THE US EXPORT-IMPORT BANK: MEETING THE CHALLENGES OF THE 21ST CENTURY[1]

C. Fred Bergsten
Director, Institute for International Economics

Subcommittee on International Monetary Policy and Trade
Committee on Financial Services
U.S. House of Representatives

May 8, 2001

Exports and the American Economy

Exports of goods and services have been a major source of US growth for 40 years. Since 1960, the share of US gross domestic product accounted for by exports has tripled—a stunning increase in globalization for a mature industrial economy. In the 1990s, even as US growth—powered by the forces of the new economy—turned in one of its best performances ever, the export share rose further from 9.2 percent to 10.3 percent. Globalization is likely to continue to accelerate and the share of exports in the US economy is thus likely to grow substantially further in the future.

When other characteristics of companies are held constant, exporting firms perform much better than nonexporters. Worker productivity is 20 percent higher. Export jobs

[1] This statement draws extensively on Gary Clyde Hufbauer's "The US Export-Import Bank: Time for an Overhaul," Economics Policy Brief PB01-3, Washington, DC: Institute for International Economics, March 2001, and also on *The Ex-Im Bank in the 21st Century: A New Approach?* eds. Gary Clyde Hufbauer and Rita M. Rodriguez. Washington, DC: Institute for International Economics, January 2001. The latter volume includes the papers contributed to a major conference hosted by the Institute on the occasion of the 65th anniversary of the Export-Import Bank. The volume also includes presentations by former Secretary

are better jobs: production workers in exporting firms earn 6.5 percent more. They are also more stable jobs: exporting firms are 9 percent less likely to go out of business than comparable nonexporting firms.[2]

Despite the dramatic export expansion, the United States will run a trade deficit that could reach $500 billion in 2001—almost 5 percent of our GDP. The deficit is no cause for panic but it is clearly unsustainable as it requires us to borrow almost $2 billion, net, from the rest of the world on every working day.[3] There are only two ways the deficit can be reduced: fewer imports or more exports. For the health of the United States and the world economy, more exports are far better than fewer imports. Ex-Im can contribute importantly to that goal.

There is another key policy reason to support a stronger Ex-Im Bank. To its great credit, the Administration is seeking Congressional support for Trade Promotion Authority (aka "fast track") that would enable it to participate in new negotiations to reduce trade barriers multilaterally (especially in the World Trade Organization), regionally (especially to create a Free Trade Area of the Americas) and bilaterally. Such negotiations are vital to enhance the access of US firms to world markets and to avoid new discrimination against the United States as other countries, in our absence from major negotiations, create regional deals of their own. It will be a difficult challenge for the Administration to garner a Congressional majority to support the needed authority, however, and the full support of the export community is an essential ingredient of

---

of the Treasury Robert Rubin, Secretary of the Treasury Lawrence Summers, Secretary of Commerce William Daley and chairman of the House Financial Services Committee James Leach.

[2] J. David Richardson. 2001. "Exports Matter… And So Does Trade Finance", in *The Ex-Im Bank in the 21st Century: A New Approach?,* eds. Gary Clyde Hufbauer and Rita M. Rodriguez. Washington DC: Institute for International Economics. Also see J. David Richardson and Karin Rindal. 1996. *Why Exports Matter More!* Washington, DC: Institute for International Economics and The Manufacturing Institute.

assembling a successful coalition. It would make no sense to reduce official support for export activities just when the strongest possible assistance from that quarter is so necessary.

Ex-Im is only one way—and a comparatively modest way at that—of promoting US export growth. However, it has two unique functions: it helps secure a level playing field for US exporters, in the face of foreign export credit competition, and it corrects market failures in trade finance. These missions have challenged Ex-Im for at least three decades but the Bank, and the United States as a whole, now face a wholly new environment of world export competition.

The New Environment of World Export Competition

Ex-Im and similar official export credit agencies (ECAs) in other countries traditionally finance exports of capital goods, mainly but not entirely to developing countries. Competition in these markets has changed dramatically since the 1970s, when the industrial nations first agreed to a "ceasefire" in export credit competition under the auspices of the OECD Arrangement on Officially Supported Export Credits.

