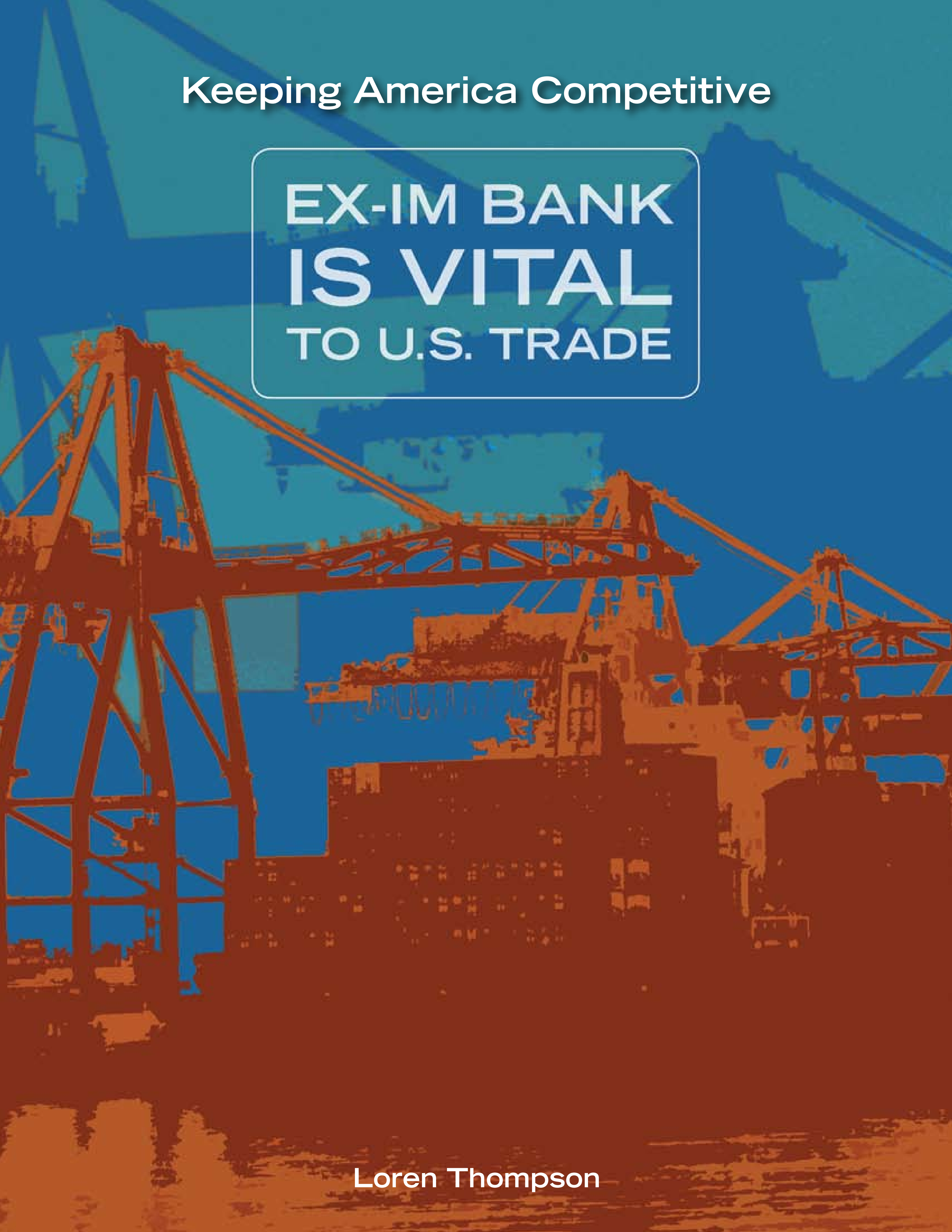
Keeping America Competitive

EX-IM BANK IS VITAL TO U.S. TRADE



Loren Thompson

Findings in Brief

For nearly eighty years, the U.S. Export-Import Bank has been the lender of last resort for U.S. companies seeking to sell their goods abroad. Ex-Im Bank, as it is called, provides loans, loan guarantees, insurance and other forms of credit when recipients of assistance are good credit risks but the private sector either cannot or will not provide financing. The bank's role tends to expand when credit conditions are tight, as in the recent recession.

