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Support the Ex-Im Bank: It Has Work to Do!

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The US Export-Import (Ex-Im) Bank is again at the center of controversy, as Congress debates the terms for its charter renewal. This policy brief critiques provisions of the House and Senate versions of the reauthorization bill and summarizes three justifications for Congress giving adequate support to the Ex-Im Bank. Box 1 provides a capsule description of the Ex-Im Bank's operations.

Justifications for the Ex-Im Bank[1]

Some critics argue that the Ex-Im Bank should be scaled back or simply eliminated because it is nothing more than a "corporate welfare" agency that subsidizes US exports.[2] This criticism shortchanges the Ex-Im Bank.

The Ex-Im Bank should be maintained and indeed strengthened because it serves three primary missions: 1) correcting exaggerated risk assessments for exports to developing countries, 2) increasing the availability of export finance for small business, and 3) providing the US Treasury leverage in international negotiations on rules for official export credit agencies. In order to achieve these three goals, the Ex-Im Bank's resources need to be augmented beyond the levels currently under consideration.

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Export Finance to Developing Countries

Even multinational corporations face difficulties in financing exports to some developing countries, particularly in times of political and financial unrest. Few troubled countries in Africa or central Asia can secure credits from private financial markets to buy US exports. For these countries, mar-

1. This section draws heavily on Hufbauer (2001), which in turn draws heavily on Hufbauer and Rodriguez (2001).

2. See Lukas and Vásquez (2002).

Box 1 The Ex-Im Bank at a glance

The Ex-Im Bank has existed since the Great Depression, basically to finance US exports. In FY2001, the Ex-Im Bank provided $9.2 billion in financing to support $12.5 billion of US exports—slightly over 1 percent of total US exports.[1]

The Ex-Im Bank provides financing for US exports in four ways:

- First, the Ex-Im Bank provides 85 percent principal and interest guarantees to back up the credit of *foreign* buyers that take out commercial loans to buy US exports. In FY2001, these loan guarantees amounted to $5.4 billion.
- Second, the Ex-Im Bank provides "export credit insurance" for US exporters to insure against defaults by foreign purchasers who buy on credit. This insurance covers 90 to 100 percent of the principal, depending on the nature of the default risk. In FY2001, the Ex-Im Bank authorized $2.3 billion in export credit insurance.
- Third, the Ex-Im Bank offers direct loans to *foreign* buyers of US exports at fixed interest rates. In FY2001, these direct loans were $870 million.
- Fourth, the Ex-Im Bank gives "working capital guarantees," which are loan guarantees that cover 90 percent of the principal and interest on commercial loans used by small and medium-sized US firms to finance their exports. In FY2001, the Ex-Im Bank provided $660 million in working capital guarantees.[2]

The Ex-Im Bank makes a concerted effort to help small businesses. Ninety percent of the authorized transactions in FY2001 were to small businesses, and the Ex-Im Bank has engaged in over 10,000 transactions with small businesses in the past five years. But small businesses receive slightly under 20 percent of the Ex-Im Bank's total financing.[3]

The Ex-Im Bank provides financing for a wide variety of industries. In FY2001 the major areas of operation were aircraft ($2.5 billion), environmental products ($460 million), energy ($2.0 billion), high-technology ($900 million), services ($690 million), and agriculture ($120 million).[4]

1. Ex-Im Bank (2001a).

2. Descriptions are based on Ex-Im Bank (1997) and amounts are taken from Ex-Im Bank (2001a).

3. Ex-Im Bank (2001a).

4. Ex-Im Bank (2001b).

Note: For a detailed description of the Ex-Im Bank's operations, see Hufbauer and Rodriguez (2001).

ket interest spreads over US Treasury bills or bonds are very high (1,000 basis points or more)—that is if private credit is available at all. Historically, the Ex-Im Bank's default experience is much better than market spreads might suggest.[3] On average, private financial markets are too skeptical of these countries. Helping to fill the gap, the Ex-Im Bank has more than $4 billion worth of exposure to countries that display the maximum risk rating as determined by the Organization for Economic Cooperation and Development (OECD).

Moreover, the Ex-Im Bank helps restore confidence in countries that are hit by financial crises.[4] Box 2 summarizes the crisis in Korea during 1998. As Southeast Asia and then Korea fell into crisis in late 1997 and early 1998, private markets became very skeptical about supporting exports to Asia. US exports to Korea declined by one-third from 1997 to 1998. Of the $16 billion of US exports to Korea in 1998, almost $1 billion were supported by short-term Ex-Im Bank credits.[5] Prompt action by the Ex-Im Bank directly helped US exporters during a difficult time and indirectly helped both US exporters and Korea by sending a strong signal to private financial markets that Korea was a viable market, despite its temporary crisis.

