

GAO

Report to the Chairman, Subcommittee
on International Finance, Committee on
Banking, Housing, and Urban Affairs,
U.S. Senate

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EXPORT-IMPORT BANK

Options for Achieving Possible Budget Reductions





United States
General Accounting Office
Washington, D.C. 20548

National Security and
International Affairs Division

B-274938

December 20, 1996

The Honorable Christopher S. Bond
Chairman, Subcommittee on International Finance
Committee on Banking, Housing, and Urban Affairs
United States Senate

Dear Mr. Chairman:

The Export-Import Bank of the United States (Eximbank), an independent U.S. government agency responsible for assisting U.S. exporters, has been the subject of considerable debate in recent years. On the one hand, some believe that it plays an important role by providing financing aimed at correcting market failures and helping U.S. exporters level the playing field against their foreign counterparts. On the other hand, some believe that the Eximbank's programs distort markets by providing unwarranted taxpayer subsidies to U.S. exporters.

As you requested, this report (1) describes how the Eximbank spends its program appropriation, (2) identifies program options that the Eximbank may want to consider to reduce the cost of its export financing programs, (3) discusses the potential implications of these options, and (4) discusses the nature and extent of the Eximbank's involvement in a type of financing known as "project financing."¹ Project financing poses different types of risk than sovereign lending but also presents new opportunities for mitigating these risks and better leveraging of Eximbank resources.

Background

In 1934, the Eximbank was created to facilitate exports of U.S. goods and services by offering a wide range of financing at terms competitive with those of other governments' export financing agencies. Such financing includes (1) loans to foreign buyers of U.S. exports; (2) loan guarantees to commercial lenders, providing repayment protection for loans to foreign buyers of U.S. exports; (3) working capital guarantees for pre-export production; and (4) export credit insurance to exporters and lenders, protecting them against the failure of foreign buyers to pay their credit obligations. The Eximbank is to absorb credit risks that the private sector is unwilling or unable to assume.

¹Project financing responds to developing countries' increasing needs for sources of private capital to finance major capital projects. It involves financing for major capital projects where the credit judgment on the likelihood of repayment is based on the project's anticipated future revenues rather than sovereign (government) guarantees.

Over the last 5 fiscal years, Eximbank financing commitments increased from \$12.3 billion in 1992 to a high of \$15.1 billion in 1993 and then declined to \$11.5 billion in 1996. Because of the continued expansion of U.S. exports from \$448 billion in 1992 to \$706 billion in 1995, the proportion of U.S. exports supported by the Eximbank declined from 2.8 percent in 1992 to 1.7 percent in 1995.

Although it is given broad discretion in implementing its programs, the Eximbank must comply with several statutory requirements. Among other things, the Eximbank is required to

- provide loans, loan guarantees, and export credit insurance at rates and on terms that are “fully competitive” with those of other foreign government-supported export credit agencies (12 U.S.C. sec. 635 (b)(1)(A),(B));
- provide loans only in circumstances in which there is a reasonable assurance of repayment (12 U.S.C. sec. 635 (b)(1)(B));
- seek to reach international agreements to reduce government-subsidized export financing (12 U.S.C. sec. 635(b)(1)(A));² and
- supplement and encourage, but not compete with, private sources of capital (12 U.S.C. sec. 635 (b)(1)(B)).

The Eximbank operates under a renewable congressional charter that expires on September 30, 1997. The Eximbank’s activities and policies are overseen by its board of directors. The board, or appropriate designees, is responsible for approving support for individual transactions and making determinations of reasonable assurance of repayment.³

Prior to 1992, the budget did not measure the true costs of federal credit programs at the time of commitment. The Federal Credit Reform Act of 1990 (P. L. 101-508, Nov. 5, 1990) aimed to improve the budgeting of federal credit programs and requires government agencies, including the Eximbank, starting in fiscal year 1992, to estimate and budget for the total long-term costs of their credit programs on a net present value basis.⁴

²The United States and other developed countries use the Organization for Economic Cooperation and Development (OECD) as the chief forum for negotiating limitations on government export credit subsidies and developing common guidelines for national export financing assistance programs. OECD is an international forum for monitoring economic trends and coordinating economic policy among 29 countries, including the United States.

³The Eximbank’s board consists of five full-time members appointed for 4-year terms by the President of the United States with the advice and consent of the U.S. Senate. In addition, the Secretary of Commerce and the U.S. Trade Representative serve as ex officio, nonvoting members.

⁴Present value analysis calculates the value today of a future stream of income or expenses.

Congress funds the Eximbank's estimated credit subsidy costs (hereafter referred to as "subsidy costs") through the annual appropriations process. Subsidy costs arise when the estimated program disbursements by the government exceed the estimated payments to the government, on a net present value basis. Administrative expenses receive separate appropriations and are reported separately in the budget. The act changed the budget treatment of credit programs so that their costs can be compared more accurately with each other and with the costs of other federal spending. (See app. I.)

Executive branch agencies are required to calculate the subsidy costs of foreign loans and guarantees using annually updated ratings and risk premiums provided through the Office of Management and Budget's (OMB) Interagency Country Risk Assessment System (ICRAS). Under this approach, each sovereign borrower or guarantor is rated on an 11-category scale ranging from A through F-, although the Eximbank limits support to those rated in the top eight categories (A through E-). Generally speaking, A and B-rated markets are considered "low risk"; C, C-, and D markets are considered "medium risk"; and D-, E, and E- markets are considered "high risk."

In the future, many discretionary federal government programs, including the Eximbank's programs, are projected to face increased budgetary constraints. The House Committee Report (104-600, May 29, 1996) accompanying the 1997 Foreign Operations, Export Financing, and Related Programs Appropriations Bill (H.R. 3540) states that the Appropriations Committee will be "hard pressed" to sustain appropriations for the Eximbank at current levels in future years and urged the Eximbank to consult with the Committee on its plans for overcoming the likely gap between demand and future federal resources.⁵ The OMB's fiscal year 1997 Analytical Perspectives also projects a decline in Eximbank resources over the next 5 years from \$726 million in fiscal year 1997 to \$587 million in fiscal year 2001.

Results in Brief

In each of the last 5 fiscal years (1992-96), the Eximbank has used an average of \$750 million of its credit subsidy appropriation to support an average of \$13.3 billion in export financing commitments (loans, loan guarantees, and insurance). These appropriations have facilitated exports to areas with important U.S. commercial and strategic interests such as China, Mexico,

⁵The annual Foreign Operations appropriations bill is the primary legislative vehicle through which Congress reviews and votes on the foreign assistance and export financing budget.

and Russia. High risk (D-, E, and E-) markets constituted a relatively small share (13 percent) of the Eximbank's total financing commitments yet absorbed a relatively large share (44 percent) of its subsidy costs in fiscal year 1995.

We identified two broad options that would allow the Eximbank to reduce subsidies while remaining competitive with foreign export credit agencies (ECA): (1) raising fees for services and (2) reducing the risks of its programs (for example, capping the maximum allowable subsidies offered, limiting program availability in certain high-risk markets, or offering less than 100-percent risk protection). The Eximbank's fees are currently lower than those charged by most other ECAs because the Eximbank has interpreted its broad congressional mandate to be "fully competitive" by setting its fees to be as low or lower than about 75 percent of those offered by other major ECAs. Similarly, the Eximbank interprets its congressional mandate to supplement, and not compete with, private capital by providing financing in a wide variety of markets, including more markets in the higher-risk (E-) categories than any of its major competitors.⁶

Both of these options could result in significant reductions in subsidy costs and would allow the Eximbank to continue to operate with reduced federal funding. To illustrate the potential savings associated with fee increases, we estimated that the Eximbank could have saved about \$63 million in fiscal year 1995 if it had raised its fees to a level where they were as low as or lower than 55-60 percent (rather than about 75 percent) of the fees charged by other major ECAs in the same importing country markets.⁷ The second set of options involving reductions in program risks could also have resulted in somewhat larger subsidy savings in the same year—up to \$157 million with only a slight effect on the overall level of U.S. exports supported with Eximbank financing. However, the specific level of subsidy savings resulting from these program options would be dependent on several factors, including the willingness of exporters and participating banks to absorb increased costs and risks, and the reaction of competitor ECAs.

The options we identified have several trade and foreign policy implications that decisionmakers would need to address before making any changes in the Eximbank's programs. Eximbank officials said any proposed

⁶The Eximbank offers financing in markets that provide a reasonable assurance of repayment.

⁷Our analysis was based on an aggregate comparison of sovereign financing provided by the Eximbank and other ECAs.

fee increases need to be considered within the broader context of current international efforts to gradually reduce government export finance subsidies. They also stated that these options could make Eximbank programs less competitive relative to other ECAs but acknowledged that it would be difficult to determine the precise trade effects of such actions. These officials also noted that these options would undermine U.S. government efforts to provide support in some higher-risk markets, such as the newly independent states (NIS) of the former Soviet Union, which they said hold promising long-term trade potential.

The project finance program was created to help U.S. exporters and project lenders compete for contracts for large capital projects in various developing countries. The program has expanded over the past few years and has accounted for an increasing proportion of Eximbank transactions. In fiscal year 1993, the Eximbank supported \$150 million in project finance transactions, \$2.1 billion in fiscal year 1995, and \$1.6 billion in fiscal year 1996. For fiscal year 1996, project finance deals constituted about 3 percent of the Eximbank's total subsidy costs. Although project financing techniques appear to highly leverage available Eximbank resources, Eximbank officials said that this technique is suited only to long-term capital projects that the Eximbank expects to be self-sustaining. The Eximbank aims to structure its project finance program so as to limit its risks and minimize its budgetary costs.