As the official export credit agency of the federal government, Ex-Im Bank also acts to level the playing field for U.S. exporters when other governments seek to influence the decisions of foreign buyers by extending credit on concessionary terms. In recent years, China has been especially active in displacing U.S. companies from foreign markets through predatory export financing, and Ex-Im Bank plays an important role in countering such market-distorting behavior.

Ex-Im Bank does not require taxpayer funds to operate. It covers the cost of its operations by imposing fees on users of its services. The value of those fees typically exceeds the cost of operations, so each year the bank turns over hundreds of millions of dollars to the U.S. Treasury that help pay down the national debt. Although the government is potentially liable for Ex-Im loans that are not repaid on time, the default rate on Ex-Im credit arrangements is below that of most commercial banks so federal exposure is minimal.

In 2011, Ex-Im Bank financed over $40 billion in U.S. exports, helping to sustain 300,000 jobs mainly in the U.S. manufacturing sector. About 80 percent of the dollar value of Ex-Im financing is received by big exporters such as Boeing and General Electric, but about 80 percent of the bank's transactions support the exports of small and medium-size companies. Smaller companies also benefit indirectly from credit extended to big exporters when they are suppliers to those companies.

The Ex-Im Bank's charter must be renewed in the near future if it is to continue operations, and it is fast approaching the $100 billion statutory limit on how much credit it can provide. It is vital to U.S. exporters that the bank's services continue to be available if they are to compete with the companies of other countries in markets where weak economic or political conditions deter private-sector sources from providing financing. Renewing Ex-Im Bank's charter with increased lending authority is the only practical way of countering the predatory financing practices of other trading nations, many of whom devote a much larger share of their national wealth to assisting exporters than America does.

Table of Contents

Introduction: The Export-Import Bank is Vital to U.S. Trade

The United States has long been a leading proponent of free trade, but its actual performance in overseas trade since the new millennium began has not been impressive. During the decade ending in 2010, its cumulative trade deficit topped $5 trillion as imports exceeded exports every year. Although America has the largest economy in the world, it is only the third biggest trader, and the value of its exports as a percentage of national economic output is only 10 percent, compared to 40 percent for Germany, 25 percent for Canada and China, and 20 percent for France. The gap between what America sold abroad and what it bought contributed significantly to the slow pace of job creation in the last decade, increasing the ranks of the unemployed by well over a million people compared with what the level would have been in the absence of a trade deficit.

Predatory practices by countries such as China have contributed to the weak U.S. trade performance, but many of America's wounds are self-inflicted. Domestic tax and regulatory policies have not been geared to encouraging exports -- they often make it more profitable to send jobs overseas rather than goods -- and the federal government has been slow to recognize the challenge to U.S. competitiveness posed by economic globalization. Even when the need for action is recognized, Washington's efforts tend to be more modest than those of other countries. Nonetheless, a handful of government agencies such as the office of the U.S. Trade Representative have struggled to strengthen America's faltering trade performance, and their impact far outweighs the small claim they make on the federal budget.

A case in point is the U.S. Export-Import Bank, established in 1934 to assist exporters in securing financing during the depths of the Great Depression. Ex-Im Bank, as it is called, acts as a lender of last resort to companies that cannot secure financing for exports to nations with fragile economic or political conditions. The bank provides loans, insurance and credit guarantees facilitating tens of billions of dollars in exports each year, sustaining about 300,000 domestic jobs. Most of the recipients are small or medium-size businesses that sometimes have more difficulty securing credit from commercial sources than big companies do. That problem is most pronounced during periods of economic weakness such as the recent recession. Ex-Im Bank also helps to level the playing field for U.S. companies when the export credit agencies of other countries offer financial backing to their own companies that might sway the decisions in purchasing countries.

Although it is a vital part of the U.S. export machine, the Ex-Im Bank costs the government nothing because its activities are paid for by fees imposed on users of its programs. However, reauthorization of the bank's charter did not occur before it expired at the end of fiscal 2011, and it is rapidly approaching the statutory limits on its ability to provide new financing to struggling exporters. This report explains why reauthorization of the Export-Import Bank with increased financing capacity is crucial to sustaining the recovery of U.S. exports. It begins by describing the challenges that U.S. exporters face in the current global economy, and then details the programs the bank funds to help overcome those challenges. It also assesses the current status of the bank's activities, refuting erroneous arguments advanced for limiting the government's role in export financing. The report concludes that without reauthorization and expansion of Ex-Im Bank programs (at no cost to taxpayers), the U.S. probably cannot close the gap between what it buys and sells abroad.

