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STATEMENT OF

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BEFORE THE

SUBCOMMITTEE ON INTERNATIONAL FINANCE
AND MONETARY POLICY
SENATE COMMITTEE ON BANKING, HOUSING,
AND URBAN AFFAIRS

ON

IMPLEMENTATION OF THE EXPORT TRADING COMPANY ACT OF 1982

Mr. Chairman and Members of the Subcommittee:

We are pleased to be here today to discuss our recent work on the progress made in implementing the Export Trading Company Act of 1982. My statement summarizes the information discussed in our report dated February 27, 1986, and provides some observations we have made based on our work.

OVERVIEW

During deliberations on how to increase exports, Congress concluded that potential exports were not being realized due to a number of factors, including a lack of business expertise in exporting, limited financing, and government regulations. Congress believed that to reach a significant number of potential exporters, well-developed export trading companies (ETCs) were needed to provide a full range of trade services and to achieve economies of scale in order to lower unit costs. Congress expected that ETCs could be more successful if they were allowed to draw upon the financial resources and expertise of the banking system. It also believed that reducing the antitrust issue as an impediment to export trade would be helpful.

The Export Trading Company Act was passed on October 8, 1982, and includes provisions regarding all of these points. It sets out to increase exports of products and services by (1) providing for the formation of an Office of Export Trading Company Affairs in the Department of Commerce to promote and encourage the formation of ETCs, (2) allowing bank holding companies to invest in ETCs, (3) reducing restrictions on trade financing, and (4) modifying the application of antitrust laws to export trade and providing for Commerce to issue certificates of review for specific antitrust protection.

Thus far, businesses' response to the Act has been slow. Only 62 ETCs have received antitrust clearance certificates from Commerce. And, only 40 bank holding companies have received Federal Reserve Board approval to invest in ETCs. Similarly, exports facilitated through ETCs have not been significant. According to the banks and ETCs we visited, the economic conditions of the past few years, particularly the high value of the dollar against the currencies of foreign countries, has hampered exporting by those ETCs which have been established. Yet, in our opinion, bankers and exporters have an increased awareness of export trading and are in a position to take greater advantage of it as economic conditions become more favorable. The increased awareness toward exporting could result in the formation of more ETCs and, eventually, in increased export trade.

We believe, however, that it would be unrealistic to expect that removal of export barriers in and of themselves would yield a major increase in exports, since U.S. export performance is determined by many variables, including the level and growth of gross national product in foreign countries; the value of the dollar; the availability of international lending and the current developing country debt problems; U.S. technological leadership; foreign tastes and preferences for and barriers against U.S. products; U.S. business attitudes; and impediments to U.S. exports created by U.S. laws and regulations. The most important determinants are fundamental economic factors, such as foreign economic growth and relative exchange rates.

COMMERCE'S OFFICE OF EXPORT TRADING COMPANY AFFAIRS

Pursuant to Title I of the Act, Commerce established the Office of Export Trading Company Affairs (OETCA) to promote and encourage the formation of ETCs and to facilitate contact between producers of exportable goods and services and firms offering export services. For fiscal year 1986, OETCA has a budget of $746,000 and has been authorized 17 people (12 professionals and 5 secretaries) to carry out both Title I ETC promotion and Title III certificate of review efforts.

Initial Commerce promotion efforts informed the public about the Act through a number of conferences held throughout the country and through publications, such as The Export Trading Company Guidebook and the Contact Facilitation Service Directory which lists by state both the export service providers and U.S. producers of goods and services that want to be registered. During fiscal year 1985 and through fiscal year 1986 to date, promotion activities have consisted of (1) conducting, co-sponsoring, or participating in over 25 promotional events, such as bank and agribusiness ETC conferences, and (2) distributing brochures and articles and updating the Directory.

As noted in our report, there is no data available on the success of these promotion efforts in bringing producers and ETCs together or on the number of ETCs formed as a result of the promotion efforts.

CERTIFICATES OF REVIEW

Under Title III, any person or firm may request the Department of Commerce to determine in advance whether its export conduct qualifies for specific antitrust protection. To date Commerce, in conjunction with the Justice Department, has issued antitrust certificates of review to 62 organizations (including 32 newly organized ones) extending antitrust protection for their export activities. These certificates also extend antitrust protection to the export trade activities of about 263 firms and individuals participating in the certificates.