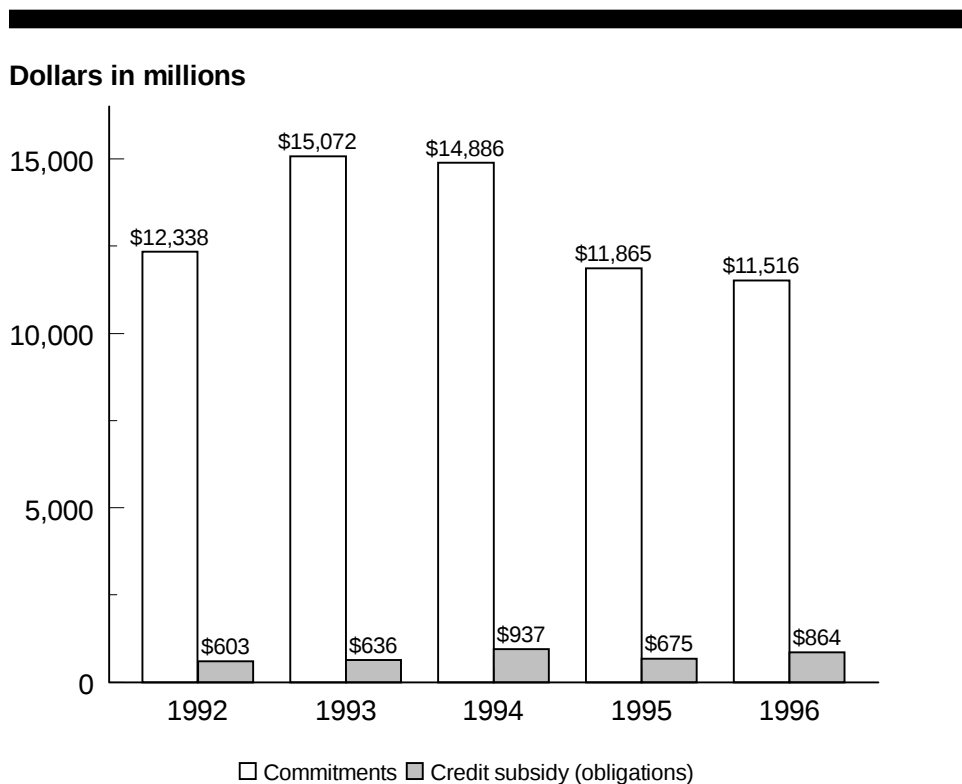
High-Risk Markets Absorb a Relatively Large Share of the Eximbank's Program Subsidy

From fiscal years 1992 to 1996, the Eximbank supported an average of \$13.3 billion in export financing commitments (loans, loan guarantees, and export credit insurance) per year at an average subsidy cost of \$750 million. These financing commitments supported U.S. exports to a number of low-, medium-, and high-risk markets. In fiscal year 1995, financing commitments to high-risk markets such as the NIS represented a relatively small percentage of the Eximbank's total financing commitments but accounted for a relatively large share of total subsidy costs.

As shown in figure 1, the Eximbank's export financing commitments reached an all-time high of \$15.1 billion in fiscal year 1993. According to the Eximbank, the subsequent decline in export financing commitments is largely attributable to the economic downturn in some Latin American countries and a cyclical decline in U.S. aircraft exports. The Eximbank's subsidy costs ranged from a low of \$603 million in fiscal year 1992 to a high of \$937 million in fiscal year 1994 and dropped to \$864 million in

fiscal year 1996. This trend is a reflection of the Eximbank's financing activity in high-risk markets.

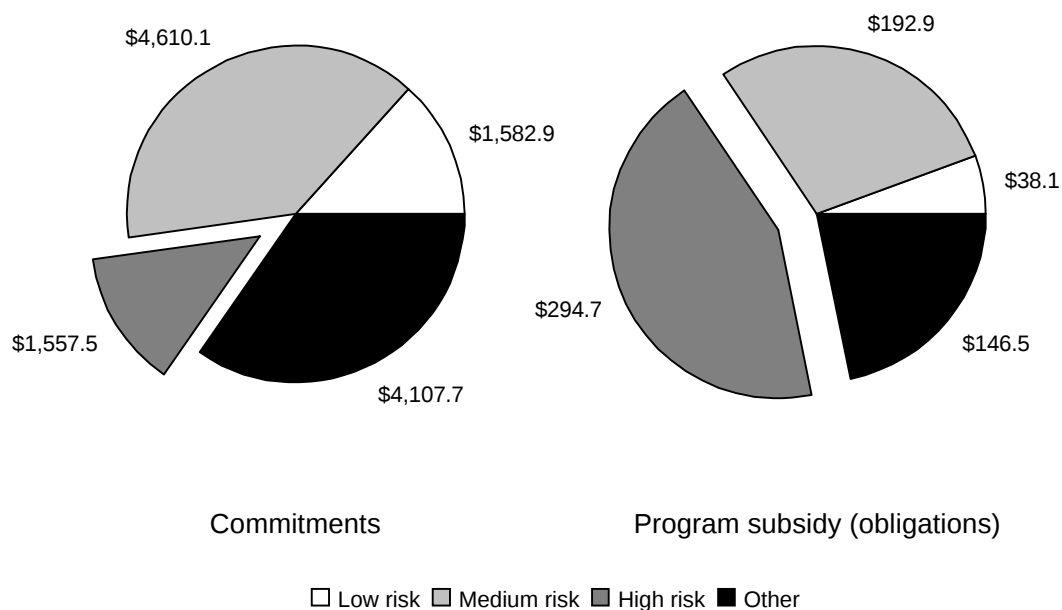
Figure 1: Eximbank Financing Commitments and Credit Subsidy Costs, Fiscal Years 1992-96



Note: Administrative costs are not included in subsidy cost totals.

Source: Eximbank.

As shown in figure 2, most of the Eximbank's fiscal year 1995 financing commitments were in the low- and medium-risk categories. Financing commitments for high-risk markets represented a relatively small (13 percent) share of total financing commitments yet absorbed a relatively large (44 percent) share of credit subsidy costs.

Figure 2: High-risk Commitments Absorbed Large Share of Credit Subsidy Cost in Fiscal Year 1995**Dollars in millions**

Note: 1. Low risk includes countries with A or B risk ratings; medium risk includes C, C-, D risk countries; and high risk are D-, E, and E- rated countries. The Eximbank also made \$6.7 million in financing commitments and incurred \$2.6 million of subsidy cost to F markets in fiscal year 1995.

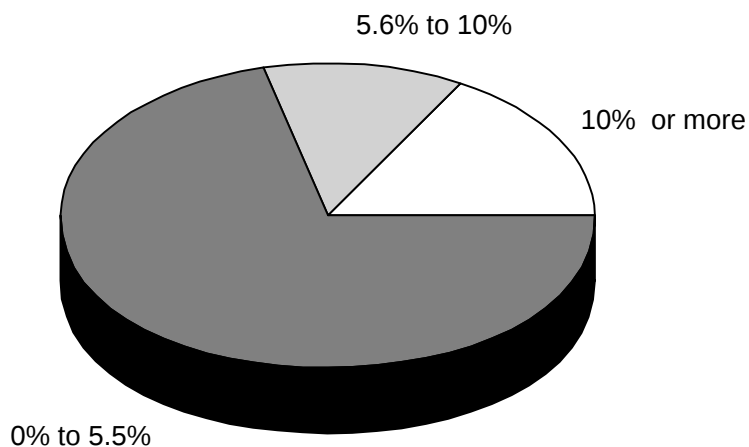
2. "Other" category includes short-term insurance and working capital guarantees.

Source: Eximbank.

In 1995, the Eximbank approved 2,049 financing transactions. As shown in figure 3, most of these transactions—83 percent—were made at or below a subsidy rate of 10 percent. The average subsidy rate for the 2,049 transactions was 5.6 percent; the range of the subsidy rates provided through these transactions varied from 0 percent to 63 percent.⁸

⁸Zero subsidy transactions include those with "negative subsidies," i.e., transactions that returned a "net profit" to the Eximbank.

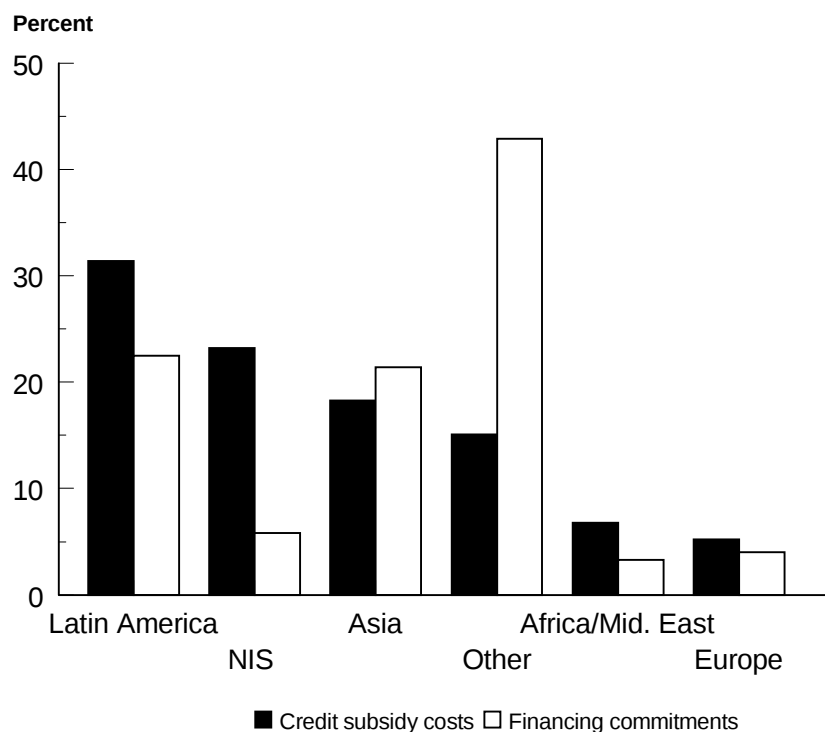
Figure 3: Distribution of Eximbank Transactions, by Subsidy Rates, Fiscal Year 1995



Source: Eximbank.

Eximbank support is provided to a variety of markets. In 1995, Latin America represented the largest single geographical region of Eximbank financing commitments and consumed the largest share (31 percent) of the Eximbank's total subsidy costs. On the other hand, financing commitments to the NIS represented a relatively small share of overall financing commitments yet absorbed a relatively large share (23 percent) of the Eximbank's total subsidy costs (see fig. 4).