U.S. Trade Performance Needs to Improve

After World War Two, the United States abandoned its long tradition of protectionist policies and became a leading proponent of trade liberalization. U.S. leaders argued that free trade would accelerate global economic growth and strengthen peaceful ties between nations. The drive for a more open trading system culminated in the creation of the World Trade Organization (WTO) in 1995, a monitoring and enforcement mechanism for free trade to which all major industrial powers belong. The information revolution unfolding during that same decade reinforced the trend toward rapidly expanding global commerce.

However, U.S. trade performance has lagged behind that of many partners, particularly since China joined the WTO in 2001. While global exports and imports grew by 135 percent between 2000 and 2010, America's exports only grew 72 percent and its imports only grew 62 percent. Because U.S. imports were growing from a bigger base, though, the United States accumulated a trade deficit of $5.5 trillion in goods and services during the same period. Meanwhile, the U.S. share of global exports in manufactured goods declined from 13.8 percent to 9.6 percent. The National Association of Manufacturers calculates that if the United States had maintained the share of global manufactured exports it enjoyed in 2000 ten years later, the nation would have exported $450 billion more in goods and created nearly 3 million additional jobs (the Department of Commerce estimates that every billion dollars in exports creates 6,250 domestic jobs).

Manufacturing lies at the heart of America's poor trade performance, because it accounts for the vast majority of items moving in global commerce, including 95 percent of Chinese exports and 80 percent of U.S. exports. Although the United States has long enjoyed a positive balance of trade in services, its chronic deficit in manufactured goods currently exceeds $2 billion per day. This imbalance has persisted even as the nation became a net exporter of petroleum products in 2011 due to recent breakthroughs in extraction technology. Weak exports of manufactured goods is the main reason why the U.S. trade deficit grew from about $500 billion in 2009 to $635 billion in 2010 to over $700 billion in 2011. It also was a contributing factor in the closure of 42,000 U.S. factories between 2001 and 2010, and the loss of 5.5 million manufacturing jobs -- an average of 46,000 jobs *every month* for ten straight years.

Because the United States is the biggest economy in the world, it is still one of the top exporters, ranking number three after China and Germany in recent years. However, as a share of Gross Domestic Product (GDP), U.S. exports lag behind those of most other major industrial powers at less than 10 percent. More dynamic trading nations such as Canada, China and Germany typically generate exports equal to 20 percent or more of their GDP. Because the U.S. economy is not exporting at anywhere near its true potential, millions of jobs are being lost and future generations of Americans will inherit trillions of dollars in obligations to foreign nations. That is the reason why President Obama set a goal of doubling U.S. exports during his time in office, and why trade-enhancing activities such as the credit programs of the Export-Import Bank are crucial to America's economic future.

Ex-Im Bank Programs Bolster U.S. Exports

The Export-Import Bank is the official export credit agency of the federal government. Its role is to assist U.S. companies in securing financing for their exports when market sources either cannot or will not extend credit. This situation arises most frequently when overseas buyers face difficult economic and political conditions, when domestic credit markets are tight due to a weak economy, or when the U.S. exporter is a small business with limited access to commercial credit. In such circumstances, Ex-Im Bank programs provide direct loans, loan guarantees and insurance that allow exports to go forward so long as recipients of assistance are deemed good credit risks. The recipients are charged a fee that covers Ex-Im Bank administrative costs, relieving taxpayers of any burden in funding the bank's activities.

Exporters often require more financing than businesses serving domestic markets due to delays in completing transactions. Companies may need to spend many millions of dollars on equipment, parts and labor to prepare a product for export before any payment is received. However, the vast preponderance of export financing occurs through normal market mechanisms, either among the companies in a supply chain or between companies and commercial lenders. Ex-Im Bank only gets involved when a company that is a good credit risk cannot find market sources of financing sufficient to carry out a transaction involving the export of U.S.-made goods. Most of the credit the bank extends benefits leading exporters such as Boeing, Caterpillar and General Electric, but over 80 percent of the companies tapping Ex-Im Bank programs are small or medium-size businesses. Even when the immediate recipient of assistance is a major corporation, much of the benefit from Ex-Im Bank programs ultimately accrues to small and medium-size suppliers of that company.

