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Statement of

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Subcommittee on International Finance,

Senate Committee on Banking, Housing, and Urban Affairs

on

[Competitiveness of Export-Import Bank Financing]

Mr. Chairman and Members of the Subcommittee:

We appreciate the opportunity to testify today on our forthcoming report on Eximbank's role in financing U.S. exports, the international competition Eximbank faces, and the ability of Eximbank to meet that competition. We will discuss a number of alternatives the Congress may wish to consider to help strengthen Eximbank's ability to meet foreign competition.

In our review we compared Eximbank's export financing programs to those of its government-supported counterparts in the United Kingdom, Germany, France, and Japan. Our review focused on the direct loan programs since this area

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of export financing is the most competitive. We met with government officials, exporters, and bankers to obtain information on each country's export financing programs. We also sent a questionnaire to 117 exporters that applied for Eximbank assistance, but were either denied direct loan support or did not use the assistance offered; 86 firms responded.

BACKGROUND ON EXIMBANK AND INTERNATIONAL EXPORT FINANCING

Financing is an increasingly important factor in exporting, particularly for sales to developing countries not able to finance expensive capital projects internally. U.S. exporters face strong foreign competition, particularly as other exporting countries develop advanced technology and manufacture competitive products. When competing exporters offer similar prices and products, financing terms often determine who makes the sale.

Commercial banks provide most of the financing required for U.S. exports, but there are limitations, particularly when borrowers require fixed interest rates and repayment periods greater than 5 to 7 years. To overcome these limitations, Eximbank supplements commercial financing through its direct credit, insurance and guarantee programs.

The Export-Import Bank Act of 1945, as amended, directs Eximbank to provide credit at rates competitive with the Government-supported rates of our principal competitors; to set interest rates taking into consideration the average cost of money to the Bank as well as the Bank's mandate to offer competitive financing; and to supplement and encourage, but not compete with, private capital. The money Eximbank lends comes from borrowings from the Federal Financing Bank, revenues from repayments, about $2 billion in accumulated income, and $1 billion in capital stock issued to the Department of the Treasury.

Other industrialized nations also have government programs to help finance their exports. Since financing is increasingly important in determining who makes a sale, there is intense competition in financing terms.

To avoid the costs of an international export credit "war," in April 1978, the United States and 21 other nations established voluntary guidelines for government-supported export financing. These guidelines, called the "Arrangement," include minimum interest rates, minimum cash payments and maximum repayment periods. Participating countries may deviate from these guidelines on a case-by-case basis after notifying other participants.

Repeated attempts by the United States to increase the minimum interest rates, prohibit mixed credits and otherwise strengthen the Arrangement have not yet been successful. However, the United States is continuing its efforts in this direction.

COMPARISON OF INTEREST RATES ON GOVERNMENT-FINANCED LOANS

Eximbank and its foreign counterparts use a variety of approaches to provide export financing. Some countries combine low-interest Government loans with commercial loans; others either refinance commercial loans or directly subsidize commercial interest rates. While the approaches differ, the interest rate to the borrower is the critical factor and serves as a basis for comparison.

Germany, France, Japan, and the United Kingdom all offer a 7.5 percent base interest rate, exclusive of fees and insurance. This is the minimum interest rate allowed by the Arrangement. The average rate on Eximbank supported direct loan financing is about 10.5 percent. This rate is based on Eximbank activity for the first quarter of fiscal year 1980 and consists of Eximbank financing approximately half the export value at 8.15 percent and commercial banks providing the remainder at 1.25 percent above their prime lending rate, or 14.6 percent as of December 1979. Combining the two loans results in the average blended interest rate of 10.5 percent, which is 3 percentage points higher than the other countries' base rates.

Medium-term loans supported by Eximbank also cost more than financing available to exporters in other countries. As of June 1979, France, Japan and the United Kingdom offered medium-term, Government-supported loans at an effective interest rate of 7.85 to 8.10 percent. German commercial banks were able to offer medium-term loans at 8.8 percent with government guarantees. Eximbank generally does not offer direct medium-term loans, but it supports some commercial bank loans either through its discount loan program or its Cooperative Financing Facility. The effective interest rates on these programs were 10.2 percent and 9.05 percent, respectively--as much as 2.4 percentage points higher than the other countries' rates. It should also be noted that Eximbank is phasing out its Cooperative Financing Facility, reducing loan authorizations from $100 million in fiscal year 1979 to $40 million in 1980 and $30 million in 1981.

These interest rate comparisons do not consider the effect of fluctuations in the exchange rate between the currency loaned and the borrower's currency, which indirectly affect the cost of a loan. For example, a foreign borrower may have to exchange more of his own currency each year to repay a loan in appreciating Deutsche marks, while less currency would be required each year to repay a loan in depreciating dollars. However, because of the uncertainties in predicting long-term exchange rate fluctuations, U.S. exporters and bankers argue that buyers in developing countries are relatively insensitive to the relationship between interest rates and the strength of the currency in which the loan is repaid. Also, Arrangement negotiations have not yet been successful in establishing minimum interest rates that vary with the strength of the various currencies loaned.