Figure 4: Allocation of Eximbank Credit Subsidy Costs and Financing Commitments by Region, Fiscal Year 1995

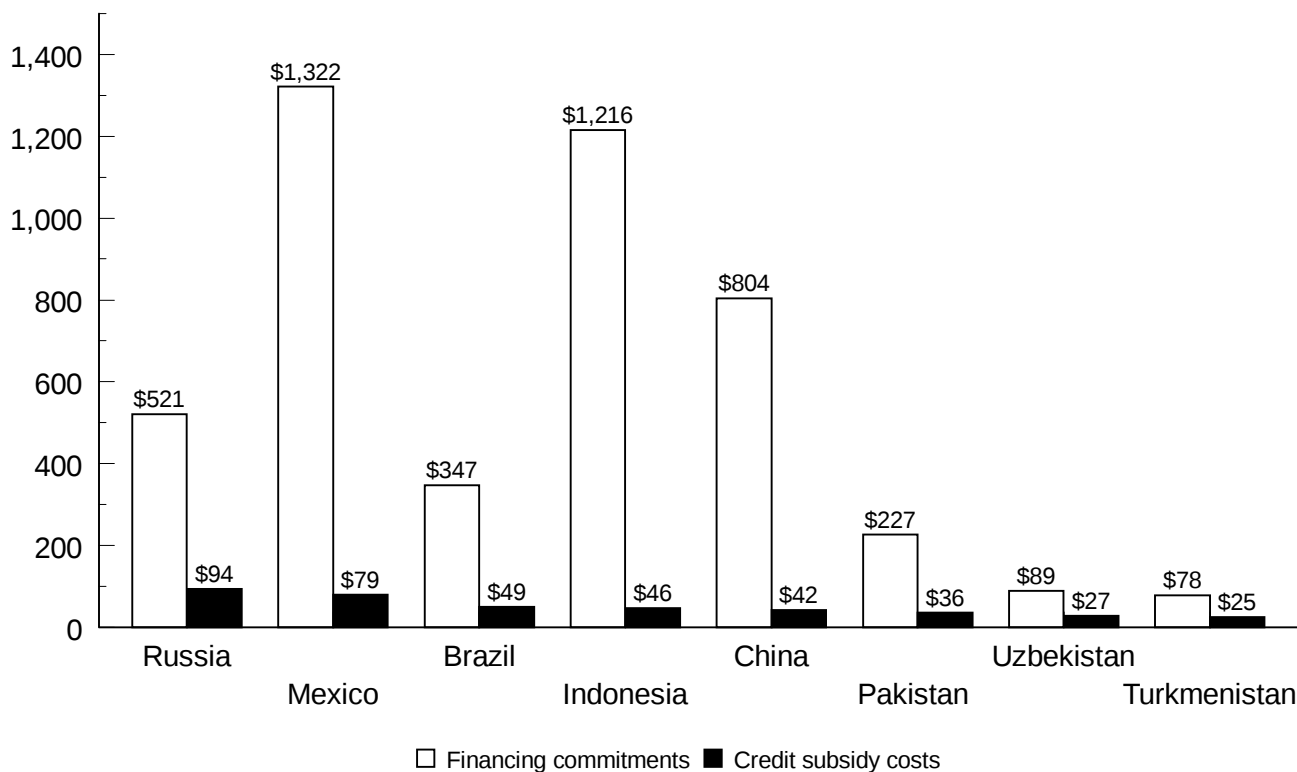


Note: Other includes OECD countries and other transactions not allocated to specific countries.

Source: Eximbank.

In fiscal year 1995, Mexico was the largest market for Eximbank-financed exports (\$1.3 billion in total commitments) and absorbed the second largest individual share (\$79 million) of the Eximbank's total subsidy costs. In contrast, Russia was the fourth largest market (\$521 million in fiscal year 1995) yet absorbed the largest individual share (\$94 million) of the Eximbank's subsidy costs. (See fig. 5.) Since 1992, Mexico has been the largest market for Eximbank-financed exports; Eximbank-supported exports to Russia increased from \$65 million in fiscal year 1992 to \$521 million in fiscal year 1995.

Figure 5: Top Eight Country Recipients of Eximbank Credit Subsidy Cost (and Associated Financing Commitments), Fiscal Year 1995



Source: Eximbank.

Raising Fees for Services Is a Policy Option

One option we identified for reducing subsidy costs at the Eximbank would be to increase the fees⁹ charged for the Eximbank's financing programs while still satisfying the congressional mandate for setting program fees at levels that are fully competitive with other ECAs. The Eximbank currently sets its fees so that they are as low as or lower than about 75 percent of the fees

⁹As used in our report, the term "fees" applies to risk exposure fees charged for the Eximbank's loan and loan guarantee programs as well as the insurance premiums charged for its insurance programs. The purpose of these fees is to compensate for the risk the Eximbank assumes when it supports a loan, guarantee, or insurance transaction. This fee is payable as the loan is disbursed, or it may be financed as part of the transaction. This fee is not to be confused with the Eximbank's flat rate application processing fee or the commitment fee (a fee charged on the undisbursed portion of the Eximbank loan).

charged by other major ECAs in the same importing country markets.¹⁰ Our analysis showed that if the Eximbank had raised its fees to a level as low as or lower than 55-60 percent of the fees charged by other major ECAs in the same markets, the Eximbank's subsidy cost would have been about \$63 million less in fiscal year 1995. The actual cost reductions associated with any fee increase would depend on the magnitude of the fee increases and on other variables, such as the sensitivity of U.S. exporters to price increases, as well as the risk levels, terms, and conditions of future transactions. Eximbank officials expressed concerns that raising fees could affect the international competitiveness of U.S. exporters who rely upon Eximbank programs.

The U.S. government has been an advocate for ongoing efforts among OECD members to establish guidelines for setting fees for government-supported export financing. Ideally, such guidelines would provide all ECAs, including the Eximbank, an opportunity to reduce their subsidy costs without putting their exporters at a disadvantage relative to their competitors. Any proposed Eximbank fee increases need to be considered within the context of the ongoing OECD negotiations to reduce government export credit subsidies.

The Eximbank's Fee System

The Eximbank charges fees in an attempt to compensate for the financial risks associated with direct loans, loan guarantees, and insurance. (Credit subsidy costs arise when the present value of fees, principal repayments, and interest payments is below the levels necessary to offset the present value of the expected government outlays.) Under its system, the Eximbank places each borrower/guarantor in one of eight country risk categories—A, B, C, C-, D, D-, E, and E-. Fee rates are based primarily on the assessed risk of the particular credit and the repayment term of the transaction. For example, a transaction with a repayment term of 5 years in the lowest risk category (A) would be charged a fee of \$1 per \$100, whereas one in the highest risk category (E-) would be charged a fee of \$7.59 per \$100 of each disbursement. The Eximbank periodically revises its fee levels to help ensure that they appropriately reflect credit risks and, at the same time, remain competitive with those of other ECAs. In 1995, the Eximbank adopted a transaction pricing approach for assessing risk and

¹⁰An importing country market is the market in which the U.S. exports are sold, using Eximbank financing support.

assigning fees for individual, nonsovereign credits in order to better deal with a growing portfolio of private risk.¹¹

Fee Increases Could Lead to Significant Subsidy Savings

The Export-Import Bank Act of 1945, as amended (12 U.S.C. 635), gives the Eximbank discretion to set fees at levels that are commensurate with risks, but at the same time at levels that are “fully competitive” with the pricing and coverage of the export credit programs offered by other major ECAs.¹² According to Eximbank officials, the Eximbank has interpreted “fully competitive” to mean that the Eximbank’s fees should be as low as or lower than about 75 percent of the fees charged by other major ECAs in the same importing country markets. They noted that the Eximbank’s goal is not to beat the lowest fee, but to be in the “best 20-25 percent” range. The implementation of this benchmark means that the Eximbank’s fees are generally as low as or lower than those charged by foreign ECAs.

To illustrate the potential savings associated with changing the benchmark, we considered three possible scenarios. Our analysis shows that the Eximbank could have reduced its subsidy costs by about \$63 million if it had set its fees to be as low as or lower than 55-60 percent of the fees charged by other major ECAs for sovereign financing in the same importing country markets. We used Eximbank program authorization data for fiscal year 1995, Eximbank fee data,¹³ and the same OMB financial model that the Eximbank uses to calculate its subsidy costs.¹⁴ To perform this analysis, we modeled the effects of raising fees by different percentage rates while holding all other variables in the OMB model constant, such as the dollar value of Eximbank-supported transactions, the interest rate, and the

¹¹Previously, the Eximbank’s exposure fees were based only on whether the borrower was public or private and did not discriminate between credits of varying risk within the public or private sectors of a country. Transaction pricing provides more flexibility to the Eximbank by allowing it to distinguish among public and private borrowers. Those with international capital market access and strong credit ratings are charged comparatively lower fees while higher-risk borrowers are charged higher fees.

¹²The act stipulates that “the Bank shall charge fees and premiums commensurate, in the judgement of the Bank, with risks covered in connection with the contractual liability that the Bank incurs for guarantees, insurance, coinsurance, and reinsurance against political and credit risks of loss.” (Section 2(c)(1)). Simultaneously, the Eximbank is directed to “provide guarantees, insurance, and extensions of credit at rates and on terms and other conditions which are fully competitive with the Government-supported rates and terms and other conditions available for the financing of exports from the principal countries whose exporters compete with United States exporters.” (Section 2(b)(1)(A)).

¹³The Eximbank compares its fees with those of its competitors in 36 importing countries for long-term transactions and 44 importing countries for medium-term transactions.

¹⁴Although the Eximbank and other ECAs regularly exchange information on fees and other program characteristics, Eximbank officials said they use caution when interpreting these data. Direct comparisons are difficult because ECAs may assign different risk levels to the same importing countries.

repayment term.¹⁵ Using the same methodology, we estimated that the Eximbank could have achieved approximately \$35 million in subsidy savings by setting its fees so that overall, they were as low as or lower than about 65-70 percent of the fees for sovereign financing charged by its major ECA competitors in the same markets, and approximately \$84 million in savings by setting fees so that they were as low or lower than about 45-50 percent of the fees charged by these competitors. (See table 1.)

Table 1: Estimated Eximbank Subsidy Savings With Fee Increases, Fiscal Year 1995

Dollars in millions			
Eximbank Programs	Estimated savings		
	Fees as low as or lower than 45-50% of competitors' fees	Fees as low as or lower than 55-60% of competitors' fees	Fees as low as or lower than 65-70% of competitors' fees
Medium- and long-term loans	\$14.99	\$11.89	\$ 5.60
Medium-term insurance	10.11	5.75	4.22
Medium- and long-term guarantees	59.29	45.19	24.68
Total savings	\$84.39	\$62.83	\$34.50

Notes: 1. With the exception of fees and risk premiums, all variables in the OMB subsidy calculation model were held constant.

2. We based our analysis on fiscal year 1995 transactions.

3. Comparisons were based on an analysis of the fees charged as of April 1995 by the Eximbank and five major ECA competitors.

4. Our analysis does not take into account restrictions on coverage imposed by some ECAs, including the Eximbank, on a country market-specific basis, typically in the higher-risk markets.

5. The Eximbank counts its fees as lower than those of another ECA if the Eximbank was open in a specific country market where that ECA was closed.

6. The estimated savings figures could be slightly higher because our analysis does not include project finance, aircraft, short-term insurance, tied aid, and working capital guarantee transactions.

7. The Eximbank bases its fee comparisons on medium- and long-term sovereign transactions.

8. The totals may vary due to rounding.

Source: Eximbank and GAO analysis.

¹⁵We acknowledge that when prices increase, quantity demanded typically falls. We did not have the data to model the sensitivity of quantity demanded to changes in price.