Since it was first established in 1934, during the depths of the Great Depression, Ex-Im Bank has operated within a framework of congressionally mandated requirements that are more demanding than those faced by the export credit agencies of many other countries. First, the bank's charter must be reauthorized by Congress at regular intervals, and the total amount of credit it can extend is capped by statute. Second, the bank cannot provide financing to domestic or foreign recipients unless they are deemed to be good credit risks (its loan default rate of 1.5 percent is well below that of most commercial banks). Third, exports assisted by the bank must contain extensive domestic content, and in some cases must be transported on U.S.-flagged ships. In addition, the bank has been directed by Congress to be self sustaining so that it requires no net appropriations, to consider environmental and domestic U.S. economic impacts of its financing activities, and to steer much of its financing to small and medium-size businesses.

Despite these constraints, the Export-Import Bank has proven to be a vital part of the U.S. export machine. In fiscal 2011 it supported over $40 billion in U.S. exports, most of which would not have occurred without Ex-Im financing due to an absence of market sources of credit. The bank has experienced record demand for its programs during the recent economic downturn in the United States due to the tightening of credit standards by many commercial lenders. It thus contributed to a steady rise in U.S. exports that softened the blow of weak economic conditions at home. Its programs are essential to sustaining hundreds of thousands of U.S. jobs, particularly in the struggling manufacturing sector, and yet it receives no appropriation from Congress owing to the fee-based nature of the services it provides. In fact, during the last four fiscal years the bank has contributed an average of over $800 million annually to the Treasury in the form of fees collected in excess of needs, making it a significant contributor to deficit reduction.

A General Electric "Evolution" series locomotive. Although General Electric makes the most fuel-efficient, reliable locomotives in the world, its ability to sell them abroad has been undermined by the efforts of the Chinese government to sway buyer preferences with concessionary financing. The Export-Import Bank recently leveled the playing field in a Pakistani railway project by countering export financing from China, enabling GE to win the competition and preserve over 700 jobs in Pennsylvania.

Predatory Traders Must Be Countered

When the Export-Import Bank was established during the Great Depression, unfair trade practices were rampant among the leading industrialized countries -- as they had been for centuries. The prevailing view was that one nation's gain was another's loss. That attitude began to change after World War Two, as the United States and other major trading nations embraced the view of classic economists that all nations might gain in a trading system that was truly open and free. The new consensus was reflected in a series of trade liberalization rounds under the umbrella of the General Agreement on Tariffs and Trade. GATT, as it was known, was superseded by the World Trade Organization in 1995 -- a body charged with enforcing principles of fairness and freedom in the global trading system.

However, although all of the world's major industrial powers now belong to the World Trade Organization, it is a constant struggle to prevent countries from reverting to their old habits of seeking unilateral advantage. For instance, the WTO recently ruled that several European nations have illegally subsidized the development and marketing of commercial transports by Airbus since its inception in the 1970s, causing substantial damage to the company's U.S. competitors. The challenge of preventing abuses is greatest in the case of countries that have only recently risen to the first tier of global traders such as Brazil, China and India, since such nations were not party to many of the understandings entered into in the early postwar period with regard to how a free trade system must operate if it is to be sustainable over the long term.

Export credits are a prime example of this problem, because if they are too generous they distort the normal functioning of market mechanisms in the trading system. Many of the leading traders agreed decades ago to restrain the scale and terms of their export credit activities, but newer entrants to the system often do not adhere to the standards that were established. For instance, China allocates about ten times as much of its economy to trade financing activities as America does, and the credit it extends often is at below-market rates with liberal repayment terms. A single Chinese telecommunications company -- Huawei -- was granted export credits equivalent to what Ex-Im Bank provides to all U.S. exporters in a typical year, and access to such extensive resources has enabled the company to displace U.S. competitors in emerging markets such as Brazil (Huawei has also been accused of stealing U.S. technology).

