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

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


3. The Working Party had available the following documents:

   L/4464 - Report (June 1976) of the OECD Group on Export Credits and Credit Guarantees, dealing with cost inflation insurance schemes, made available by that organization.

   L/4467 and Addenda 1-3 - Information submitted by contracting parties relating to export inflation insurance schemes and other measures.

   L/4491 - Communication from the European Communities.

   L/4493 - Communication from Finland.

   L/4506 - Statement by France.
I. Examination of Individual Export Inflation Insurance Schemes

4. The Working Party carried out a detailed examination of the schemes maintained by Finland, France, Italy, Portugal, Spain and the United Kingdom based upon information supplied by these countries. In the course of this examination questions were raised and answers were given by members of the Working Party concerning specific issues such as the products or sectors covered, the exporters’ costs covered, the basis for calculation of cost increases, the threshold levels and premium rates, the limits on total coverage, the administration of the schemes, the budgetary implications, if any, the length of time the schemes have been in operation, any modifications to the schemes, and the rationale behind the introduction of the schemes and behind any modifications. In this context reference was made to the information submitted by contracting parties and reproduced in document L/4467 and Addenda 1-3, as well as to the information made available to the Working Party by the OECD and reproduced in document L/4464. The Working Party noted that the schemes of Italy and Spain were not presently in operation.

5. In an introductory statement, the spokesman for the European Communities pointed out that there still existed a number of national systems within the European Communities. The issues relating to these systems were being studied at a Community level, especially as regards their relationship to the relevant provisions of the Treaty of Rome, and in respect to substantive issues which might arise through the nature and operation of such schemes, taking account of international obligations. This fact had certain consequences for the participation of the European Communities in the work of the Working Party.
6. In reply to a question why the schemes maintained by some of the member States of the European Communities did not apply to trade with other member States, the spokesman for the European Communities referred to Article 92 of the Treaty of Rome and pointed out that the status of these schemes under that provision had no bearing on their compatibility with the General Agreement because the latter did not stipulate the stricter obligations contained in the Treaty of Rome.

II. OTHER MATTERS

7. Following communications received from the European Communities (L/4491) and from Finland (L/4493), the Working Party discussed the issue of whether certain exchange rate guarantee schemes should be examined under its terms of reference.

8. One member of the Working Party said that the issue of exchange rate guarantee schemes had been raised in the present context and should be discussed by the Working Party. In support of his view, this member elaborated further on the reasons contained in document L/4491. He stated that there existed an analytical link between export inflation insurance schemes and exchange rate guarantee schemes which was based on economic considerations. He regretted that in the absence of sufficient factual information the Working Party had been unable to determine whether exchange rate guarantee schemes fell under the competence of the Working Party.

9. Another member of the Working Party said that the terms of reference should be interpreted in a flexible manner so as to include exchange rate guarantee schemes, but that his authorities would be open to other possible solutions if it were not deemed feasible by the Working Party to discuss such schemes.
10. Several other members of the Working Party did not agree that exchange rate guarantee schemes fell within the terms of reference and urged the Working Party to focus its attention on schemes or measures used to attenuate or compensate for the effects of cost inflation in the exporting country. Some of these delegations stated that they would not be opposed to discussing exchange rate guarantee schemes and similar measures in a different GATT context if this were decided.

11. There was also a brief discussion of a measure maintained by Japan which had been brought to the attention of the Working Party (Article 55 of the Special Taxation Measures Law as implemented by Cabinet Order) followed by bilateral consultations between the delegations principally concerned. This measure appeared to offer certain tax accounting advantages in relation to specified contracts for overseas construction projects where the period of the contracts was in excess of three years. According to the information available these advantages were not available for similar contracts in the domestic market. Some delegations took the view that these advantages might enable Japanese enterprises to offset price increases to some degree and stabilize their contract price during the period of construction. The delegate for Japan said that in the Japanese scheme, no benefits for Japanese companies were involved. Rather, the scheme provided for a certain tax accounting measure which applied only to big export contracts concluded within the framework of bilateral agreements between Japan and developing countries. Under the scheme, Japanese companies were in fact obliged to pay taxes in advance. Since the Japanese scheme did not provide for any financial advantage for Japanese exporters, no element of subsidization was involved and consequently the measure was not covered by the terms of reference of the Working Party.
III. EFFECTS OF EXPORT INFLATION INSURANCE SCHEMES ON INTERNATIONAL COMMERCE IN THE LIGHT OF THE GATT PROVISIONS

12. One member of the Working Party stated that his authorities considered export inflation insurance schemes to be subsidies in contravention of Article XVI:4 of the General Agreement, that they should be notified under the provisions of Article XVI:1 and that they should be dismantled promptly. He said that such schemes distorted international trade. In addition to being a disincentive to control costs, they conferred a competitive advantage on the beneficiary exporters as individual transactions who could bid more aggressively in the international markets, secure in the knowledge that they would not have to bear alone their cost increases due to inflation. Moreover, since the guarantees applied only to the costs of products destined for export, they resulted in lower prices abroad for a given product than in domestic markets. The evidence showed that such schemes tended to run significant budgetary deficits over time. In this connexion he noted that one country had abolished its scheme because high inflation rates had made it too costly to the government, that another had not instituted a proposed scheme because of high inflation rates, and that a third admitted its scheme had been in deficit for several years and was likely to remain in deficit for the indefinite future. He said that even where such schemes were presently inactive, their mere existence constituted a potential threat to third-country exporters. He noted that these
schemes lead other countries to develop similar subsidies in order to counter the trade distortions inherent in these schemes. He noted that the 1960 illustrative list of measures\(^1\) considered to be export subsidies under Article XVI:4 was not intended to be exhaustive and that export cost inflation schemes fell within the general prohibition of Article XVI:4. He stressed the seriousness with which his Government viewed these schemes, called for their abolition, and noted that his Government reserved its rights to pursue this matter further either in the GATT or by other available means.

