existent in the private market. Eximbank generally encourages private export financing by allowing private banks to receive the first repayments while Eximbank takes the longer term maturities.

Through its Cooperative Financing Facility, Eximbank also extends medium-term (1-5 year) loans to foreign financial institutions to cover one-half of their financing of purchases of U.S. exports. Loans currently carry an interest charge of eight percent per annum plus a commitment fee of 0.5 percent per annum.

Discount Loans. In order to stimulate private export financing, Eximbank discounts medium-term export credits by U.S. commercial banks. A commercial bank that has received an advance commitment may draw on Eximbank funds at any time during the life of an export credit for 100 percent of the outstanding value. The existence of an advance commitment provides the commercial bank with a backup source of fixed rate funds that can be drawn upon during periods of tight money. The minimum rate for discount loans is currently eight percent. A one-time commitment fee of 0.25 percent is also charged.

Insurance and Guarantees. In cooperation with the Foreign Credit Insurance Association (FCIA)—a private institution including over 50 major casualty insurance companies--Eximbank provides export credit insurance to U.S. exporters. FCIA covers commercial risks, though these risks subsequently may be reinsured by Eximbank. Under contract FCIA serves as Eximbank's agent for political risk insurance. Commercial credit risks are normally covered up to 90 percent, while political risks receive 95 percent coverage. No insurance is provided for exchange rate or inflation risks at the present time.

Rates for FCIA insurance are determined by two factors: the terms of repayment and the country of destination. Premiums for short-term cover range from 0.54 to 1.42 percent per annum and for medium-term cover, from 1.61 to 4.24 percent per annum.

Eximbank provides guarantees to commercial banks to cover commercial and political risks associated with supplier credits. These guarantees are normally restricted to transactions with repayment terms ranging from 181 days to five years. Guarantee fees range from 2.01 to 5.20 percent.

Eximbank also provides financial guarantees for buyer credits. Guarantees of up to 85 percent of contract value may be provided for a fee of 0.75 to 1.5 percent per annum on loan amounts outstanding.

Department of Agriculture

1. Commodity Credit Corporation. The Agriculture Department finances export credit sales through the Commodity Credit Corporation (CCC) under the Agricultural Trade Development and Assistance Act of

1954, as amended (commonly known as P.L. 480). Such sales of commodities owned by the Corporation may also be made under the CCC Charter Act. The CCC program is administered by the office of the General Sales Manager, U.S. Department of Agriculture.

The CCC export credit sales program, which has been in existence since 1956, provides financing for private export sales of U.S. agricultural commodities on commercial terms where such financing is not otherwise available. Program objectives include the maintenance and expansion of existing foreign markets and the development of new markets for U.S. agricultural commodities. The program is particularly useful in helping to move production into export channels in line with market-oriented production policies.

Credit financing of export sales by CCC extends up to 3 years, to be repaid in equal annual installments. As repayments occur, repayments and interest are returned to Treasury's General Fund account. Agricultural exports under the CCC Export Credit Sales Program for FY 1975 amounted to $249 million, a 16-percent reduction from $298 million in FY 1974, and a 76-percent reduction from $1,029 million during the peak year 1973. Of the $249 million financed in FY 1975, approximately $52.8 million was done under six and twelve-month repayment terms. Export of cotton, tobacco, and rice used about 73 percent of total financing. Credits were utilized where financing was needed to maintain U.S. markets.

Budget:	1975 est.	1976 est.	TQ est.	1977 est.
Export credit sales program (obligations)	248,550	900,000	125,000	450,000

The CCC is administered by the Office of the General Sales Manager (USDA), with a staff of approximately 105 employees.

2. Public Law 480, Title I. Agricultural Trade Development and Assistance Act of 1954, as amended, authorizes the USDA to finance export sales to developing countries on concessional credit terms. This program is also administered by the Department of Agriculture's Office of the General Sales Manager.

Sales of agricultural commodities for foreign currencies and for dollars on credit terms are made under Public Law 480, Title I.