Export Finance for Small Business

Small firms frequently have difficulty securing export finance from commercial banks. They face both country risk and size disadvantages. Developing countries are vulnerable to unexpected financial crises, so commercial banks are reluctant to offer credits with repayment terms longer than one year. But small businesses also have difficulty getting export finance when selling to stable emerging nations or even OECD markets. Giant banks focus almost exclusively on giant companies, and medium-sized banks do not have the resources to evaluate

3. A spread of 1,000 basis points over Treasury rates implies an annual default risk of 10 percent. This is much higher than the 1.4 percent default rate that the Ex-Im Bank averages.

4. Lukas and Vásquez (2002) emphasize that the majority of the Ex-Im Bank's exposure is to countries that can obtain private credit such as China, Mexico, Brazil, Turkey, Korea, Indonesia, Venezuela, Saudi Arabia, and Russia. But at times each of these countries has endured spells where private credit was unavailable. Moreover, these countries account for a sizeable share of economic activity among developing nations, and some of these countries still have high-risk ratings. For a list of risk ratings, see OECD (2002). Other OECD nations focus their export financing activity on these markets, which puts US exporters at a potential disadvantage.

5. Cline (2001).

Box 2 The Ex-Im Bank during the Korean financial crisis of 1998

- Virtually no exports were being shipped to Korea in the immediate aftermath of the crisis.
- The Ex-Im Bank worked with several Korean banks to insure letters of credit, which enabled Korean industrial firms to buy US exports.
- The Ex-Im Bank facilitated 2,460 transactions with Korea in the first nine months of 1998.
- The Ex-Im Bank supported $920 million out of the $16 billion of total US exports to Korea in 1998.

Note: This information is based in part on a telephone conversation on April 23, 2002, between Gary Hufbauer and James Harmon, the former president of the Ex-Im Bank.

risk on international transactions. The Ex-Im Bank helps correct these market failures.

Leverage

The Ex-Im Bank gives the United States leverage in international negotiations to eliminate export finance subsidies. One expert estimates that $800 billion worth of exports are supported by export credit agencies in 100 countries throughout the world.[6] The Ex-Im Bank is small compared to its international counterparts both in terms of staff and as a share of exports. If the Ex-Im Bank did not exist, the United States would have little or no ability to counter official export financing practices of foreign governments.[7] For example, the Ex-Im Bank "challenges" tied aid offers from other governments by offering matching terms so that US exporters are not at a disadvantage. Progress has been achieved toward reducing tied aid and other market distorting practices by combining a ready-to-challenge Ex-Im Bank with international negotiations that have successively refined the OECD Arrangement on Guidelines for Officially Supported Export Credits. But the current OECD Arrangement has not kept up with three newly invented distortions—1) so-called "market windows," 2) de facto tied aid that is characterized as untied aid, and 3) interest make-up schemes.[8]

"Market windows" are hybrids of public and private banks. They are partially public because they receive funding from the government to cover administrative costs and they enjoy tax breaks and government loan guarantees. But they are partially private because they offer credit to the private sector at interest rates that are designed to earn a healthy rate of return. Market windows in foreign countries, especially Canada and Germany, claim that they are not bound by the OECD Arrangement.

Untied aid is a misnomer because recipients know full well that the prospects for receiving more "untied aid" in the future will sharply diminish if they do not use today's money to buy exports from the donor country. Aid that is explicitly tied is regulated by the OECD Arrangement, but de facto tied aid is not. Thus, some countries—notably Japan—successfully use de facto tied aid to subsidize their exports.

"Interest make-up" occurs when governments fully guarantee commercial loans and pay the commercial banks a commission of 40 to 150 basis points for making the loan. When the commission exceeds the commercial risk, the commercial bank can offer especially attractive terms to private-sector buyers. This practice is essentially an export subsidy, since governments are providing an extra incentive to commercial banks.

To better meet the Ex-Im Bank's multiple mandates, we advocate a larger authorization—enough to support at least $15 billion of US exports annually. This would require budget authorization of about $6 billion over five years.

Market windows, de facto tied aid, and interest make-up schemes all distort markets and should be prohibited, but unilateral disarmament is not a winning strategy. The Ex-Im Bank essentially serves as a negotiating chip: the United States will limit the operations of the Ex-Im Bank only when foreign governments regulate their own market distorting practices. If the United States unilaterally curtails

6. Gianturco (2001, 1).

7. Also, the Ex-Im Bank is unique in that it insists that the projects it supports meet World Bank standards for environmental and social impact. Downsizing the Ex-Im Bank would severely hamper US efforts at persuading other export credit agencies to adopt environmental and social impact standards.