Thirty years ago, the dominant users of ECAs were vertically integrated "national champions" like Siemens, Hitachi, and General Electric. In that era, large firms were not nimble at changing the source of components for major capital goods. Instead, each firm would strive to produce components at designated factories within its corporate structure. The goal of ECAs was to ensure that their national champion won the order; and the goal

---

[3] Catherine L. Mann. 1999. *Is the U.S. Trade Deficit Sustainable?* Washington, DC: Institute for International Economics as updated by Catherine L. Mann. 2001. "Is the US Trade Deficit Still Sustainable?" Washington, DC: Institute for International Economics. March 1.

of the OECD Arrangement was to limit highly subsidized competition between the ECAs. Today, things are different:

- No longer are major capital goods, such as power plants and civil aircraft, made in vertically organized firms based entirely in a single country. Instead, economic efficiency requires enormous amounts of outsourcing. The value-added chain is sliced up and the slices are located wherever production costs are lowest.
- Responding to this new reality, important trading nations are using export credits (among other industrial incentives) in a strategic fashion to attract procurement and direct investment from multinational corporations that can choose from a range of locations around the world. Most other countries depend even more heavily on exports than does the United States; the competition in global markets is thus becoming tougher all the time.
- Small- and medium-sized companies are becoming a bigger factor in the export picture. One reason is the slicing and dicing of the value-added chain. Another reason is falling communication and transportation costs: air freight, fiber optics, and the Internet are all helping smaller firms reach new customers overseas. But small companies are still handicapped by the cumbersome character of trade finance.
- Meanwhile, foreign ECAs have invented clever ways around the OECD Arrangement to the disadvantage of US exporters. Unlike the Ex-Im Bank, where operating procedures are rooted in the bureaucratic practices of the 1980s, many foreign ECAs have acquired the streamlined characteristics of market competitors while retaining the advantages of government support.

Securing a Level Playing Field: A Two-Track Strategy

In the field of export credit competition, as in many dimensions of international affairs, the olive branch is diplomacy. Through continued negotiations under OECD auspices, the industrial countries have whittled down the subsidies offered by official government export financing programs. Despite US efforts, however, the OECD Arrangement has not been extended to cover new practices and institutions that *indirectly* distort credit terms and export competition.

This is where the arrows come into play—specifically Ex-Im. Unless the United States, through Ex-Im, is prepared to counter the financing terms offered outside the letter of the OECD Arrangement, foreign governments have little incentive to extend the rules, through OECD negotiations, to cover the new practices and institutions.

In the 1970s and 1980s, the United States successfully used both carrots and sticks to curb wasteful competition among OECD countries in the export credit realm. Substantial increases in Ex-Im program levels in the late 1970s enabled us to negotiate the original OECD Agreement that brought subsidized interest rates, unrealistic loan terms, tied aid, and bargain insurance terms back to commercial norms.[4] The creation of the "war chest" in the 1980s had a similarly salutary effect in checking competition in the use of tied aid to support exports. But in recent years Ex-Im has been hampered both by a shortage of money and its own legislative constraints from effectively supporting US diplomacy. The

[4] Peter C. Evans and Kenneth A. Oye, 2001 "International Competition: Conflict and Cooperation in Government Export Financing". In Hufbauer and Rodriguez, *op. cit.*

result is the growing importance of financial practices that skirt the edges of the OECD Arrangement on Official Supported Export Credits.

In an era of high US trade deficits, it is not acceptable for the US government simply to sit back and accept the market-distorting practices that have crept into the export credit picture. Over the last few years, three financial practices have badly eroded the value of the OECD Arrangement, disadvantaging US exporters: market windows, untied aid, and interest make up.

Market windows. These are official institutions that operate both as official lenders and private banks. Canada's Export Development Corporation and Germany's Kreditenanstalt fűr Wiederaufbau are the leading exemplars. The Canadian and German market windows are hybrid institutions with advantages over both private banks and official ECAs.[5] Together, they did $12 billion of financing in 1999.

Unlike private banks, market windows get start-up money from the government. They pay no corporate income taxes. They raise funds with an implicit government guarantee. They can shift some of their administrative costs to the government payroll. Unlike official ECAs, market windows can respond rapidly and flexibly to commercial opportunities, and they can pay competitive salaries to attract talented personnel.

Market windows have so far insisted, against US objections, that they are *not* subject to the OECD Arrangement and its reporting requirements. Ex-Im may not even know that it faces competition from a foreign market window until a deal is lost.

Untied aid. In principle, untied aid is bilateral aid extended to a developing country with no requirement that the recipient procure goods and services from the donor country.

[5] Allan I. Mendelowitz. 2001. "The New World of Government-Supported International Financing". In Hufbauer and Rodriguez, *op. cit*.