1. Sale of agricultural commodities for foreign currencies and for dollars on credit terms (Title I):

Item	1976	1977 (estimated)	Increase or Decrease	1978 (estimated)
Program:				
Expenses of shipments:				
Commodity costs:				
Foreign currency	--	--	--	--
Long-term credit	$603,343,158	$772,400,000	$ -4,400,000	$768,000,000
Total commodity costs	603,343,158	772,400,000	-4,400,000	768,000,000
Ocean transportation:				
Foreign currency	-317,256	--	--	--
Long-term credit	41,983,459	61,503,365	+8,496,635	70,000,000
Total ocean transportation	41,666,203	61,503,365	+8,496,635	70,000,000
Total expenses of shipments:				
Foreign currency	-317,256	--	--	--
Long-term credit	645,326,617	833,903,365	+4,096,635	838,000,000
Total	645,009,361	833,903,365	+4,096,635(1)	838,000,000

SOURCE: U.S. House of Representatives. Committee on Appropriations. Hearings. Agriculture and Related Agencies Appropriations for 1978. 95th Congress, 1st session, part 1, p. 1004.

Employees:

The Office of the General Sales Manager (OGSM) has direct responsibility for administering Public Law 480, as well as other activities.

OGSM employment:	1975 actual	1976 est.
	110	110

The purpose of Title I of P.L. 480 is to expand international trade, develop and expand export markets, and encourage economic development in the developing countries. Sales for dollars on credit terms may be made with foreign governments or foreign private trade entities. Credit terms are made as favorable to the United States as the economy of the foreign country will permit; but not less than for development loans made under section 201 of the Foreign Assistance Act of 1961, as amended. This is currently three percent. Repayments, including interest at minimum rates set by law, may be made in dollars for up to 20 years, or in foreign currency convertible to dollars for up to 40 years.

Although the intention of original Title I legislation was the reduction of burdensome surpluses and the development of new markets, recently passed legislation has emphasized using Public Law 480 for developmental and humanitarian assistance.

The new emphasis was formalized by the Congress by passage of the International Development and Food Assistance Act of 1975, Public Law 94-161. Title II of that Act included a number of amendments to Public Law 480, the most significant of which were: (a) The "75/25" provision, limiting Title I food assistance to countries with more than $300 annual GNP per capita to not more than 25 percent of the total food tonnage programmed by Title I in any fiscal year; and (b) a new concessional sales debt forgiveness feature, under which up to 15 percent of the value of agreements signed in any year may be considered repaid if participating countries spend the local currency on approved agricultural development or population planning projects.

Trade and market development objectives, however, are still served by Title I concessional sales. Exports of wheat, rice, and vegetable oil under Public Law 480 all help to counter U.S. market trends characterized by slackened demand and declining prices.

EXPORT TAX INCENTIVES

Domestic International Sales Corporation

The principal tax device designed to promote U.S. exports is the Domestic International Sales Corporation (DISC). Created by the Revenue Act of 1971 (P.L. 92-178), DISCs are paper organizations designed to purchase export goods from their domestic U.S. parent corporations, and then to export them to a foreigner purchaser. For instance, General Motors might establish a wholly owned DISC. Cars destined for export would be sold by General Motors to its own DISC, and the DISC would in turn sell the cars to purchasers in a foreign country.

Prior to the Tax Reform Act of 1976, taxable income from the export sale was divided between the parent and the DISC in one of two ways. Depending on which was larger, 50 percent of the profits or 4 percent of the gross receipts was allocated to the DISC. In most instances, the 50 percent rule was followed. The 50 percent of taxable income attributed to the parent company was subject to the statutory corporate tax rate of 48 percent. However, only 50 percent of the income attributed to the DISC (i.e., half of half) was taxed at the statutory corporate rate. The rest would not be taxed until it was returned to the parent corporation. Because the tax need never be returned to the parent, the delay (deferral) in paying the tax was generally regarded as a permanent subsidy. In summary, a DISC reduces the tax rate applied to export income from 48 to 36 percent. In other words, only three quarters (3/4) of the export income earned by a DISC was subject to the normal corporate rate.

The benefits of a DISC, however, are to be gradually reduced as a result of Tax Reform Act of 1976. From the start, the DISC mechanism was criticized because it reduced taxes on both the income from new exports and the income from exports that would have been made in any case. The new law addresses that problem by applying the DISC subsidy only to the portion of export income that exceeds a particular historical base period.