Competitiveness Implications of Raising Fees

According to the Eximbank, several factors play a role in the competitiveness of the loan, guarantee, and insurance programs that the Eximbank offers. These include both external factors (those that contribute to the overall demand for Eximbank support) and factors that are, to a greater extent, within the control of the Eximbank, such as the fees it charges and other technical program characteristics.¹⁶ Although interest rates and repayment terms for export credits (i.e., direct loans) are elements of cost competitiveness, they are highly constrained by the provisions of the OECD's Arrangement on Guidelines for Officially Supported Export Credit. These provisions limit the variability of interest rates charged and repayment terms allowed by member ECAs. Since exposure fees charged for loans, loan guarantees, and insurance are now excluded from the OECD Arrangement, differences in fees are the most significant factor accounting for program cost differences between the Eximbank and other ECAs.

When we asked Eximbank officials about the prospects for future fee increases, they responded that the Eximbank had raised fees in August 1994 and expressed concerns about how future increases would affect U.S. export competitiveness. They said that should the Eximbank lower its "competitiveness target," the number of instances in which U.S. exporters would risk losing sales as a result of uncompetitive financing would also increase. At the same time, Eximbank officials said it is difficult, if not impossible, to predict the impact of fee changes on exporter behavior, because exporters' sensitivity to fee changes would vary by transaction.

As noted earlier, Eximbank fees are generally as low as or lower than those of its major competitors in most country markets. In some of the higher-risk markets, the Eximbank's fee advantage over some of its competitors is even greater. For example, Eximbank fees are as low as or lower than those of its major competitors for about 85 percent of medium-term transactions in high-risk markets. Thus, we believe it would be possible for the Eximbank to further offset subsidy costs by raising fees while remaining competitive relative to other major ECAs. For instance, if fees were set at the 65-percent competitiveness level, Eximbank fees would still be as low as or lower than those of other ECAs in 65 percent of the same importing country markets, and the proportion of cases in which its

¹⁶According to the Eximbank, external factors include movements in several basic economic variables, such as non-OECD import demand (especially for capital goods), the value of the dollar relative to other competitors' currencies, and the supply of private export financing. Factors that are more within Eximbank control include the technical aspects of its programs, such as cost; risk-taking; special programs, such as tied aid and project finance; and program attributes, such as foreign content and local cost policies.

fees would be higher than other ECAs would increase from 25 percent to 35 percent.

The trade implications of increasing the Eximbank's fees are uncertain and would depend in part on the magnitude and timing of such action. It is possible that charging higher fees would result in an incremental reduction in program participation on the part of U.S. exporters selling to some higher-risk markets. However, the overall impact of Eximbank fee increases are speculative. U.S. exporters' sensitivity to a fee increase would depend on factors such as the size of the fee increase, the volume of U.S. exports to a particular market, and the risk of the importing market. Raising fees for financing transactions in the higher-risk markets, such as the NIS, could lead to a decline in U.S. exports to these countries, but we were unable to quantify the precise impact.

OECD Members' Efforts to Minimize Fee Differences

The Eximbank, under the leadership of the U.S. Treasury, participates in ongoing OECD negotiations to minimize export financing competition and reduce government export credit subsidies.¹⁷ In order to remain competitive, any potential Eximbank fee increase should be considered within the broader context of progress made in these international negotiations.

The United States, European Union (EU) member states,¹⁸ and other countries are attempting to limit government export credit subsidies and create a level playing field among their ECAs through the OECD. The OECD has promoted efforts to limit government subsidies and provide common guidelines for national export-financing assistance programs. The OECD's Arrangement sets terms and conditions for government-supported export credits and has been progressively strengthened since it was first established in 1978. Although it was last modified in 1994 to require member countries to use only market-based interest rates on all government-provided export loans, it does not currently contain guidelines as to the minimum fees member ECAs must charge for officially supported loans, loan guarantees, or export credit insurance.

¹⁷The Export-Import Bank Act of 1945, as amended, directs the Eximbank to participate in multilateral discussions to minimize competition among government ECAs. For example, section 2(b)(1)(A) provides that "the Bank shall . . . seek to minimize competition in government-supported export financing and shall . . . seek to reach international agreements to reduce government subsidized export financing."

¹⁸The EU, formerly the European Community, is a political and economic union of 15 European countries.

In 1994, the participants in the OECD Arrangement formed a Working Group of Experts on Premia and Related Conditions to create a framework for more uniform risk premiums (i.e., exposure fees). The working group's goal is to develop guiding principles for setting fees, among other issues, before the 1997 OECD Ministerial Meeting. As part of this overall effort to gradually reduce government export finance subsidies, OECD members have tentatively agreed to work toward creating member export financing systems that include, among other things, (1) risk-based premiums (defined to include exposure fees) based on a common reference country classification system, (2) premiums that are set high enough to cover long-term operating costs and losses, and (3) establishment of a fee benchmarking system. According to an Eximbank official, it is hoped that these negotiations will eventually lead to an agreement for fee convergence that would allow for reductions in the costs of OECD members' officially supported export financing programs. The agreement would be implemented after an appropriate transition period.

The U.S. government is an advocate for reaching an OECD agreement in this area. Although the working group has developed a set of broad guiding principles, members have yet to agree on the extent to which fees should be covered by the OECD disciplines (practices), according to the Eximbank.

Risk Reduction Could Lead to Reduced Subsidy Costs and Lower Overall Exposure

The level and scope of the risks of the Eximbank's programs could be reduced by several means, such as placing a ceiling on the maximum subsidy rate allowed in Eximbank transactions, reducing or eliminating program availability offered in high-risk markets, and offering less than 100-percent risk protection. Although these options, if implemented, could lead to significant subsidy savings for the Eximbank and an overall reduction in U.S. exposure to high-risk markets, they would also result in reduced levels of Eximbank-financed exports and could present important foreign policy tradeoffs. Representatives of the Eximbank, private financial institutions, and export finance trade associations we spoke to generally opposed making any changes to the Eximbank's programs on the grounds that potentially disruptive effects would result.

As shown in table 2, the options we identified, if implemented separately, would have resulted in subsidy savings of up to \$157 million in fiscal year 1995, with only a slight effect (5 percent or less of total exports financed) on the overall level of U.S. exports supported with Eximbank financing. The estimated subsidy reductions and export losses listed were based on our analysis of Eximbank subsidy estimates and authorized commitments for

fiscal year 1995. Our estimates assumed that all other factors, such as the volume of financing to specific markets, were unchanged and there was no reaction by other ECAS.

Table 2: Estimated Subsidy Savings Associated With Reducing Eximbank Risks for Fiscal Year 1995 Activities

Dollars in millions

	Options			
	Subsidy cap of 25% for individual transactions ^a	Provide only short-term cover in high-risk (E and E-) markets ^b	Eliminate cover in risky (E-) markets ^b	Require 5% private sector risk-sharing ^c
Estimated program subsidy savings	\$123	\$157	\$122	About \$5 million but could be substantially greater. ^d
Estimated decrease in Eximbank-supported exports	\$369	\$582	\$394	Could not derive a meaningful estimate.
Estimated decrease in Eximbank-supported exports as a percent of total Eximbank-financed exports	3.1	4.9	3.3	Could not derive a meaningful estimate.

Note: The estimated program subsidies were computed as if they were stand-alone options.

^aTo compute the estimated subsidy savings related to the 25-percent fee cap option, we subtracted the value of transactions whose subsidy rate exceeded 25 percent from total subsidy usage and export commitments for fiscal year 1995.

^bWe assumed that once the Eximbank ceases to provide long- to medium-term support in the E and E- markets, or withdraws from the E- market transactions, the subsidy savings would not have been used to support additional transactions in other markets.

^cThe Eximbank calculated the impact of this option only for guarantees for the D to E- risk categories and assumed a 5-year term and 2-year grace period. This analysis did not include an estimate for guarantees with a term of over 5 years nor an estimate for loans.

^dThe Eximbank did not include an estimate of longer-term transactions (greater than 5 years) in higher-risk markets in its analysis. These transactions typically involve larger subsidies and therefore would result in greater subsidy savings if risks were shared.

Source: GAO analysis of Eximbank data.

Cap Maximum Subsidy Rates

To reduce its subsidy costs, the Eximbank could consider placing a cap (limit) on the maximum subsidy rate that it could incur in a typical

transaction (this would not include tied aid transactions).¹⁹ For example, although most of the 2,049 transactions completed in fiscal year 1995 had a 10-percent subsidy rate or less, a relatively few (38) transactions had a subsidy rate of 25 percent or more. These transactions consumed approximately \$123 million (about 18 percent) of the Eximbank's total subsidy costs yet supported 3 percent of Eximbank export financing commitments for the year. We estimate that if the Eximbank had capped its subsidy rate for each transaction at 25 percent for fiscal year 1995, it would have saved about \$123 million (assuming that fees were held constant and deals over a subsidy rate of 25 percent were not refinanced at lower rates).

Eximbank officials noted that a subsidy cap could have a disproportionate impact on high-risk markets, such as the NIS, and therefore would limit the Eximbank's ability to support high-risk transactions in these markets. However, we noted that this option consists of a subsidy cap that exceeds the average subsidy rate (21.6 percent) for all Eximbank-supported transactions to the NIS. In other words, this option is unlikely to eliminate all financing transactions in this market—just those with a subsidy rate greater than 25 percent.

Reduce Eximbank Program Availability in High-risk Markets

Before 1994, the Eximbank provided short-, medium-, and long-term financing in low- and medium-risk markets.²⁰ In 1994, as part of an effort to provide additional support to emerging market economies, the Eximbank expanded the level of financing available to U.S. exporters to high-risk E and E- markets to include long-term coverage for E markets and medium-term cover for E- markets. As a result, in fiscal year 1995, Eximbank services were available in more E- markets than were those of any of its major competitors, and the Eximbank provided unrestricted program cover²¹ for almost twice as many markets as did Germany, its nearest competitor.

¹⁹Tied aid refers to foreign assistance that is linked to the purchase of exports from the country extending the assistance. Tied aid can consist of (1) foreign aid grants alone, (2) grants mixed with commercial financing or official export credits ("mixed credits"), or (3) concessional (low-interest rate) loans. The Eximbank needs to retain its flexibility in responding to the tied aid offers of foreign competitors because U.S. exporters can be put at a competitive disadvantage in bidding on overseas projects when foreign competitors make tied aid available.

²⁰As defined by the Eximbank, "short term" involves credit terms of 1 year or less; medium-term cover for capital goods and related services involves financing of \$10 million or less, with a usual repayment term of 1 to 5 years; and long-term cover involves financing of more than \$10 million or repayment terms of greater than 5 years.

²¹According to the Eximbank, restrictions on cover are often differentiated by term and sector (i.e., private, public, or sovereign) within a given market. Restrictions may take various forms such as limits on total activity or security requirements for a specific buyer.