The persistence of trade-distorting activities by the export credit agencies of other nations has given Ex-Im Bank a growing role in leveling the playing field for U.S. exporters by countering the predatory financing practices of countries like China. In one transaction, 700 jobs in Erie, Pennsylvania were preserved when Ex-Im Bank stepped in to match credit terms being offered to Pakistan by China in a $500 million competition for locomotives and other railway equipment. The Pakistanis were willing to pay a premium for what they considered to be superior U.S. technology, but without Ex-Im Bank involvement, the credit terms being offered by China might have been too appealing to pass up. U.S. exporters are facing similar situations with increasing frequency in Africa, Asia and Latin America, and as a result the Export-Import Bank now plays a central role in assuring that U.S. products are judged on their merits by foreign buyers rather than on the basis of what financing other governments are willing to provide.

Ex-Im Bank Financing Limits are Nearly Exhausted

When the Export-Import Bank was reorganized in 1945 as an independent agency within the executive branch of the federal government, it was given a renewable charter that Congress must periodically reauthorize if the bank is to continue operating. The last multiyear reauthorization occurred in 2005, when Congress extended the charter through the end of fiscal year 2011. A planned four-year extension through 2015 was not passed in the most recent session of Congress, due to a range of policy and process issues -- many of them unrelated to Ex-Im Bank operations. As a result, the bank is currently operating under a temporary extension of its authority.

The Ex-Im Bank charter does more than simply provide the legal authority under which the institution operates. It also imposes a statutory limit on how much total credit the bank can extend in support of U.S. exports, and specifies a series of conditions concerning how that credit shall be made available. For example, the current charter directs that the bank shall not compete with private-sector sources of financing, that recipients of financing must be good credit risks likely to repay loans in a timely fashion, and that financing shall only be made available for exports containing extensive U.S.-made content. The range of requirements and restrictions bearing upon when Ex-Im Bank may act has tended to grow over time, notwithstanding the fact that bank activities are self-sustaining and require no funds from the Treasury.

A key issue facing Congress when it takes up reauthorization is the current $100 billion limit on how much credit the bank may extend. Since financial commitments in support of exports sometimes take years to close out, the bank can only extend a fraction of this amount in new credit each year. With Ex-Im Bank experiencing record demand for its services and expanding its support to several categories of exporters such as small businesses, it will reach its statutory limit of $100 billion on outstanding financial commitments sometime in 2012. At that point, the bank will need to cease offering new credit unless old obligations are retired. It therefore is important that any multiyear renewal of the charter include a higher statutory ceiling on permissible financing if the organization is to keep pace with the export credit agencies of competing nations.

Ex-Im Bank President Fred P. Hochberg has told Congress that under the existing credit ceiling, “Ex-Im does not have the resources to match the trade-distorting concessional financing offered by the Chinese in many cases.” Even if predatory financing practices were not an issue, the steady increase in global trade means Ex-Im Bank would need some expansion in its financing authority simply to continue its current role in supporting the nation’s 290,000 exporters (97 percent of whom are small or medium-size businesses). The congressional committees that oversee Ex-Im Bank activities have proposed raising the statutory limit on export credits between 40 and 60 percent for the next four years, in line with White House recommendations. Lesser increases would constrain the bank’s capacity to support U.S. exporters at a time of intense competition in the global trading system.

Criticisms of Ex-Im Bank are Unreasonable

Although the Export-Import Bank has operated for nearly 80 years, sustains hundreds of thousands of U.S. jobs, and requires no taxpayer funding, it nonetheless has been a target of criticism. In general, critics oppose the bank's activities either for philosophical reasons or because they feel particular economic interests have been disadvantaged. The two most prevalent philosophical complaints are that Ex-Im credit activities distort the functioning of market forces and that they are a form of corporate welfare in which government picks winners and losers.

The complaint about distorting market forces ignores the fact that every major trading nation in the world has one or more export credit agencies, and they often promote local exports far more vigorously than the Ex-Im Bank does. As a percentage of Gross Domestic Product, the governments of Brazil, Canada, China, France, Germany, India and Italy all allocate substantially more funding to export credit services than the U.S. government does. In fact, each of them allocates at least four times more of their GDP to export financing, and often with fewer legal constraints than are imposed on Ex-Im Bank. Ex-Im Bank not only is prohibited from competing with private sources of financing, but must comply with a raft of other restrictions on when providing credit is permissible. Given the scale of credit activities by other governments, Ex-Im Bank's role can more accurately be seen as leveling the playing field for U.S. exporters so that market forces actually do function, rather than impeding their operation.