8. See Mendelowitz (2001) and Evans and Oye (2001).

the Ex-Im Bank, foreign governments will be tempted to expand their export financing subsidies.

Current State of Legislation and Recommendations

The charter for the Ex-Im Bank expired at the end of FY2001 and the Bank has since operated under continuing resolutions. For FY2003, the Ex-Im Bank estimates that it will need to support $11.5 billion in US exports, and President Bush's budget endorses this request. Even with this level of export-supporting capability, the President's budget request for FY2003 is actually lower than in earlier years ($541 million for FY2003 versus $727 million for FY2002) because the Office of Management and Budget (OMB) changed the rules for scoring international risk, lowering the amount of budget authorization needed to finance the Ex-Im Bank's operations.[9] To better meet the Ex-Im Bank's multiple mandates, we advocate a larger authorization—enough to support at least $15 billion of US exports annually. This would require budget authorization of about $6 billion over five years.[10]

Both the House and the Senate are considering versions of a bill that would extend the Ex-Im Bank's charter. In the Senate, the bill (S. 1372) was unanimously reported out of the Committee on Banking, Housing, and Urban Affairs on August 3, 2001, and passed on the Senate floor on March 14, 2002. In the House, the corresponding bill (H.R. 2871) was reported out of the Committee on Financial Services on Novemer 15, 2001, and passed on the House floor as an amendment to the Senate bill on May 1, 2002. The two versions are similar, but there are significant differences between the two bills that will need to be resolved by the House-Senate Conference Committee; important potential changes to the existing charters are summarized in table 1.

Duration

The Senate version reauthorizes the Ex-Im Bank through September 30, 2006, one year longer than the House version. We prefer 2006 because a new Ex-Im president—appointed by the US President elected in 2004—will have been in the saddle for at least a year by 2006 when the next reauthorization comes around.

Tied Aid

In spring 2000, a US company lost an export deal to an Austrian competitor that benefited from tied aid. The Ex-Im Bank initially decided to match the level of tied aid. After the Treasury Department protested, however, the Ex-Im Bank changed its position. Although this type of flap has only occurred once, it was a cause celebre, and the Ex-Im Bank and the Treasury Department reached a mutual agreement on how future disagreements will be handled. Nevertheless, the House version of the Ex-Im Bank reauthorization bill goes further by prohibiting the Treasury Department from overruling the Ex-Im Bank's judgment on tied aid challenges.[11] Although it is important for the United States to challenge tied aid, we believe the current agreement between the Treasury Department and the Ex-Im Bank is sufficient to meet these concerns. The Treasury Department has the responsibility of representing the United States at the OECD in export credit negotiations. In our view, it is more important for the United States to have a single agency with the final voice both on negotiations and retaliation. This is more important than Monday morning criticism of the Treasury's questionable decision in a single prior case.

[B]oth the House and Senate versions of the bill seek to increase the percentage of financial support that small businesses receive. This move is good because large corporations can, as a rule, conduct international business without the aid of government.

Market Windows

Both the House and Senate versions of the bill explicitly authorize the Ex-Im Bank to treat market window financing as if it were tied aid and to match the terms offered by market windows in other countries. Under current law, the Ex-Im Bank might be able to match market-window offers anyway, but we

9. Ex-Im Bank (2002). Revised and more realistic budget scoring was recommended in Hufbauer and Rodriguez (2001), and we endorse the OMB's reforms.

10. The $6 billion figure is calculated by taking the House version of the bill, adjusting it for a five-year authorization, increasing the support for exports, and allowing for inflation and small increases in export support. We also support the language in the House version of the Ex-Im Bank reauthorization bill that increases direct spending on tied aid, which requires "pay-as you-go" budget rules.

11. The Senate's position on this issue is not entirely clear. There is no language in the S. 1372 bill on Treasury Department review, but the report by the Committee on Banking, Housing, and Urban Affairs curiously interprets the existing agreement between the Treasury Department and the Ex-Im Bank as giving the final say to the Ex-Im Bank.

Table 1 Summary of Senate and House versions of Ex-Im Bank reauthorization bills

Note	Provision	Senate version	House version	Our recommendation
(1)	Length of reauthorization	Through 2006	Through 2005	Senate
(2)	Matching of offers by market windows	Authorized	Authorized	Agree
(3)	Date for annual competitiveness report	Due June 30	Due June 30	Agree
(4)	Treasury Department review of tied aid actions	No language in current bill	No Treasury veto	Status quo is sufficient
(5)	Small business threshold	18 percent of total value	20 percent of total value	Agree
(6)	Subject to an unfair trade order	No language in current bill	Firm is not eligible	House
(7)	Subject to a preliminary unfair trade finding	No language in current bill	Requires the Ex-Im Bank to develop procedures	Senate
(8)	Employment objective	No requirement	Required	Senate
(9)	Cost	$3.4 billion	$3.3 billion	About $6 billion
(10)	Pay-as-you-go rules required	No	Yes	House
(11)	Outstanding credits permitted at one time	$75 billion	Over $100 billion	House