Twenty-nine of the firms provide export services to facilitate the sale of goods and services of non-affiliated firms in export markets, and 33 of them or their members produce at least some of the goods or services that are exported.

The type of export conduct certified can be classified as horizontal or vertical. Horizontal arrangements are those in which domestic competitors have joined together to fix prices and allocate markets, customers, or quotas--28 certificates have been granted for which the antitrust issues were principally horizontal.

Vertical arrangements are restrictive agreements with U.S. suppliers of export products or distributors in export markets. They can be non-exclusive or exclusive agreements where the ETC can refuse to deal with other U.S. suppliers or other distributors in export markets--32 certificates have been granted for which the antitrust concerns were principally vertical. There were no antitrust issues for the remaining two certificate holders.

The 62 certificate holders are geographically disbursed, with 8 in the Northeast, 26 in the South (including several in Washington, D.C.), 16 in the Midwest, and 12 in the West. These firms handle a wide variety of products, as shown in appendix II to our report.

Many of the firms we contacted clearly had not done as well as they had hoped. Since the data collection for our report was completed several months ago, we contacted 18 of the 23 firms we had previously contacted and learned that they were still not doing as well as anticipated. Six did report an increase in exports this past year, but 10 reported decreases, and 2 reported no change. They continue to believe that the value of the dollar had been their major problem, but also still cite availablity of financing as a problem.

The annual reports filed this past year with OETCA by the certificate holders show that some have done no exporting. Of the 40 firms who reported, two went out of business and 14 were in the process of getting organized and initiating business activities. The remaining 24 firms reported a total of about $60 million in export sales. Most of these firms, or their members, were exporting before obtaining certificates from OETCA. For example, one of these firms by itself accounted for a third of the reported exports and the three largest firms accounted for 69 percent.

Only 26 of the 40 firms voluntarily reported the number of employees engaged in exports--and most had 5 or less employees.

Some reasons why more businesses have not sought certificates of review

Commerce states that one reason for the low number of certificates of review is because Title III is a new process. A company must provide proprietary business data to the Commerce and Justice Departments and may want to know that the benefits are worth doing so. A second reason may involve the lack of antitrust issues; many applications were withdrawn because the firms did not have antitrust issues--they did not handle competing products, had no need to fix export markets or prices, or did not want to combine with others for this purpose. The executive director of a trade association also told us that more companies have not applied for certificates because most companies are specialized and have such small shares of the market that they do not see themselves in potential violation of the antitrust laws.

Other reasons why so few businesses have sought the certificates might be that (1) antitrust restrictions are not perceived to be a barrier to exporting or (2) businesses may be relying on the protection under Title IV of the Act, which clarified the antitrust laws in regard to export trade. Commerce has emphasized that Title IV may have reduced antitrust uncertainty and noted that the extent of its impact on increased exports cannot be determined.

BANK HOLDING COMPANY INVESTMENT IN ETCs

Title II permits bank holding companies, under the review and supervision of the Federal Reserve Board, to invest in ETCs. The Board gave approval to bank holding companies to form 40 bank ETCs; 30 of them are wholly-owned subsidiaries of the bank holding companies, two are subsidiaries of bank holding companies but allow other investors, and 8 are joint ventures.

The bank ETCs are geographically disbursed--13 in the Northeast, 11 in the West, 6 in the Midwest, 9 in the South, and one overseas. The total authorized investment in the 40 companies is about $84 million, ranging from a high of $18 million to a low of $10,000.

As shown in table 1, the size of the bank holding companies which invested in the ETCs varies considerably. Nine multinational money center banks, accounting for 10 ETCs, represent 84 percent of the approved investments.

Table 1

Size of Bank Holding Companies and Their Investments in ETCs

Size of bank holding company	Number of ETCs	Total approved investment: Amount (thousands)	Total approved investment: Percent
Money center banks	10	$71,103	84
Assets over $5 billion	13	6,573	8
Assets between $1 billion and $5 billion	5	3,250	4
Assets below $1 billion	8	1,275	2
Joint venture of three banks	2	702	1
Dissolved ETCs	2	1,150	1
Total	40	$84,053	100

At the time of our survey, most of the bank ETCs were in the formative stages of getting organized and identifying markets and customers. The eight that we visited reported only limited exports.