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

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

15. Another member of the Working Party said that his authorities were concerned about the large budgetary deficits that some export inflation insurance schemes had caused, and cited in this connexion the very large losses suffered since 1969 by one of the schemes under examination. He said that when premium rates and threshold levels were set high enough, such schemes could be self-financing, but that when this was not the case, they constituted export subsidies and were incompatible with Article XVI. He noted that none of the schemes contained a formula or mechanism for frequent adjustment of premiums or scope of cover or both in case of losses. His government, too, had found itself subject to pressures aimed at the establishment of a similar scheme so as to offset the competitive disadvantage suffered by his country's exporters. His authorities were, however, keenly aware of the need to avoid any proliferation of such schemes and sought their termination so as to prevent the global inflationary spiral that would inevitably result otherwise.
16. Another member of the Working Party said that although the existence of export inflation insurance schemes in some other countries had not yet appeared to have had serious repercussions in his own country, in the view of his authorities these schemes were nevertheless incompatible with the General Agreement and constituted an unfavourable influence on world markets. For these reasons the schemes should be eliminated.

17. One member of the Working Party said that there were several methods by which export contracts could be sheltered in substantially equivalent ways, such as by influencing the relative movements of currencies in a system of floating parities rather than by maintaining fixed exchange rates, by providing guarantees against inflationary cost increases, by providing fiscal guarantees, by providing exchange rate guarantees or by having exporters use a strong currency when concluding a contract. Before undertaking a detailed examination of any one of these possibilities it would be necessary to determine, in economic terms, how these various mechanisms actually worked. He did not agree that export inflation insurance schemes inevitably resulted in budgetary losses, and cited the example of his own country's scheme, which had been designed to operate in equilibrium and had actually done so for a decade until unforeseen economic and monetary disorders had made it impossible to maintain that equilibrium from 1969 onwards, despite a progressive raising of the threshold level. In fact the concerns expressed by some other GATT contracting parties and raised in the Working Party had recently led his government to modify the structure of the scheme so as to permit a self-financed operation in the future. In any case, the sole fact that a scheme resulted in a budgetary deficit could not be construed to mean that the measure was incompatible with GATT. There would have to be proof of dual-pricing, which would not be easy to demonstrate since each contract had its own individual characteristics.
18. Another member of the Working Party expressed the view that the restructuring of a scheme with the intent to achieve self-financing operations in the future would still amount to an overall subsidy to exporters unless provisions were made to absorb the losses already incurred prior to the modification.

19. One member of the Working Party said that an unexpectedly high rate of world inflation had amplified the need to protect against cost increases, especially in those countries where the inflation rate was higher than the world average. He said that in such countries there should be especially vigorous efforts aimed at countering inflationary forces. His authorities recognized that in the light of the GATT provisions any schemes designed to reduce the effects of inflationary cost increases should not distort trade, should provide only partial insurance to exporters and should be self-supporting. He did not agree, however, that by its mere existence an export inflation insurance scheme constituted a subsidy. In his view, a basic criterion was whether budgetary funds were drawn upon to finance a scheme. In actual fact, his country's scheme had over the last few years not only been self-supporting but seemed to have produced a slight profit.

20. One member of the Working Party said that his authorities did not agree that cost inflation insurance schemes were necessarily incompatible with the General Agreement. In his view there were two pertinent elements under Article XVI, the only applicable GATT provision on which the Working Party had to base its examination. First, where a scheme was a subsidy it would have to be notified under Article XVI:1. His country's scheme, which was intended to operate as an
insurance scheme and not as a subsidy, had not resulted in any budgetary deficit and was not expected to do so. A hypothetical example discussed bilaterally with another delegation had not shown any subsidy effect whatsoever. Second, there would have to be a showing that a measure resulted in lower prices on the export market than in the domestic market. No evidence of such dual-pricing had been produced in the Working Party. He said that if taken seriously, that line of argument could, in any case, be applied to other types of protection available to exporters, such as credit insurance or even fire insurance. In this connexion he pointed out that in each instance the exporter bought a specified measure of security and paid a certain price for it. The only relevant factor was whether the price paid was adequate in relation to the benefits received. Thus, it could not be argued that this was a disincentive to control costs. He concluded by stating that his own country's scheme did not distort competition in any way and, in fact, was aimed at helping that country's exporters to regain a competitive parity.

21. Another member of the Working Party pointed out that efforts had been made in the Working Party to elicit information on individual transactions and on transactions by product category so as to show the extent of dual pricing, but that those members maintaining such schemes would not divulge such information. Further, he added that by their nature, whereby these schemes were available for export transactions but not domestic transactions, they carried a presumption of dual pricing.

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

23. The Working Party could not reach any unanimous conclusion as to the compatibility of the export inflation insurance schemes with the provisions of the General Agreement. Some members of the Working Party held the view that export inflation insurance schemes were incompatible with the provisions of GATT because these schemes were subsidies in contravention of Article XVI:4, that they should be notified under Article XVI:1, and that they should be dismantled promptly. Some other members of the Working Party held the view that export inflation insurance schemes were in conformity with the General Agreement since they were not subsidies and since no evidence of dual-pricing had been produced in the Working Party. In view of this divergence of views, the Working Party felt that it should limit itself to report the opinions expressed to the Council.

24. The Working Party was also unable to reach consensus on the question whether the other measures mentioned in paragraphs 7 to 10 above fell under its terms of reference. The Working Party therefore decided to draw the attention of the Council to this fact.