The charge of corporate welfare is grounded in the fact that big industrial exporters such as Boeing, Caterpillar and General Electric get more of Ex-Im Bank's credit assistance than smaller exporters do. As a May, 2011 report by the Congressional Research Service noted, "Large firms account for about 80% of the *dollar value* of Ex-Im Bank's credit and insurance authorizations and small firms account for about 20%." However, the report went on to note that, "In contrast, small firms account for about 80% of the *number* of Ex-Im Bank's credit and insurance transactions, whereas large firms account for about 20%." This disparity has less to do with favoritism than it does with the structure of the export market. The kinds of capital-equipment exports most in need of credit assistance are typically made by big industrial companies. But Ex-Im Bank services are important to small exporters because such companies often have difficulty securing financing for their products in private credit markets. Moreover, even when exports are manufactured by big industrial companies, they usually contain content from many smaller suppliers. Ex-Im Bank's standards require it to treat all prospective recipients of credit assistance equally, and the bank has made extensive efforts to tailor its services to the needs of small and medium-size businesses.

Criticism from those who feel their economic interests have been harmed by Ex-Im Bank activities usually originate in industries that face heavy overseas competition. For instance, steelmakers object to the government assisting in the export of machinery that might make foreign steel producers more competitive. Airlines object to the credit support foreign carriers might obtain in purchasing planes exported from the U.S. However, there is little evidence that real harm has been caused to U.S. economic interests by Ex-Im activities, and the net benefit to the economy is considerable. In most cases, the customers for U.S. exports have alternatives they can buy from other countries, often by tapping credit facilities more liberal than those available through Ex-Im Bank. Thus, unilaterally withdrawing U.S. financing programs would hurt American exporters without helping aggrieved companies. On close inspection, the arguments against reauthorizing the Export-Import Bank prove to be unrealistic and unreasonable.

Ex-Im Bank Should Be Reauthorized with Expanded Credit Authority

The United States is gradually recovering from a deep recession, but as it does the nation's trade deficit is growing. In 2010, U.S. imports of goods and services exceeded exports by $500 billion, an increase of 31 percent over the previous year. In 2011 the trade gap increased another 12 percent, to $558 billion -- nearly four-percent of Gross Domestic Product. Trade gaps of this magnitude are a major drag on economic growth and job creation. The White House and Congress are currently pursuing a range of initiatives to improve U.S. trade performance.

Reauthorization of the Export-Import Bank with increased capacity to provide credit is an essential part of any plan to improve America's trade competitiveness. Every major trading nation has an export credit agency, and many of them are more active in assisting indigenous companies than Ex-Im Bank is. If the United States were to unilaterally abolish or severely constrain its own export credit agency, the current trade deficit would grow considerably worse -- especially in goods, where U.S. exports are already lagging behind imports by about $2 billion per day. The most salient features of Ex-Im Bank operations can be easily summarized:

- The bank exists to serve as a lender of last resort when private-sector sources of finance are either unable or unwilling to assist U.S. exporters.

- The bank also counters the predatory export-credit practices of other traders, leveling the playing field so that market forces can function effectively.

- The bank does not compete with the private sector, and only extends credit when proposed recipients of assistance are judged to be good credit risks.

- The bank requires no taxpayer funding since it covers the cost of its services through fees on users, surpluses from which help reduce the budget deficit.