Since the data collection for our report was completed several months ago, we updated our information. Of the eight bank ETCs we visited earlier, only two reported no change in operations or key personnel; four had major changes in the ownership or operations; and two had changes in key personnel.

In December 1985, one bank holding company sold its ETC to its managers; a second ETC, organized as a full service trading company, had been reduced in size from about 40 employees to 4 and is now active only in trade financing; a third, which represented small to medium sized U.S. companies in overseas markets, principally China, decided to disband the company in late January 1986; and the fourth, although still functioning the same as before, has now merged with a trade development group in the parent bank to create a new bank ETC. Regarding the two ETCs which have had changes in personnel, one has changed presidents and the other continues to provide trade development services on a contracting-out basis but no longer has any staff--its services are integrated with the bank and provided by bank employees.

Some reasons why more bank holding companies have not invested in ETCs

More bank holding companies have not invested in ETCs for such reasons as (1) they do not service many exporters, (2) they believe that ETCs should be undertaken only by large international banks, or (3) they believe the profitability of an ETC is too uncertain and find other areas of banking more profitable.

--One bank, for example, advised us that capital is needed for its lending activities. Export trading is a new area where margins are small, and an ETC will be formed only if it appears more attractive than other business areas.

--Another stated that it can encourage trade and meet the needs of its clients without establishing an ETC. Its clients are large multinational companies experienced in exporting.

--A third said that it does not need to form an ETC to provide its clients with expertise in exporting. It believes that the potential constraints on its capital and the strength of the U.S. dollar made a poor climate for exporting.

CONCERNS ABOUT FEDERAL RESERVE BOARD REGULATIONS

Bank ETCs we surveyed believe that certain provisions of the Act and certain Federal Reserve Board regulations and policies have affected or will affect their export performance, potential to compete with foreign-owned trading companies, and ability to survive. Of particular concern are the Board provisions that bank ETCs (1) must derive more than 50 percent of their revenue from exporting, with third-country trade and countertrade counted as non-export revenue, (2) cannot invest in firms that themselves export services, (3) must observe the same collateral requirements as non-bank affiliates when borrowing from parent banks, (4) are discouraged from having a leveraging, or asset-to-capital, ratio not greater than 10 to 1, thereby limiting the amount that can be borrowed and (5) must have proposals to take title to goods in excess of $2 million (except against firm orders) approved by the Federal Reserve Board. The Federal Reserve Board has emphasized to us that it promulgated its regulations to reflect a congressional concern for the balance between bank participation in ETCs and fundamental concerns about assuring the safety and soundness of banks.

We are sensitive to the concerns reflected in these provisions that bank investment in ETCs conform to standards of banking and financial prudence. In our opinion, however, all five provisions place bank ETCs at a competitive disadvantage with non-bank ETCs.

Exporting Requirement - The Act requires a bank ETC to be operated principally for the purpose of exporting; the Board's test for this requirement is that more than 50 percent of total revenue--including exports, imports, and the sale of foreign products in overseas markets--must come from exporting over a 2-year period. The proceeds of countertrade and trade that the ETCs arrange between two foreign countries are counted as non-export revenue. The bank ETCs argue that if half of the business must consist of exports, they may not be able to meet the Board's requirement. They assert that, as a minimum, the 50-percent requirement should encompass more than a period of 2 years and that a transaction necessary to make an export sale should not be counted as non-export revenue. For example, the element of a countertrade transaction involving a third country should not be counted as non-export revenue.

The Board views its 50-percent requirement as assuring that the legislative intent is carried out. Importing is less difficult, and the Board feels that without the 50-percent export requirement, bank ETCs would have less incentive to find markets for U.S. goods. The Board is reluctant to take what it feels would be a stance against the export intent of the legislation. Board representatives advised us that ETCs which have commented on the regulation stated that the problem is anticipatory; they have had no difficulty meeting the test to date.