The Eximbank cannot operate in certain high-risk markets (F risk category) because, in the judgment of its board, the Eximbank cannot expect reasonable assurance of repayment.²²

Another way in which the Eximbank could reduce its risk and associated subsidy costs in the high-risk (E and E-) categories would be to provide only short-term support in high-risk markets. Short-term transactions typically involve lower risks and subsidy expenditures than medium- and long-term transactions in the same market. We estimated that this option would have reduced subsidy costs by up to \$157 million (23 percent of the Eximbank's total subsidy costs) and reduced the Eximbank financing commitments by approximately \$582 million, or about 5 percent, in fiscal year 1995.

Another option that the Eximbank could consider would be to withdraw completely from E- markets; this would substantially reduce its exposure to high-risk transactions. Eliminating coverage in the Eximbank's most risky markets (E-) would have produced subsidy savings of up to \$122 million and eliminated approximately \$394 million in Eximbank export financing commitments in fiscal year 1995—about 3 percent of the Eximbank's total financing commitments for the year.

Implications of Reducing Eximbank Program Availability in High-risk Markets

This option would result in a reduction of Eximbank subsidy costs but there could be implications for trade promotion and foreign policy objectives. First, Eximbank officials and some U.S. exporters stated that while exports to high-risk (E and E-) markets are small relative to total U.S. exports, the long-term export potential of these markets could be substantial. Eximbank officials point out that one of the agency's primary objectives is to help U.S. exporters gain an early foothold in the high-risk, potentially high-growth markets in which the private sector is unable or unwilling to venture.²³ Second, reducing program availability in high-risk markets would result in a reduction in Eximbank-supported transactions to transitional market economies, such as Russia, that the U.S. government's

²²According to the Eximbank, limitations on the availability of Eximbank financing apply to "routine" business transactions. However, the Eximbank may provide support for transactions that provide reasonable assurance of repayment even when these transactions are in markets that do not provide this level of assurance. These transactions may involve borrowers that have a record of independent access to private or international capital markets, utilize insulated project finance structures with hard currency earnings and escrow accounts for debt payment, or use secured aircraft leases.

²³The Export Enhancement Act of 1992 provides that it is the policy of the United States to "assist the export of high technology exports to emerging democracies" and that the Eximbank shall "develop a program for providing guarantees and insurance with respect to the export of high technology items to countries making the transition to market based economies. . . ." (P.L. 102-429, sec. 114, Oct. 21, 1992).

foreign policy establishment is trying to assist. Eximbank officials said that the Eximbank is an independent agency and not part of the U.S. foreign policy or assistance apparatus (i.e., the Eximbank will not support a noncreditworthy transaction to meet U.S. foreign policy objectives). However, they stated that restrictions on Eximbank financing to high-risk markets such as the NIS may be perceived as a reduction of U.S. support for the region and detract from the U.S. government's efforts to promote regional stability.

The potential negative effect of this option on trade and foreign policy objectives could be moderated in a number of ways. Various export financing techniques exist that would allow the Eximbank to reduce the risks of some of the transactions in these markets. For example, the Eximbank's Russian Oil and Gas Framework Agreement, which gives support for longer-term transactions that generate hard currency earnings, has relatively lower risks and thus is the recipient of full Eximbank support. These transactions are budgeted at lower subsidy rates.

It is also important to note that a number of other federal programs support U.S. foreign policy objectives in the NIS. Since 1990, 23 government agencies have obligated \$5.4 billion for technical assistance programs, grants, exchange programs, training, food and commodity donations, science and technology projects, and support of joint space efforts. The U.S. government also made available \$10 billion in credit for bilateral loans, loan guarantees, and insurance programs for fiscal year 1990 through December 1994. Trade and investment programs include those sponsored by the Department of Agriculture and the Overseas Private Investment Corporation (OPIC). Thus, concerns about restrictions on Eximbank support and its impact on U.S. policy objectives in this region would need to be viewed in the broader context of the overall U.S. assistance effort.

Greater Private Sector Risk-sharing

Currently, the Eximbank provides 100-percent unconditional political and commercial risk protection on virtually all of the medium- and long-term cover that it issues. Some of the Eximbank's major competitors, such as European ECAs, on the other hand, generally require exporters and banks to assume a portion of the risks associated with such support and do not absorb 100 percent of the risks involved. Instead, they require that exporters or banks assume a minimum percentage (usually 5 percent to

10 percent) of the risks. This concept of risk-sharing is a fundamental difference between the Eximbank and EU ECAs.²⁴

One way to reduce the Eximbank's subsidy costs across all risk categories would be to have private sector participants assume more of the risks in Eximbank-supported transactions. For example, if the Eximbank only financed up to 95 percent of the risks of an export transaction, private sector banks or exporters would have to assume the remaining 5 percent risk. According to Eximbank officials, this requirement may also provide private sector lenders greater incentives to properly evaluate loan applications for which they seek Eximbank support because they will share more of the risks associated with such transactions.

Implications of Greater Private Sector Risk-sharing

Eximbank officials said that the Eximbank does not generally require the private sector to engage in greater risk-sharing in its loan guarantee program because the private sector is usually unwilling to accept the risks associated with Eximbank-financed transactions.²⁵ These officials cited a number of other concerns related to greater risk-sharing, including (1) the presence of bank regulatory requirements that banks maintain higher loss reserves for foreign loans not fully covered by Eximbank guarantees, (2) the higher cost of trade financing that would result if private lenders were required to raise their fees to compensate for additional export risks, and (3) the reluctance of smaller U.S. banks to engage in trade finance if they have to take on additional risk. Representatives of trade associations that we interviewed also stated that greater risk-sharing requirements will frustrate the small businesses that have fewer options to structure alternative financing than do large firms. Eximbank officials also told us that the introduction of increased risk-sharing requirements may result in

²⁴In addition, most EU ECAs provide export financing on a more conditional basis, i.e., payment of any claims is conditioned on the claims meeting certain pre-agreed conditions, while the Eximbank certifies that conditions are fully met before providing its support. For more information on the differences between Eximbank and EU ECAs, see *Export Finance: Comparative Analysis of U.S. and European Union Export Credit Agencies* (GAO/GGD-96-1, Oct. 24, 1995).

²⁵We noted that the Eximbank already requires risk-sharing with the private sector in several programs, including its working capital guarantee program and project finance program. Under the working capital guarantee program, the Eximbank's guarantee covers 90 percent of the principal and interest. The lender must retain a 10-percent risk share in the loan. Under its project finance program, the Eximbank negotiates with various parties as to what risks it will undertake after an extensive analysis of project elements and may request collateral and other guarantees for aircraft transactions. In April 1996, the Eximbank launched a 1-year pilot study that utilizes expanded risk-sharing with export financing entities in six states: Florida, California, Maryland, Minnesota, Massachusetts, and Georgia.

higher administrative costs to the Eximbank and may also impair private banks' ability to "securitize" loans backed by Eximbank guarantees.²⁶

However, several factors may mitigate some of the effects of a requirement for increased risk-sharing and should be considered as well when assessing the feasibility of this option.

- According to Eximbank officials, the agency used to require some risk-sharing and only started offering 100-percent risk coverage (principal and interest) through its loan guarantee program beginning in the late 1980s. Before that, it offered 95-percent loan guarantees on interest.
- Similar objections about increased private sector risk-sharing requirements were raised when the Eximbank reduced its risk coverage on its export working capital guarantee program from 100 percent to 90 percent of principal and interest in September 1994. However, U.S. exporters and their commercial lenders continued to use this program at an increased rate after these changes went into effect. The volume of Eximbank export working capital loan guarantees increased 99 percent from fiscal year 1994 to fiscal year 1995.²⁷
- U.S. banks that we interviewed acknowledged that they utilize the services of competitor ECAs that generally provide less than 100-percent risk coverage in support of their trade finance activities.
- Private sector lenders and a representative of Moody's Investor Services stated that Eximbank-backed loans with less than 100 percent cover could still be securitized, although the structure and pricing of the security would reflect the higher marginal risk associated with the reduced U.S. government cover.

Project Finance Program Provides Opportunities for Potential Subsidy Reduction

Project financing is a rapidly expanding export financing mechanism that the Eximbank is using to meet the needs of U.S. exporters and project sponsors while taking advantage of the growth of privatization and private sector-oriented reforms in various developing countries. It involves lending for major capital projects where the assurance of repayment is provided through the project's structure and anticipated future revenues rather than through sovereign or other forms of guarantee. In contrast to

²⁶Securitization is the process whereby loan obligations are converted into securities and sold to investors who obtain a stream of interest and principal payments at specific intervals over a specified period of time. This practice enables banks to make loans that they otherwise might not have been able to make.

²⁷According to Eximbank data, approved working capital guarantee commitments for fiscal year 1995 totaled about \$302 million, a 99-percent increase from the approximately \$152 million authorized in fiscal year 1994. According to the Eximbank, this increase may reflect program enhancements such as improved application procedures and the greater use of delegated authority by participating banks.

traditional Eximbank financing, the Eximbank and lending institutions depend primarily upon the financial success of the project for the repayment of loan principal and interest. Project financing provides the Eximbank considerable flexibility in stipulating which risks it will assume on a project-by-project basis, thus permitting the government to reduce risk and subsidy usage.

Eximbank project financing support is generally available in A through D risk markets, is available in E markets only in limited circumstances, and is not available in E- markets.²⁸ Project finance requires a relatively stable legal and commercial environment in the host country in order for risk mitigation of the project to be possible. Some high-risk markets do not yet have the legal and commercial structures that would make project finance possible. Once a project is completed, the Eximbank provides the same level of risk coverage, that is, 100 percent guarantees, under its project finance program as is currently available in its traditional program—but only for the share of the project that is financed by the Eximbank. During the project construction period, the Eximbank provides only political risk coverage; other risks are assumed by the private sector.

The Eximbank's policy is that the project sponsor and other participants must assume a portion of the entire project risk and all or most of the commercial and technical risks during the construction phase of an infrastructure project. The Eximbank may also share project risks with other ECAs, multilateral institutions such as the International Finance Corporation, or OPIC. The Eximbank may also look for opportunities to establish hard currency escrow accounts outside the project country for certain projects and seek other risk mitigation to protect taxpayer interests and to reduce the associated subsidy costs. According to the Eximbank, if properly structured, these techniques can lower the risks for the Eximbank that would otherwise be involved in supporting these transactions in risky countries. Because this program is fairly new, it is too early to determine if budget estimates are accurate.