<u>Lower rates offered on a case-by-case basis</u>

Both Eximbank and its foreign counterparts offer lower rates on a case-by-case basis. France, and to a lesser extent, the United Kingdom, selectively finance export projects of particular national importance with a mixture of normal export loans and lower cost foreign assistance funds. Mixed credits typically include 30 to 50 percent foreign aid at 2 to 4 percent interest repayable over 20 to 30 years.

Eximbank also modifies its normal lending practices on a case-by-case basis to compete with the standard and mixed credit financing of its foreign counterparts. Eximbank tries to be competitive on a selective basis by reducing the interest rates on its portion of a loan, and by financing portions of the loan normally financed by commercial banks. During fiscal year 1979, Eximbank made

19 of its 98 direct loans at interest rates averaging .67 percentage points below its standard rates to compete with other countries standard rates. In 15 of these 19 loans, Eximbank financed the export without commercial bank participation. On an even more limited basis, Eximbank tries to compete with mixed credits. In one case, a U.S. firm was able to win a sale when Eximbank matched a French mixed credit by financing 100 percent of the loan at 6 percent interest.

EXPORTS LOST BECAUSE OF UNCOMPETITIVE FINANCING

Eximbank reviewed the status of 140 exports it had offered to finance with direct loans, which were resolved between April 1, 1978, and March 31, 1979. U.S. firms won 62 sales; foreign firms won 55; and 23 were deferred or cancelled. Of the 62 sales won, Eximbank financed 16 sales at rates below its normal interest rate scale. Eximbank determined that 7 of the 55 sales lost to foreign competitors were valued at $91 million and resulted primarily from uncompetitive financing; in 4 cases, foreign governments offered aid or mixed credit loans, and in three cases, they offered normal export loans. This does not include cases where Eximbank believed uncompetitive financing contributed to a loss but was not the primary reason, or cases where Eximbank could not determine the reason for a loss.

Our questionnaire also asked exporters about specific 1978 sales for which Eximbank offered long-term financing. The 86 responses identified 10 sales, valued at $434 million, that were lost to foreign competitors primarily because of uncompetitive financing. Examples of the reported lost sales are described below.

--A U.S. manufacturer bid on a $48-million cement plant project in Thailand. According to the foreign buyer, the company's offer was rejected because Eximbank's 8 percent interest rate, when combined with the commercial bank interest rate, was not competitive.

--An $8 million dollar sale of grain storage plants to Tunisia was lost because Eximbank financing at 8.4 percent (to be supplemented by commercial financing) was not competitive with 3 percent Government financing offered by a foreign competitor.

--A $4 million sale of data-transmission equipment to Brazil was lost because Eximbank financing at 8.5 percent was not competitive with foreign government supported financing at 7.5 percent.

The 10 lost sales include only those where exporters applied for and received Eximbank preliminary commitments for long-term financing. We also asked exporters about potential 1978 sales for which they did not formally apply for Eximbank financing. Eight firms responded that one reason they did not apply was that the expected financing terms were known to be unsuitable.

These lost sales illustrate the point that government-supported export financing can be critical in the competition for some export sales. However, we could not estimate the total value of exports that may have been lost since there is no comprehensive information available on sales for which U.S. exporters compete. Also, differences among competitors' prices, products, and services, as well as financing, frequently make it difficult to determine why a sale was lost.

FACTORS WHICH PREVENT EXIMBANK FROM CONSISTENTLY OFFERING COMPETITIVE RATES

Efforts to be self-sustaining

Eximbank's reports to the Congress on export credit competition stated that its selective efforts to be competitive must be tempered so as not to jeopardize the Bank's longstanding tradition as a self-sustaining institution. To remain self-sustaining, Eximbank estimates that it must charge about one-quarter to one-half a percentage point more than its marginal cost of money. For example, money borrowed at 9 percent should be lent at 9.25 to 9.50 percent.

Eximbank established its current direct loan rate scale of 7.75 to 8.75 percent in October 1977. At that time, its marginal borrowing cost was 7.25 percent. By December 1979, Eximbank's marginal borrowing cost had jumped to 10.5 percent. However, Eximbank has not adjusted its lending rate scale to reflect these increased borrowing costs. The Office of Management and Budget estimates that this negative spread between Eximbank's borrowing expense and its lending rates costs the Bank over $125 million annually in lost income and additions to reserves.

Continued high borrowing costs, which depend on the market rates for Government securities, will adversely affect Eximbank's income and weaken its financial position if its lending rates remain stable or it tries to consistently match lower foreign rates. Eximbank estimates that if its average borrowing rate increases more than one-eighth of one percent per year and lending rates remain constant, it could be operating at a $65 million net loss by 1988. Since the Bank's accumulated income is also its reserve against loan defaults and claims, it cannot use accumulated income to subsidize its lending rates and absorb such losses without jeopardizing the adequacy of its reserves.

Budget limitations

The number of exports and the portion of each export that Eximbank can finance each year is limited by the annual direct loan authorization approved by the Congress. Since high cost commercial financing must be used for the portions of a sale not financed by Eximbank, the direct loan ceiling has an impact on the competitiveness of Eximbank supported loans.