Notes:
(1) Length of reauthorization is the amount of time the Ex-Im bank would be permitted to operate under its charter.
(2) We also support the directives to the Treasury Department to negotiate a market windows agreement.
(3) The Ex-Im Bank submits an annual competitiveness report, but there is currently no specific due date.
(4) The Treasury Department currently comments on Ex-Im Bank recommendations regarding tied aid.
(5) The small business threshold is the percentage of credit the Ex-Im Bank must give to small businesses.
(6) In practice, foreign applicants that are under an unfair trade order do not receive Ex-Im Bank assistance.
(7) An unfair trade investigation is preliminary and the respondent enjoys a presumption of innocence until shown otherwise.
(8) House version says that Bank actions should maintain or increase employment of US workers.
(9) Congressional Budget Office cost estimate, based on Office of Management and Budget scoring criteria. The Senate version is calculated on the basis of a 5-year reauthorization and the House version is calculated on the basis of a 4-year reauthorization. Both the Senate and House versions contemplate initial support of $11.4 billion of exports annually. Our recommendation is based on a 5-year reauthorization and contemplates initial support of $15 billion of exports annually.
(10) Pay-as-you-go rules are required if the bill affects direct spending, which the House version does on tied aid.
(11) Outstanding credits are the maximum amount of exposure that the Ex-Im Bank can have due to past and present operations. This ceiling is distinct from the budget authorization needed to support new operations in a fiscal year.

Sources: Committee on Financial Services (2001); Committee on Banking, Housing, and Urban Affairs (2001); and the bills (H.R. 2871 and S. 1372) available at http://thomas.loc.gov.

support the move to make the matching option explicit. Both versions also direct the Treasury Department to attempt to negotiate an OECD agreement on market windows and report to Congress within two years on the results of its endeavor.[12] By authorizing the Ex-Im Bank to challenge market windows, the prospects for reaching an agreement at the OECD on market windows are improved. At a minimum, the US negotiating objective should require OECD countries to disclose in advance the terms offered by market windows, using standards of transparency similar to the agreed disclosure requirements for tied aid.

Small Business

Under the current law, the Ex-Im Bank must allocate 10 percent of its financial resources to

12. In addition to this report, both versions of the Ex-Im Bank reauthorization bill require the Ex-Im Bank to submit its annual report by June 30 of each year. We support this deadline because it would give Congress the opportunity to review the annual report before making budget authorizations for the next fiscal year.

small businesses. Although the Ex-Im Bank currently exceeds that threshold, both the House and Senate versions of the bill seek to increase the percentage of financial support that small businesses receive. This move is good because large corporations can, as a rule, conduct international business without the aid of government. The exception to this rule is that even large businesses sometimes have difficulty getting financing for transactions with developing countries. However, the 18 to 20 percent small business "set-asides" in the House and Senate bills still leave plenty of room to handle worthwhile export deals by large companies operating in developing countries.

Coordination with US Unfair Trade Remedies

Currently, if a foreign applicant for a loan or guarantee is subject to a US countervailing duty or antidumping order, the Ex-Im Bank will not approve the application. The House version writes this policy into law and directs the Ex-Im Bank to develop procedures for dealing with firms subject to a preliminary finding of an unfair trade law violation. We oppose this directive because it contemplates the punishment of the foreign applicant even before a final determination has been made that the firm is guilty of violating US unfair trade laws.

Employment Mandate

The House version inserts the following language: "The Bank shall ensure that its loans, guarantees, insurance, and credits are contributing to maintaining or increasing employment of United States workers." While we agree with the sentiment, legislative requirements like this just make the Ex-Im Bank more cumbersome compared to its light-footed foreign competitors. An annual report should meet congressional concerns, without the necessity of detailed "employment scoring" on each transaction.

Total Outstanding Credits

Finally, the ceiling on total outstanding credits for the Ex-Im Bank is now restricted to $75 billion; in FY2001 the Ex-Im Bank had $58 billion in total exposure. The ceiling acts as a separate limit on the Ex-Im Bank's activity, in addition to the budget scoring. The Senate version of the bill does not change the current $75 billion ceiling, but the House version increases it to $100 billion in FY2003 and by another $10 billion in each year thereafter, and adjusts the ceiling for inflation. We support the House version. It would be unfortunate if the Ex-Im Bank's operations were substantially curtailed by an artificial ceiling.

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