Under the project finance program, many of the administrative costs that the Eximbank traditionally incurs in evaluating a project's financial, legal, and technical risks are to be borne by the private sector rather than the Eximbank. When the Eximbank assumes any risks, private sector project participants are expected to pay premiums that compensate the government for most of these risks. However, the Eximbank's ultimate

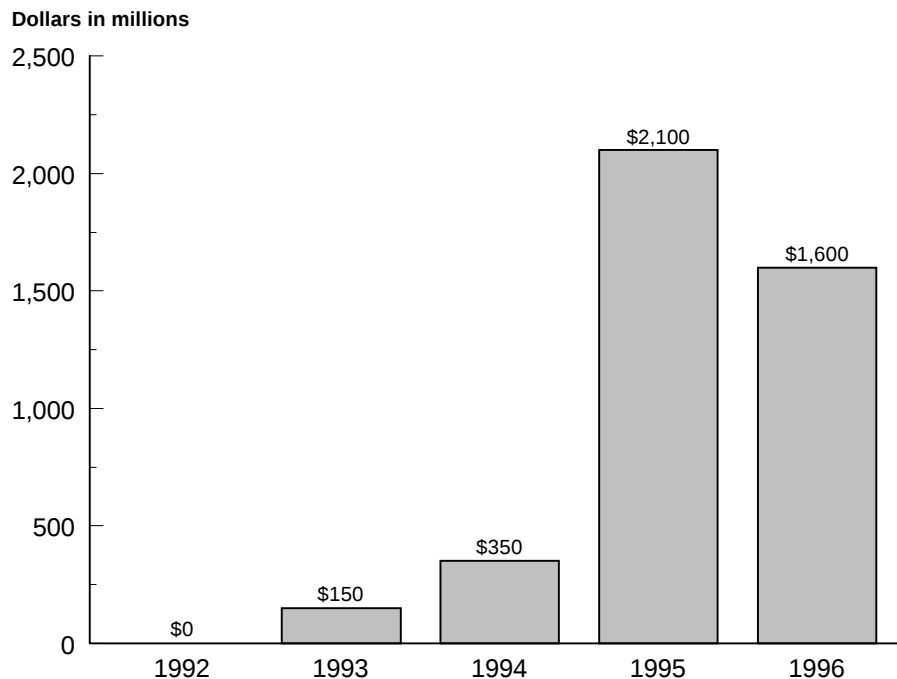
²⁸The Eximbank will only proceed with E-rated transactions where some type of acceptable risk-sharing is provided by a creditworthy sponsor.

flexibility in passing these costs on to the private sector may be constrained by the level of fees charged by competitor ECAS.

Eximbank officials told us that the Eximbank's goal is to structure project financing transactions in a manner that will ultimately require no taxpayer subsidy. Although the Eximbank has yet to meet this program goal, the average subsidy rate for project finance transactions was lower than the overall subsidy rate incurred for all Eximbank transactions in 1996. In that year, the average budgetary cost for project finance deals was about 3 percent, whereas the average cost for all Eximbank-supported transactions was 7.5 percent. According to Eximbank officials, the Eximbank's success in meeting this goal will ultimately depend on its willingness and ability to limit risk in high-risk transactions while complementing, but not competing with, the private sector.

The Eximbank's project finance program has expanded over the past few years and has accounted for an increasing proportion of Eximbank transactions. In 1993, project finance accounted for less than 1 percent of the Eximbank's total financing commitments. By fiscal year 1995, project finance constituted almost 20 percent of the Eximbank's total financing commitments. The Eximbank attributes this growth to developing countries' emphasis on privatization, their need to reduce sovereign debt obligations, and the rapid economic growth in emerging markets. As shown in figure 6, Eximbank project financing commitments expanded from \$150 million in 1993 to \$2.1 billion in fiscal year 1995—the program's first full year of operation. Eximbank project financing declined slightly, to \$1.7 billion, in fiscal year 1996.

**Figure 6: Eximbank Project Financing,
Fiscal Years 1992-96**



Source: Eximbank.

From fiscal year 1993 to 1995, the Eximbank approved a total of 11 project finance transactions valued at more than \$2.6 billion. Six of these projects were located in Asia, four in Latin America, and one in Europe. These projects were generally located in countries that the Eximbank rates as medium-risk category countries and were mostly power generation infrastructure projects.

The growth of project financing is consistent with the Eximbank's expanded financing of exports to private sector buyers in developing countries. According to Eximbank officials, in fiscal year 1992, 71 percent of the Eximbank's financing commitments were used to support foreign public sector purchasers, while 29 percent was used to support foreign private sector purchasers in emerging markets around the world. By fiscal year 1995, the ratio was reversed—about 35 percent of the Eximbank's commitments supported foreign public sector purchases and about 65 percent supported foreign private sector purchasers. Although private sector purchasers are becoming larger users of export financing in

developing countries and the Eximbank's project financing program provides the flexibility necessary for reducing the subsidy cost of these transactions, this method of financing is not suitable for all transactions. It is best suited for large transactions, for example, major infrastructure projects, that generate revenues that are sufficiently high to repay debt obligations.

Conclusions

Eximbank financing helps support the sale of billions of dollars of U.S. goods and services to foreign markets each year consistent with U.S. foreign policy interests but comes at a cost to U.S. taxpayers—about \$3.75 billion in appropriated program funds over the last 5 years. OMB projects a substantial decline in these resources over the next 5 years.

We identified two options for reducing the Eximbank's subsidy costs: (1) raising fees (based on a modified definition of "fully competitive") and (2) reducing program risks. If implemented, these options may help the Eximbank respond to the projected decline in resources over the next 5 years. These options would not require a change in the Export-Import Bank Act of 1945, as amended, because they fall within its present authority. However, these options need to be considered within the full context of their trade and foreign policy implications and should be consistent with the Eximbank's other statutory obligations.

Raising exposure fees within the context of ongoing international negotiations to reduce government export credit subsidies seems to be the least disruptive of the two options for a number of reasons. First of all, Eximbank fees for sovereign financing are generally lower than those of other ECAs in most country markets. Second, a fee increase could be implemented without raising some of the foreign policy concerns associated with restricting or eliminating program coverage in certain risky markets. Third, exposure fee increases are compatible with U.S. government efforts to minimize competition in government-supported export financing among OECD members and consistent with its legal directive to do so. The magnitude and timing of any fee increases should take into account progress in the ongoing OECD negotiations to minimize the possible competitive impact on U.S. exporters.

Agency Comments

In commenting on a draft of this report, the Eximbank made four general observations:

- The subsidy cost computations should only be interpreted as approximations of the cost of the Eximbank's programs.
- Because no estimate of the amount of lost exports, jobs, federal tax revenue, or other potential adverse consequences of raising fees or lowering the amount of the Eximbank's risk have been developed, the implementation of the options presented needs to be considered with great caution.
- Taking unilateral action to increase fees could undermine the U.S. negotiating position with other OECD members.
- Other alternatives for reducing the Eximbank's budget that would not adversely affect the Eximbank's programs have not been considered.

Regarding our cost computations, we used the same methodology for our analysis that the Eximbank uses to estimate the subsidy costs for its official budget submission to Congress. We agree that the methodology utilized to meet the requirements of the Credit Reform Act yields estimates and that the actual costs for a particular case may be higher or lower than the estimate. However, since the actual costs cannot be predetermined, these estimates can be used to make rational program decisions.

In preparing this report we did consider the likely impact of the options we identified on Eximbank-supported exports. We acknowledge that we could not precisely quantify the impact of implementing the fee increases. Nevertheless, our review indicated that the Eximbank could raise fees while still maintaining a competitive position relative to other ECAs. Moreover, we did estimate that the reduction in Eximbank-financed sales associated with reducing program risks would only have a slight effect (5 percent or less) on the overall level of U.S. exports supported with Eximbank financing in a given year.

Our past work has shown that no definitive empirical research exists that demonstrates unequivocally the net macroeconomic impact on the nation—positive or negative—of government funding for federal export promotion programs or of reductions in Eximbank funding levels.²⁹ It is difficult to fully quantify the net benefits of federal export promotion programs because it is difficult to demonstrate “additionality,” that is, the level of exports that would have been provided in their absence. Proponents and opponents of these programs have mainly relied on qualitative arguments to state their cases rather than demonstrate quantitatively the impact on exports, jobs, and federal tax revenue.

²⁹See *Export Promotion: Rationales for and Against Government Programs and Expenditures* (GAO/T-GGD-95-169, May 23, 1995).

We recognize that the most efficient means to reduce Eximbank subsidies without disadvantaging U.S. exporters is to reach agreement with other ECAs to lower and eventually eliminate export subsidies. We clearly stated in the report that any proposed fee increases should be considered only in the broader context of the ongoing OECD efforts to negotiate minimum fee schedules and that the magnitude and timing of such an increase should take into account progress in these negotiations.

Eximbank also commented that we did not recognize other alternatives for reducing the Eximbank's budget without adversely affecting its program. While other options for reducing the Eximbank's funding may exist, we believe that we focused on the two most feasible ones—raising fees or reducing program risks—that could be implemented within the Eximbank's existing authority. The two options proposed by the Eximbank (changing its program mix and making greater use of asset-based financing) would have some drawbacks that were not disclosed in its letter. For example, the budgetary and possible implementation difficulties associated with the greater use of Eximbank loans as opposed to guarantees are not addressed in the Eximbank's comments. In addition, the potential for extending asset-based financing beyond the areas noted in the Eximbank's comments is uncertain. Finally, it is not clear whether OMB would endorse any of the Eximbank options noted in its letter.

The Eximbank's comments are reprinted in appendix II, along with our specific evaluation of them. The Eximbank also provided technical corrections and updated information that were incorporated throughout the report where appropriate.

Scope and Methodology

To develop information on how the Eximbank spends its program funds, we reviewed budget data provided to us by the Eximbank and reviewed various Eximbank reports, including annual reports, budget reports from the Office of the Chief Financial Officer, and the Eximbank's 1992-96 Report to the U.S. Congress on Export Credit Competition and the Export-Import Bank of the United States. In addition, we completed a transaction analysis of the Eximbank's financing commitments made in fiscal years 1994 and 1995, including an analysis of the Eximbank's high-subsidy transactions. We defined "high-subsidy" transactions as those transactions that consumed \$1 million or more of the Eximbank's subsidy budget in a given year or consumed a subsidy of 15 percent or more of the financed amount. We did not independently verify the accuracy of this data. Our report focused on

the Eximbank's use of its program subsidy appropriation—the largest component of its annual appropriation.³⁰

To create a conceptual framework for identifying and assessing the available options for reducing the Eximbank's subsidy appropriation, we reviewed various governmental, research, and trade association reports, including those of the Eximbank, the Congressional Budget Office, the Institute for International Economics, the CATO Institute, the Coalition for Employment Through Exports, and the National Association of Manufacturers. We also interviewed officials from these organizations and the private banking industry to obtain their views on the feasibility and likely impact of the options.