The initial export base was to be the average amounts of gross receipts from exports for the four-year period that includes 1972 through 1975. After 1979, the base period would move forward year by year. In other words, in 1979 the base period would be the average for 1973 through 1976. In 1980, it would be 1974 through 1977. To qualify for DISC benefits, export income must exceed 67 percent of the average base period income. The new provisions apply to export income for all tax years beginning after December 31, 1975.

The Tax Reform Act of 1976 contained a number of other features that further restricted the use of the DISCs. After October 2, 1975, only 50 percent of export income from military sales could qualify for DISC treatment. The ability of a parent corporation to make a tax free disposition of DISC securities has also been curtailed.

Although its effectiveness has become the subject of considerable controversy, there is no question that the DISC program has been used extensively by business and industry. The most recent figures for the DISC program cover DISC year (part of 1973 and part of 1974) 1974. According to those figures there are now some 4,162 DISCs. More than 55 percent of manufactured exports and almost 85 percent of agricultural exports were channeled through DISCs. In DISC year 1974, DISCs accounted for $44.209 billion of exports, with new pre-tax profits of $3.149 billion. The cost to the U.S. Treasury in terms of foregone taxes was just over $750 million.

The Western Hemisphere Trade Corporation

The Western Hemisphere Trade Corporation (WHTC) program has constituted a limited subsidy to U.S. exports to the Western Hemisphere for some time. To qualify as a WHTC, a firm must make all of its sales outside the United States but within the Western Hemisphere. In addition, 90 percent of the WHTC's income must be from the active conduct of a trade or business (as opposed to receiving dividend payments) and at least 95 percent of the preceding three year's (or the life of the corporation if shorter) income must be from outside the United States.

For the most part, the WHTC has been used by U.S. firms in the development of raw materials. In terms of the export of manufactures, the WHTC is most likely to appeal to wholesale firms or trading companies. The 1975, U.S. Statistics of Income indicate that well over 50 percent (392 of 697) of the WHTC returns were in wholesale trade.

The contrast to a DISC is striking. The subsidy involved in a DISC applies to all the income from an export sale—the value added in manufacturing and the additional profits from acting as a wholesaler. In the case of the WHTC, it is only the profits from sale that qualify for special treatment. Consequently, in most instances an exporter would not opt for a DISC rather than a WHTC. He cannot opt for both.

For firms that do qualify as a WHTC, there is a substantial reduction in taxes. The overall effect of a WHTC is to reduce the corporate income tax rate from 48 to 34 percent--a drop of 14 percentage points. Despite the evident advantages of the WHTC, it has been little used. In 1972, the taxes foregone to permit the WHTC deduction amounted to some $40 million.

However, the future of the WHTC is extremely limited. The Tax Reform Act of 1976 provided for a four-year phaseout of the WHTC benefit. For tax years (as determined by company practices rather than the calendar) following 1979, the WHTC will be repealed.

China Trade Act Corporation

A China Trade Act Corporation (CTAC) can obtain a special deduction that can completely eliminate any U.S. income tax liability. Both a source of income test and an ownership test are necessary before a firm may qualify as a CTAC. For a CTAC, income must be derived from within Taiwan and Hong Kong (the original purpose of the 1922 law was to promote business in China, but after the Communist takeover CTAC's were restricted to Taiwan and Hong Kong). The deduction is further limited by the proportion of par value stock that is owned by U.S. citizens or residents of Hong Kong, Taiwan, or the United States. If 100 percent of the stock meets the ownership test, all U.S. corporate tax liability would be eliminated.

In addition, dividends paid to shareholders that are residents of Hong Kong or Taiwan are not subject to U.S. tax. In other words, a group of American citizens that owned a CTAC and lived in Hong Kong or Taiwan would not have to pay any U.S. corporate or individual income taxes on CTAC income.

Much like WHTC, the CTAC appeals to both raw material producers and wholesalers. Because of the radical changes that have taken place on mainland China, the CTAC provision is little used. Since enactment of the provision in 1922, nearly 300 firms have been incorporated under the Act. By 1968, however, the majority of these firms were no longer in existence and only four were actively conducting a business in Hong Kong or Taiwan.

In any case, the China Trade Act (CTA) is destined for a quick extinction. Under the Tax Reform Act of 1976, deductions under the CTA are to be phased out and eliminated for taxable years beginning after December 31, 1977.

O