The annual volume of untied aid is running about $11 billion. Supposedly the recipient country can use the aid funds to procure goods and services from the cheapest source worldwide.

In practice, "untied aid" is often an oxymoron. The recipient country knows very well who is providing the funds and places orders accordingly. Japan is the most important donor of untied aid. Peter C. Evans and Kenneth A. Oye provide a detailed case study of Chinese power plant purchases demonstrating that, for practical purposes, Japanese untied aid finances procurement from Japan.[6]

Unlike tied aid, nominally untied aid need not have a minimum 35 percent grant element. And unlike normal export credits, untied aid need not observe minimum commercial terms of the OECD Arrangement (interest rate, down payment, and maturity terms). Putting these two loopholes together, untied aid amounts to a backdoor route for subsidizing export credits.

Interest make up. *S*everal European ECAs (e.g., France, Italy, Spain, and the United Kingdom) use this method to provide official export credits at the fixed rates permitted under the OECD Arrangement. In this method, commercial banks are guaranteed a return equal to the cost of borrowed funds (say the London Interbank Offer Rate, Libor), *plus a spread of 40 to 150 basis points a year,* when they provide official financing to overseas borrowers. Thus the ECAs "make up" the difference between the permitted OECD Arrangement rate and the commercial cost of funds.

There is nothing wrong with this in principle. However, the size of the "make up" may be excessively generous, relative to the services provided and the risks taken by the

[6] Peter C. Evans and Kenneth A. Oye. 2001. "International Competition: Conflict and Cooperation in Government Export Financing", in Hufbauer and Rodriguez, *op. cit.*

commercial bank. In turn, the generous spreads may induce European commercial banks to provide export financing for projects and countries that US commercial banks would not extend to US exporters. In extreme cases, the European commercial banks may even "kick back" some of the extra spread to the borrower, providing an additional inducement to buy European exports.

Market Failures in Private Trade Finance

Over the past decade, innovation in the private financial markets has moved at a breathtaking pace—but not in the realm of export finance, where the trend has been more retreat than attack. Commercial banks have merged with investment companies and insurance firms, and a whole new menu of financial products has been invented. These innovations have not, however, transformed the world of trade finance, and export credits are nowhere nearly as efficient a market as home mortgages. Market failures today are different than they were 20 years ago but they are no less important:

- On average, in 1995-98, the United States exported $128 billion of capital goods annually to developing countries (table 1). Many of these developing countries enjoyed reputations for economic stability—*before* the 1994-95 Mexican crisis and the 1997-98 Asian crisis. In the wake of the financial crises of the 1990s, however, commercial banks reevaluated the risks of trade finance. Today they are less willing to accept medium- and long-term export credit risk (terms over 1 year), even for shipments by major US corporations to steady markets such as Brazil and Korea.[7]

[7] William R. Cline. 2001. "Ex-Im, Exports, and Private Capital: Will Financial Markets Squeeze the Bank?" In Hufbauer and Rodriguez, *op. cit.*

- Meanwhile, small- and medium-sized exporters (whose ranks grew by 65 percent in the 1990s) report difficulty getting export credits, even for shipments to Europe or Japan. Small exporters are not big enough to establish strong client relationships with giant banks, and their trade finance business is not worth the hassle for medium-sized banks. Dot.com trade finance is still on the drawing boards. Banks have not yet securitized trade credits the way they have routinely bundled home mortgages.

Meeting the Challenge

Our competitors abroad have found new ways to play the export financing game at the official level while oue private financial markets at home have not yet perfected export financing packages. This has left many US exporters between the proverbial rock and hard place. Ex-Im is the arm of the US government that should buttress US diplomacy in curbing export credit subsidies (however disguised). Ex-Im should also step in when private export finance is not available for particular foreign markets and aspiring US exporters.

But Ex-Im is seriously disadvantaged in fulfilling its two core missions—providing arrows to reinforce the US stance in official negotiations and stepping in when private markets fail. Ex-Im is limited by the modest size of its financial muscle, relative both to competitor ECAs and the needs of the export market (see table 1). Ex-Im is also limited by a series of crippling legislative constraints. Hence Congress should give the Bank new financial muscle and relax the legislative constraints that hamper Ex-Im.