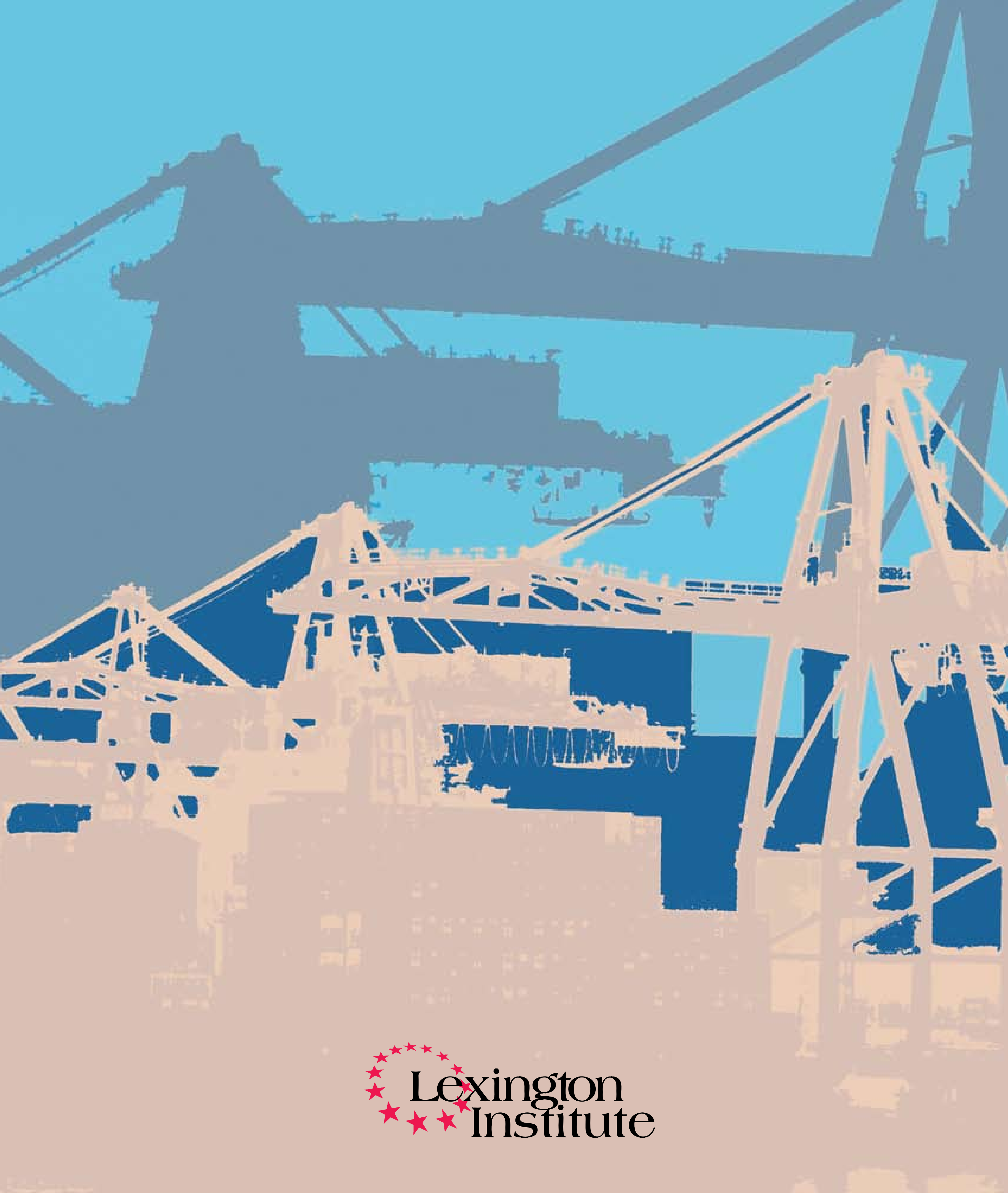
- The bank assists large and small companies alike when their exports contain substantial U.S.-made content, sustaining 300,000 jobs that typically pay well.

By any reasonable standard, the Export-Import Bank is a model federal agency. But in order to function effectively, it must be reauthorized for a multiyear period. The four years currently proposed is the minimum timespan that should be considered, given the duration of some international transactions and the need to plan for the efficient allocation of bank resources. In addition, the bank needs a significant increase in its statutory credit authority to keep up with the expanded financing activities of foreign export credit agencies and the steadily increasing volume of global trade.

This is not a hard decision to make. It imposes no burden on taxpayers and is vital to keeping the United States competitive in international trade. Failure to act on reauthorization in a timely fashion would send a devastating signal to America's exporters, a clear sign that the government cannot accomplish even the simplest objectives in support of national economic strength.

A Boeing 737 airliner displaying Lion Air colors. The Indonesian carrier recently ordered 230 Boeing commercial transports, and may pay to obtain Export-Import Bank loan guarantees that facilitate financing, as it did in past transactions. Ex-Im Bank plays an important role in helping to level the playing field for Boeing, the nation's biggest exporter, by countering the assistance given to rival Airbus by three European export credit agencies.

Printed in The United States of America, March, 2012.



Lexington Institute

1600 Wilson Boulevard • Suite 900 • Arlington, VA 22209 • Tel: 703.522.5828 • Fax: 703.522.5837
www.lexingtoninstitute.org • mail@lexingtoninstitute.org