To illustrate potential subsidy savings associated with different levels of fees, we estimated the possible subsidy savings that would have been obtained in fiscal year 1995 by setting fees within the 45-50, 55-60, and 65-70 percent competitiveness levels, holding all other variables (such as dollar value of transactions, interest rates, and repayment terms) constant. We used aggregate Eximbank fee data and an OMB financial model to perform this analysis.³¹ (We did these calculations by setting fees at a level that fell within the range we specified. Specifically, the fees selected for our analysis at the 45-50, 55-60, and 65-70 percent competitiveness levels included medium- and long-term fees set at the 47th and 46th, 57th and 56th, and 66th and 65th percentiles, respectively). These fee comparisons were based on medium- and long-term sovereign financing, which is currently the only basis for comparison, although we recognize that an increasing portion of Eximbank program activity is for nonsovereign transactions.

Eximbank officials told us that any interpretation of such analysis must include a recognition of the potential pitfalls of fee comparisons. The

³⁰In fiscal year 1996, the Eximbank received a net program appropriation of \$744.5 million and a separate appropriation of \$45.6 million for the Eximbank's administrative costs.

³¹As required by the Federal Credit Reform Act of 1990, the Eximbank calculates the estimated subsidies associated with its loan, guarantee, and insurance programs based on guidance provided by OMB. The subsidy estimates are based on the following 15 variables: (1) the authorized amount of the transaction; (2) the commitment fee rate; (3) the interest rate on the loan; (4) whether the interest is capitalized; (5) the U.S. Treasury interest rate prescribed for credit reform calculations; (6) the exposure fee charge on the transaction; (7) whether the exposure fee is capitalized; (8) the risk premium associated with the term of the transaction and the OMB risk classification; (9) the time period when interest repayment begins; (10) the time period when principal repayment begins; (11) the number of semiannual principal repayments; (12) the participant's risk-sharing arrangements, if any; (13) the percentage of potential loss the participant will take, if any; (14) the risk premium for participant default, if any; and (15) the yearly disbursement pattern. These inputs are used to calculate the subsidy, i.e., the estimated cost to the government, of the transaction.

differences in program characteristics, coverage restrictions, and other variables may limit the accuracy of such comparisons. We did not independently verify the accuracy of the Eximbank's fee data or test the OMB's ICRAS subsidy model for accuracy in predicting subsidy cost estimates. Instead, we have accepted the validity of the current model and explored the options for reducing program subsidies through the data generated by the current OMB-approved model.

To assess the effects of limiting program risks, we identified the Eximbank's financing and subsidy commitments made in various risk categories. We focused on the effects of limiting program risks in higher-risk markets because the Eximbank's subsidy costs in these markets are large relative to other markets. We did not model the effects that increased risk-sharing would have on the Eximbank's subsidy expenditures; rather, we accepted the analysis that the Eximbank completed on this issue.

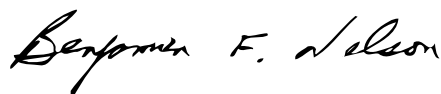
To complete our work related to project finance issues, we reviewed trade and academic literature and interviewed project specialists at the Eximbank and the World Bank, and interviewed financial experts in Washington, D.C.; New York; and London.

We conducted our review from February 1996 to September 1996 in accordance with generally accepted government auditing standards.

As agreed with your office, unless you publicly announce its contents earlier, we plan no further distribution of this report until 30 days after the date of this letter. At that time, we will send copies of this report to other congressional committees and the Chairman and President of the Eximbank and will make copies available to other interested parties upon request.

This review was done under the direction of JayEtta Z. Hecker, Associate Director. If you have any questions concerning this report, please contact Ms. Hecker at (202) 512-8984. Major contributors to this report are listed in appendix III.

Sincerely yours,



Benjamin F. Nelson
Director, International Relations
and Trade Issues

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Abbreviations

ECA	export credit agency
EU	European Union
Eximbank	Export-Import Bank
ICRAS	Interagency Country Risk Assessment System
NIS	newly independent states
OECD	Organization for Economic Cooperation and Development
OMB	Office of Management and Budget
OPIC	Overseas Private Investment Corporation

The Federal Credit Reform Act of 1990

After over 20 years of discussion about the shortcomings of using cash budgeting for credit programs and activities, the Federal Credit Reform Act of 1990 was enacted.¹ The act changed the budget treatment of credit programs so that their costs can be compared more accurately with each other and with the costs of other federal spending.

Prior to the act's implementation in fiscal year 1992, it was difficult to make appropriate cost comparisons between direct loan and loan guarantee programs and between credit and noncredit programs. Credit programs—like other U.S. government programs—were reported in the budget on a cash basis (i.e., loan guarantees did not show up in the budget unless and until they defaulted). This created a bias in favor of loan guarantees over direct loans. In the budget year, loan guarantees appeared to be free, while direct loans appeared to be expensive because the budget did not recognize that at least some of the loan guarantees would default and that some direct loans would be repaid. Under the act, the President's budget for fiscal year 1992 and after must include the total estimated net cost to the U.S. Export-Import Bank (Eximbank) of the cash flows, discounted to present value, of its direct loans, guarantees, and insurance.

Credit reform requirements separate the government's cost of extending or guaranteeing credit, called the "subsidy cost," from administrative costs. Administrative expenses receive separate appropriations and are reported separately in the budget. The Credit Reform Act defines the subsidy cost of direct loans as the present value—at the time of disbursement—of the net cash flows, that is, the disbursements by the government minus estimated payments to the government after adjusting for projected defaults, prepayments, fees, penalties, and other recoveries. The act defines the subsidy cost of loan guarantees as the present value—at the time of disbursement—of cash flows from estimated payments by the government (for defaults and delinquencies, interest rate subsidies, and other payments) minus estimated payments to the government (including fees, penalties, and recoveries).

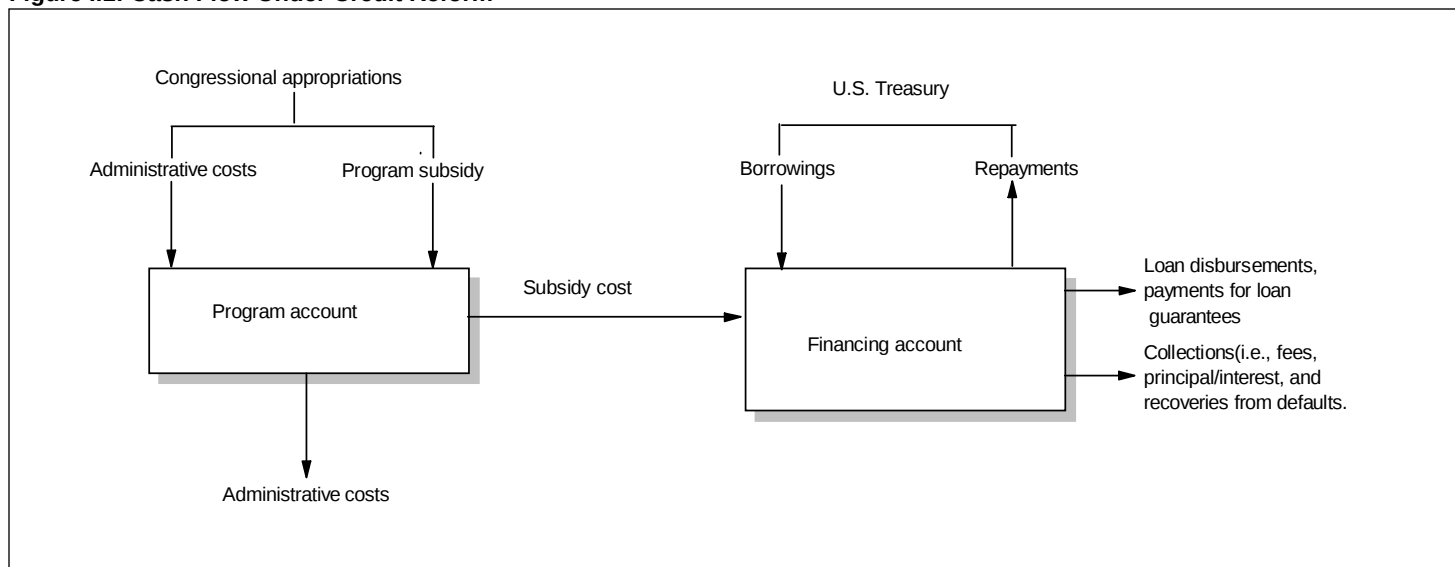
Agencies subject to the Credit Reform Act, such as the Eximbank, use a special budget system to record the budget information necessary to implement credit reform. Three types of accounts—program, financing, and liquidating—are used to handle credit transactions. Credit obligations and commitments made on or after October 1, 1991—the effective date of credit reform—use only the program and financing accounts. The program account receives separate appropriations for the administrative and the

¹As title B of the Omnibus Budget Reconciliation Act of 1990 (P. L. 101-508, Nov. 5, 1990).

subsidy costs of a credit activity. When a direct or guaranteed loan is disbursed, the program account pays the associated subsidy cost for that loan to the financing account. Figure I.1 diagrams this cash flow. If subsidy costs are accurate, the financing account will break even over time as it uses its collections to repay its Treasury borrowings. The program account has a permanent, indefinite appropriation for re-estimates made to cover estimation errors.

Credit activities conducted before October 1, 1991, are reported on a cash basis in the liquidating account. This account continues the cash budgetary treatment used before credit reform and has permanent, indefinite budget authority to cover any losses.

Figure I.1: Cash Flow Under Credit Reform



Comments From the Eximbank

Note: GAO comments supplementing those in the report text appear at the end of this appendix.



November 6, 1996

Ben Nelson, Director
International Relations and Trade
U.S. General Accounting Office
Washington, DC 20548

Dear Mr. Nelson:

Thank you for the opportunity to review and comment on your draft report "EXPORT-IMPORT BANK: Options for Achieving Possible Budget Reductions". The Ex-Im Bank is committed to providing the taxpayer the best return for the resources invested in the Ex-Im Bank budget and, consistent with that goal, the Ex-Im Bank is always interested in considering ways to reduce the cost and improve the efficiency and effectiveness of Ex-Im Bank programs.

SUMMARY OF THE GAO DRAFT REPORT

The GAO draft report takes the current "credit reform" formula for computing charges against Ex-Im Bank's program budget or -- to use the jargon of credit reform -- "credit subsidy appropriation" and looks at two different ways of reducing the "credit subsidy." The two ways considered are 1) reducing the risk of Ex-Im Bank supported export finance transactions, and 2) raising the exposure fees (i.e., risk premia) Ex-Im Bank charges for its export loans, and credit guarantees and insurance. The different GAO simulations follow arithmetically from

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the way the "credit subsidy" is computed under credit reform. Simply put, the draft holds the formula for computing the "credit subsidy" constant, and the "credit subsidy" is automatically reduced by the formula if either the risk in the transactions Ex-Im Bank supports is reduced or if the fees collected for each transaction are increased.