Financial muscle. Table 1 compares Ex-Im's financial muscle with its major competitors. The focus is on medium- and long-term credits (credits over 1 year), the arena where competition is hottest. In recent years, Ex-Im's medium- and long-term credits amounted to about 4 percent of US capital goods exports to the world and 8 percent of US capital goods exports to less developed countries (LDCs). The figures for competing G-7 industrial exporters were 6 percent and 15 percent respectively.

These comparisons, coupled with business experience recorded in our volume *The Ex-Im Bank in the 21st Century*, point to a clear recommendation. Ex-Im should increase its medium- and long-term credit activity by at least 50 percent so that it can effectively carry out its dual mission. With this increase, Ex-Im's total annual budget for new export credits, guarantees, and insurance would rise to about $20 billion, up from the current figure of about $13 billion annually.[8]

Under its current authorizing legislation, Ex-Im is permitted a total of $75 billion of loans, guarantees, and insurance outstanding at any one time.[9] Of this amount, $61.6 billion had been used at the end of fiscal year 2000. Annual repayments of outstanding loans, and expiration of guarantees and insurance, amount to about $10 billion annually. To support $20 billion of new activity each year in FY 2002 and FY 2003, and to provide a cushion for extraordinary circumstances, the Ex-Im ceiling should be raised to at least $110 billion.[10]

---

[8] An argument sometimes made against increasing Ex-Im's budget is that Ex-Im will turn into another giant government credit agency, like Freddie Mac or Fannie Mae. The comparison is totally misleading. Together, the two home finance agencies have floated about $1.4 trillion of securitized loans. By comparison with these elephants, Ex-Im is a mouse.

[9] Export-Import Bank of the United States. *2000 Annual Report*, p. 42.

[10] The rough calculation is as follows. Two years of new credit activity at $20 billion per year equals $40 billion. Two years of repaid loans and expired guarantees and insurance at $10 billion per year equals $20 billion repaid. Additional authorization for extraordinary activity (matching untied aid and short-term crisis loans) equals $10 billion. Cushion at the end of FY2003 equals $5 billion. Total authorization ceiling equals present authorization of $75 billion plus $40 billion minus $20 billion plus $10 billion plus $5 billion equals $110 billion.

The immediate constraint facing Ex-Im, however, is *not* the ceiling on loans, guarantees, and insurance. Instead, it is the combination of annual appropriations to cover possible losses together with the schedule of required reserve ratios. Annual congressional appropriations have been running about $800 million to $900 million. For FY 2001, the figure is $927 million. The OMB (in consultation with Ex-Im) sets required reserve ratios on loans, guarantees, and insurance for different countries and sectors to cover potential losses. The ratios are very conservative and Ex-Im reserves have now reached $10 billion to cover possible losses on assets of $60 billion.[11]

In order to support a 50 percent increase in annual activity, a combination of two measures should be taken. OMB should modestly reduce the required reserve ratios for seasoned loans. In addition, Congress should raise the current level of appropriations from $927 million in FY 2001 to about $1.3 billion in FY 2002.

By contrast with this recommendation, President Bush's budget calls for a 25 percent *cut* in Ex-Im's appropriation to $699 million in FY 2002.[12] Ex-Im's total activity would be slashed from $12.6 billion in FY 2000 to $8.5 billion in FY 2002. Cutting Ex-Im's budget at this time would be a major mistake. It would undermine US commercial diplomacy and US exporters just at a time when faster export growth is needed to strengthen our economy and reduce the trade deficit in a constructive manner.

I should note that Ex-Im's budget has been cut before. There were sharp reductions in the middle 1970s and again in the early 1980s. In both cases, such steps clearly turned out to represent mistakes and the policies were quickly reversed. We should not repeat

[11] Under the Federal Credit Reform Act of 1980, Ex-Im is required to set aside very generous reserves for potential credit, insurance, and guarantee losses. Annual appropriations cover these reserves. According to Allan I. Mendelowitz, *op. cit.*, Ex-Im's excess reserves over probable losses may total $10 billion.

[12] As reported in *Inside U.S. Trade*, vol. 19, no. 9, March 2, 2001.

the historical errors of the past and, once again, lose market share for US exports that has to be made up by redoubled efforts at a later time after much ground has been lost.

Besides increasing Ex-Im's financial muscle, Congress should give Ex-Im legal authority to compete in the 21st century of export finance—both to support US exports and to bolster the OECD Arrangement. The legal authority would have several components, any of which could be implemented with Treasury approval:

- Power to match market-distorting "market window" activity both in third world markets and within the United States.[13]
- Power to use the so-called "war chest" funds to match officially untied aid.[14]
- Power to launch an "interest make up" program similar to the European programs.