Eximbank selectively provides up to 100 percent of the required financing for an export sale, thereby achieving rates more competitive with foreign government-supported financing. Eximbank cannot consistently do this unless it finances fewer exports or obtains higher direct loan ceilings. Also, Eximbank generally does not use its direct loan program for medium-term financing or for sales under $5 million. Eximbank would need higher direct loan ceilings to support these exports with direct loans.

Limited capability to match mixed credits

Some of Eximbank's foreign counterparts offer mixed credit financing, but Eximbank does not have access to foreign assistance funds. Thus, Eximbank must use its income and reserves to absorb the costs involved in offering the equivalent of mixed credits. As we previously pointed out, however, Eximbank cannot consistently match even the standard rates offered by its foreign counterparts without adversely affecting its income and its reserves.

OTHER FACTORS WHICH AFFECT EXIMBANK'S COMPETITIVENESS

In addition to interest rates, there are a number of other factors which affect Eximbank's efforts to offer competitive financing.

Other countries base eligibility for export financing primarily on the creditworthiness of the borrower. However, eligibility for Eximbank financing also depends on factors such as U.S. foreign policy, the domestic impact of an export and the foreign components of an export project. It is this last area that we would like to further discuss.

Some exports, such as power plants and construction projects, involve goods and services from more than one country. In such cases, buyers attempt to obtain financing for the entire project from the primary supplier, including segments supplied from within its own country, commonly called local costs, and segments supplied by third countries, referred to as foreign content.

Local cost financing

The Arrangement allows government-supported loans for local costs, up to the amount of the cash payment, which is usually 15 percent. The German and Japanese export financing agencies readily support local costs up to the Arrangement limits. The French and British agencies are reluctant to support local costs but do so because of competitive pressures.

Eximbank believes the Export-Import Bank Act generally makes goods and services of non-U.S. origin ineligible for Eximbank financing and is reluctant to use its direct loan authority for local costs. Although the Bank has recently matched some local costs offers on a case-by-case basis, U.S. exporters cannot predict the availability of local cost financing and this puts them at a competitive disadvantage when negotiating a sale.

Foreign content financing

Germany, France, and the United Kingdom routinely provide financing for foreign content--up to 40 percent of the contract value for goods from European Economic Community countries and up to 10 percent for goods from other countries. Japan does not have preestablished limits, but will finance foreign content in Japanese export projects if required by the buyer or if the goods are not available in Japan.

Foreign content generally is not eligible for Eximbank financing for basically the same reasons local costs are not eligible. For some exports that include foreign content, Eximbank has attempted to negotiate co-financing arrangements with other export financing agencies. For example, in June 1979 Eximbank announced a co-financing agreement with the Japanese and Italian export financing agencies for financing sales of a jet aircraft predominantly of U.S.

manufacture. While such an approach results in each country financing its share of the export, the agreements are rare and apply only to specific exports. Thus, U.S. exporters often are at a competitive disadvantage if foreign buyers seek foreign content financing from Eximbank.

MATTERS FOR CONSIDERATION

A re-examination of the framework and financial constraints within which Eximbank now operates seems indicated. If foreign governments continue or intensify their use of concessionary financing and U.S. commercial interest rates and Eximbank's own borrowing costs continue at current high levels, Eximbank will need increased flexibility and resources if it is to consistently offer competitive financing.

There are a number of alternatives that may be considered:

Eximbank's annual direct loan ceiling was increased to $3.7 billion in fiscal year 1979 and the Bank used the full amount of its authorization. The Administration requested $4.1 billion and $4.3 billion ceilings for fiscal years 1980 and 1981, respectively. Even at these levels, the Administration recognizes that Eximbank may not be able to offer competitive financing on all exports facing foreign government export financing support. Thus, the Congress may wish to consider whether Eximbank should be given additional direct loan authority so that Eximbank could increasingly offer:

--up to 100 percent of the required long term financing in cases where a mixture of commercial and Eximbank loans results in a blended interest rate higher than rates offered by other governments, and

--medium term direct loans, and loans for exports under $5 million, in cases where commercial interest rates and Eximbank's discount rates are not competitive with financing offered by other governments.

We are not in a position to estimate what the increased level of authority might be under this alternative

An alternative or supplement to increased direct loan authority is lowered Eximbank lending rates, thereby enabling increased commercial bank participation. However, as we previously noted, Eximbank's standard lending rates are already below its marginal cost of borrowing, and it selectively offers even lower rates. In the long-term, this jeopardizes the Bank's traditional self-sustaining structure. If Eximbank were to continue or increase the subsidization of its lending rates with its accumulated reserves, appropriations could be needed in the future if reserves are inadequate to pay loan defaults and claims for which Eximbank is liable. Another alternative would be to provide appropriations to subsidize the difference between Eximbank's normal lending rates and the rates offered by other governments competing for a sale.

This might also be a good time to consider whether other constraints on Eximbank financing--such as local costs and foreign content financing--should also be re-examined.

Mr. Chairman, this concludes our prepared testimony. We would be pleased to answer any questions you or other subcommittee members may have at this time.