We believe the Board is clearly authorized to establish the 50-percent export requirement. The term "principally" in the context of the statutory provision contemplates that the preponderance of an ETC's activity will not be imports, and the legislative history, at least on the House side, anticipates the Board's measuring an ETC's activities in terms of revenue shares. Therefore, the Board acted within its authority by defining "principally" only in terms of export revenues and in setting the requirement that exports be more than 50 percent of all revenues.

The statute, however, does not itself address how such revenues should be calculated or whether revenue should be the sole basis for determining if an ETC is organized and operated principally for the purpose of exports. In fact, it does not even include the term "revenue". Therefore, in setting the

50-percent requirement, we believe the Board could redefine its own term "revenues" to include only proceeds from imports to and exports from the United States. This change would ordinarily exclude, for purposes of establishing whether an ETC meets the 50-percent requirement, the proceeds from foreign products sold in overseas markets that do not enter U.S. commerce. The Board could also devise indices additional to "revenue" to determine whether a company is "organized and operated" principally for exporting or for facilitating exports and it could extend beyond 2 years the period during which qualifying revenues are computed. We believe modifications along these lines could be framed to have the effect of reducing the extent to which companies view the current regulation as a potential impediment to operations and still assure that exporting would be the paramount ETC activity.

In a letter to us dated April 21, 1986, the Board reiterated its (1) position on determining whether an ETC is organized principally for export and (2) belief that excluding revenues from third-country trade would allow, and likely result in, ETCs owned by banking organizations engaging in activities unrelated to exports. However, the Board offered no evidence to support its opinion that such a "worst case" outcome is likely. And, we have seen no evidence that would lead us to conclude that this is likely to happen. We do not believe that it is required or desirable for the Board to retain this restrictive regulation that may discourage the formation and limit the commercial vitality of bank ETCs.

S.1934, the "Export Trading Company Amendments Act of 1985," would make changes to address this and other matters. For computation of the Board's 50-percent requirement, the bill proposes to amend the Act to qualify a company as an ETC when its export revenues exceed its import revenues; this would exclude from the calculation of revenues those third-party transactions involving neither exports to nor imports from the United States. We support this change.

Exporting of services - According to the Act's definition, a bank ETC is a company which is principally organized and operated for either of two purposes. It may itself export goods or services produced in the United States or it may facilitate the export of goods or services produced in the United States by unaffiliated persons by providing one or more export trade services.

Under the Board's definition, however, an ETC can provide services only to facilitate the export trade of others. Thus, a bank may not invest in an ETC that itself exports services to foreign customers. The Department of Commerce disagrees with the Board's position on this and correspondence has been exchanged about the matter between the Secretary of Commerce and the Chairman of the Board of Governors of the Federal Reserve System. The Board reasoned that its position that banks ETCs serve only as trade facilitators, not as investors in service industries, is sufficiently supported by the Act's purpose and legislative history.

Commerce contends that the regulatory definition of an ETC adopted by the Board is not supported by either the language of Title II or its legislative history. Instead, Commerce contends that a straightforward reading of the statutory definition clearly indicates that Congress intended an ETC to export goods or services itself or to facilitate the exports of goods or services of others by providing export trade services. Commerce concludes that the Board, by finding in the statutory language an "ambiguity" on which to base its interpretation, has merely established a vehicle to permit the Board to substitute its own view of the proper role for bank ETCs for the role Congress expressed in the statute and the legislative history.

A straightforward reading of the ETC Act's definition of "export trading company" permits bank holding companies to invest in an ETC which exports its own services. We think the Board is wrong in both its position that the definition is ambiguous, and its conclusion that the better interpretation is that an ETC can provide services only to facilitate the export trade of others. However, unless the pertinent statutory language is changed, the Board could continue to use this same justification for implementing its view of the statute. We note that Senator Heinz, in his introductory remarks to S.1934, clearly states his own belief, which we share, that the Board's interpretation of "export trading company" under the ETC Act is wrong. We believe that the new definition of "export trading company" in S.1934 is so explicit that, if enacted, the Board would no longer maintain that an ETC cannot export its own services or the services of its affiliates.

Mr. Chairman, this concludes my statement. I would be happy to respond to any questions you have at this time.