Legislative contraints. Ex-Im faces several congressional mandates that also make it a sluggish competitor. Three should be singled out for correction in the 2001 charter renewal:

- Under existing law, Ex-Im must ensure that that there is less than 15 percent foreign content in the exports it supports.[15] While the Ex-Im changed its procedures in 2000 to apply the foreign content rule more flexibly, the requirement can still be at odds with the new ways of slicing and dicing the value-added chain with components from a range of countries. Ex-Im should be permitted to act as the umbrella finance agency when a major project is predominantly built with US capital equipment even if US exports do not amount to 85 percent of the total. However, Ex-Im should also keep a running set of records with other ECAs to ensure that they either refinance part of the

[13] To match market window finance within the United States, the powers under Section 1912 of the Ex-Im statute should be widened.
[14] The "war chest" was created in the mid-1980s so that the Ex-Im could match tied aid. It succeeded in invigorating negotiations that significantly curtailed tied aid. See Peter C. Evans and Kenneth A. Oye, *op. cit.*

project or that, in their role as the umbrella finance agency for other projects, they finance an equivalent amount of US exports.

- Over the last 20 years, Congress has given Ex-Im multiple tasks with wide-ranging national interest objectives. Ex-Im is mandated to meet official competition worldwide, make sound credit calls on risky transactions, create new financial instruments to access US capital markets, manage more than $60 billion of global assets in a wide range of legal and financial systems, and aggressively help small, rural, and environmental exporters. Yet, over the same period, Ex-Im has been administratively starved. It has roughly the same staff numbers as 20 years ago, it has minimal flexibility in its pay and average grade structure,[16] and its information technology system is outdated. Congress should scale up Ex-Im's administrative capability to the size and scope of its mission.
- There are times when economic sanctions are necessary, whatever the cost in terms of exports.[17] For Ex-Im, however, economic sanctions are more an issue of reputation than reality. In 1999, for example, Ex-Im, was closed for foreign policy reasons in only five markets: Cuba, Iran, Iraq, Libya, and Pakistan. To reduce the "reputation cost" of sanctions, however, Congress should eliminate the Chafee Amendment requirement that Ex-Im Bank transactions be withheld for foreign policy reasons under certain circumstances. If the Amendment is retained, it should be implemented only upon direct approval of the President, after consultation with the

---

[15] Allan I. Mendelowitz, *op. cit.*
[16] Ex-Im can hire only 35 employees outside the normal civil service pay structure.
[17] But unilateral US sanctions seldom succeed and sanctions of all types have decreased sharply in effectiveness over the past several decades. See the comprehensive analysis in Elliot, Kimberly Ann, Jeffrey J. Schott, and Gary Clyde Hufbauer. *Economic Sanctions Reconsidered* (3rd edition). Washington, DC: Institute for International Economics. Forthcoming (2001).

appropriate congressional committees; currently, the power to curtail Ex-Im transactions for foreign policy reasons, is delegated to the Secretary of State.

Conclusion

With more financial muscle and a new legislative mandate, Ex-Im can fulfill its twin missions. On the one hand, it can reinforce US diplomatic efforts to update the OECD Arrangement to curtail untied aid, and to bring market windows and interest make up plans fully within the purview of official discipline. On the other, it can fill the holes in private trade finance. Both missions will provide essential support for US exports. Without new authority from Congress, Ex-Im will sink into irrelevance. US exporters will be put at a severe disadvantage in world markets. The US economy will suffer substantially. I urge the Congress to make the recommended changes when it passes legislation to renew the Bank's authority later this year.

Table 1. Medium and Long Term Official Export Credits Related to Capital Goods Exports, annual average 1995-1998. ($ billions and percentages)

	US	Canada	Japan	France	Germany	Italy	UK	Totals for G-7, except the US
				($ billions)				
Medium/long term credits	10.5	3.5	10.9	8.0	10.7	1.8	3.2	38.2
Capital goods exports				*($ billions)*				
World	270.9	34.4	212.1	86.8	173.6	72.0	91.3	670.2
LDCs	128.1	3.2	110.8	29.2	56.1	26.9	29.3	255.3
Medium/long term credits as percent of capital goods exports				*(percentages)*				
World	4%	10%	5%	9%	6%	2%	4%	6%
LDCs	8%	112%	10%	27%	19%	7%	11%	15%