The GAO draft report does not do a cost-benefit analysis of the consequences of reducing Ex-Im Bank's program budget. For example, there is no estimate of the lost exports, jobs, and federal government tax revenue that would result from increasing the risk-based fees that Ex-Im Bank charges its borrowers. The report does not analyze ways in which new legislation or other measures could be used to reduce the estimated "credit subsidy" cost of Ex-Im Bank's programs without reducing U.S. exports and jobs.

GAO DRAFT REPORT MAKES NO RECOMMENDATIONS

The GAO draft report does not recommend reducing the Ex-Im Bank "credit subsidy appropriation" nor does it recommend that Ex-Im Bank implement any changes to its lending programs.

EX-IM BANK ANALYSIS

Ex-Im Bank's analysis of the GAO draft report is provided under three groupings of comments: 1) Budgeting for Ex-Im Bank's programs under credit reform; 2) Recognizing the offsetting costs of trying to reduce Ex-Im Bank's program budget in the ways discussed by the GAO draft; and 3) Additional opportunities, not considered by GAO, for reducing the taxpayers' "credit subsidy" cost of operating Ex-Im Bank without adversely affecting the scope and effectiveness of the Ex-Im Bank programs.

Budgeting for Ex-Im Bank Under Credit Reform

Charges against Ex-Im Bank's program budget, or "credit subsidy appropriation," are made using the model developed for implementing the 1990 Credit Reform Act. This model has been in use since 1992. The credit reform approach represents a significant improvement over prior practices for budgeting and controlling the real costs of government credit programs. However, while credit reform is a significant improvement, its application to international lending programs does not yield precise or completely accurate measures of the actual cost of these programs when calculated at the time of commitment. Therefore, these cost computations should only be interpreted as approximations of the cost of Ex-Im Bank's credit programs. This is not to criticize the credit reform budget approach, but only to point out limits imposed by informational and methodological realities. As was recognized when credit reform was proposed to and approved by Congress, it is not possible to compute in advance a precise cost number for international lending programs that corresponds to actual outlays made by direct expenditure programs. Therefore, an international lending program cost estimate should be viewed as representative of a reasonable range of likely program costs into which the actual program costs are likely to fall. The final outcome will not be known for a number of years and it may ultimately even be a profit. In line with this observation, the 1996 annual re-estimate of the value of Ex-Im Bank's portfolio resulted in a \$665 million increase in value. Counting this gain, Ex-Im Bank operated at an overall profit for fiscal year 1996 - even though the 1996 budget included and charged a "credit subsidy" appropriation for new commitments of over \$700 million.

While not providing a precise cost number, the discipline of credit reform does assure a level of consistency in controlling costs incurred

by the Federal government in its credit programs. Therefore, credit reform cost estimates for international programs should be viewed more as an important component of a budget discipline for controlling costs rather than a process that can be expected to produce precise actual cost numbers. As a result, the GAO discussion by focusing on how to make marginal reductions in Ex-Im Bank's "credit subsidy appropriation" by increasing fees or arbitrarily limiting portfolio risk, places undue emphasis on numbers that are at best reasonable estimates of cost rather than precise measures.

Recognizing the Offsetting Costs of Reducing Program Support

The implementation of any of the alternatives the GAO draft discusses should be considered with great caution. Both raising fees or lowering the amount of risk Ex-Im Bank assumes would result in a loss of U.S. exports, among other adverse consequences. In light of this, it is especially important to note the GAO draft's stated limitations. For example, the GAO draft states that GAO did not analyze the extent to which fee increases would reduce U.S. exports. Without this analysis the draft is missing the information needed to assess the net budget and economic impacts of increasing fees. Lost exports mean fewer jobs and lower federal tax revenues which can more than offset any "credit subsidy" saving. Consequently, increasing fees could actually make the federal budget deficit larger rather than smaller.

The likelihood that unilaterally increasing exposure fees to the levels considered by GAO will result in lost exports is significant. Ex-Im Bank's charter mandates that the Bank provide financing that is "fully" competitive with the financing provided by foreign governments to their exporters. Raising exposure fees to the levels considered by GAO would result in Ex-Im Bank financing programs that are not fully competitive. Although it is not feasible to match fees on a deal by deal

basis, Ex-Im Bank's exposure fee schedule is set so that at least 75 percent of the time U.S. exporters supported by Ex-Im Bank financing will not lose export opportunities because of lower foreign government export financing fees. Raising Ex-Im Bank exposure fees to the levels that GAO discussed would mean that half of all Ex-Im Bank supported financing offers would carry fees which would put U.S. exporters at a significant competitive disadvantage.

A more complete analysis is especially important because in the annual budget debates the potential impact of Ex-Im Bank on the budget deficit is obscured by the rules applied to the Congressional budget process. Congressional budget rules prohibit counting any secondary increase in tax revenue that may result from a program expenditure. Even if Ex-Im Bank programs were to generate tax revenue that exceeded Ex-Im Bank's budget, that revenue cannot be counted to offset the costs of Ex-Im Bank programs. Consequently, despite the methodological difficulties, it is all the more important for GAO to include an estimate of the measurable lost benefits and any other costs that would be incurred by the taxpayer if the alternatives that GAO discusses were implemented. Without such an analysis, the draft report is akin to looking at a business ledger and only examining the costs without looking at revenues.

The GAO draft recognizes that Ex-Im Bank is currently in the midst of ongoing negotiations in the OECD to reach an agreement to establish minimum risk-based premia for all member countries' Export Credit Agencies (ECA's). In prior OECD negotiations the United States and the Ex-Im Bank were successful in persuading other OECD members to agree to minimum interest rates on direct loans and restricting the use of tied aid, thus achieving a significant reduction in export credit subsidies. A key factor in the success of the United States in those negotiations was the ability and willingness of Ex-Im Bank to pressure

See comment 3.

other governments by effectively meeting foreign export credit agencies' low interest rates and tied aid practices. The perceived strength of our will now to maintain highly competitive fees is directly linked to our ability to successfully negotiate a minimum fee schedule in the OECD. A broad brush requirement to unilaterally increase fees at this time would undercut the negotiating position of the United States as we try to induce other countries to reach a common agreement on minimum fees. A successful agreement will level the playing field for U.S. exporters in the short run and holds out the promise of reductions of export credit subsidies across the board in the longer run. Ex-Im Bank should not commit the strategic error of "unilaterally disarming" by raising exposure fees while these important negotiations are on going.

See comment 4.

Just as highly competitive fees are needed for a strong negotiating position, Ex-Im Bank is most needed in the highest risk markets in which we are open for business. Placing an arbitrary ceiling on the level of risk that may be incurred in a transaction is not a good option. Because these markets represent our highest risk markets, lending to these markets will, by definition, be most costly in terms of "credit subsidy" calculations. However, it is in such markets that Ex-Im Bank support holds the promise of some of the best future returns. For example, Russia is going through a difficult transition, but it is a country rich in highly-educated, well-trained workers and abundant natural resources. With the success of its transition to a market economy Russia has great potential as a future market. For Ex-Im Bank to close in Russia because of an arbitrary limit on acceptable risk which the Bank can assume would be short sighted from a commercial interest perspective. Furthermore, it could be interpreted as an adverse foreign policy message to the government in Russia. Neither message would be desirable.

A more constructive approach to reducing the cost of financing exports to higher risk markets is to focus on creative ways to mitigate risk. For example, Ex-Im Bank has entered into financing arrangements in higher risk markets in which the risk of default was significantly reduced by linking the repayment of Ex-Im Bank guaranteed loans to reasonably secure sources of hard currency earnings. These transactions are charged against the Bank's "credit subsidy appropriation" at a lower amount reflective of the reduced risks, since the real risk and cost of the financing is significantly lower than it otherwise would have been. It would be unfortunate if the ability to support exports to higher risk markets were limited because of budget formulations that do not precisely reflect the actual risk and costs of the export finance support provided.

Opportunities for Non-disruptive Budgetary Savings

The GAO draft did not include an analysis of alternatives to reduce Ex-Im Bank's budget without disrupting the exports that Ex-Im Bank can support or threatening the success of ongoing negotiations. The Bank offers the following as examples such alternatives:

- (1) Under the credit reform estimation methodology, the "subsidy" cost of an Ex-Im Bank guarantee is greater than the "subsidy" cost of an Ex-Im Bank direct loan. However, a bank loan that receives an Ex-Im Bank guarantee carries a lower interest rate than a comparable direct loan from Ex-Im Bank. This makes bank loans with an Ex-Im Bank guarantee more attractive to borrowers than a direct loan from Ex-Im Bank. This situation was an unintended consequence of the interaction of two changes that took effect in the early 1990's -- the passage of credit reform legislation and the success in reaching an agreement in the

See comment 5.

OECD on minimum interest rates on direct export loans. Greater reliance on less costly financing alternatives would enable Ex-Im Bank to stretch its program budget even further. The Bank would have found it helpful if the GAO draft had evaluated this situation and developed possible remedies.

- (2) Ex-Im Bank engages in significant structuring of export finance transactions in order to reduce the risk of the transactions. Some of the Bank's efforts in this regard were previously mentioned. However, there are many other examples of such efforts. The Bank's aircraft lending is very important because U.S. aircraft manufacturers face intense ECA-supported competition in every market. However, by transforming most aircraft export finance into asset-based lending and taking other important measures to reduce risk, aircraft export finance uses almost no "credit subsidy appropriation". Similarly, Ex-Im Bank has been a leader in mitigating risk through project finance structuring. In such undertakings, risk is mitigated by the project structure and loans are repaid out of future project revenues. We would have found it helpful if the GAO draft had identified other opportunities for reducing program cost by mitigating risk. Such suggestions could make it possible to lower the budgetary cost of Ex-Im Bank's programs without adversely affecting the level of exports that Ex-Im Bank can support.

In addition to the broader analytical and conceptual points raised in this letter, the Bank provided your staff with a number of suggested technical clarifications. For example, the fee comparisons that GAO

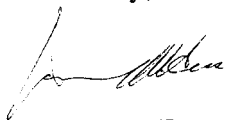
See comment 6.

cites are for sovereign lending only. However, sovereign lending represents a rapidly shrinking portion of Ex-Im Bank financing and is now less than a third of Ex-Im Bank's current activity. Non-sovereign borrowers under Ex-Im Bank programs are generally charged significantly higher fees than the sovereign borrower in the same country. However, the data needed to make comparisons with other countries' non-sovereign exposure fees are not available. Additionally, the terms of the financing support offered by ECA's differ. While the GAO draft noted that certain features of the Ex-Im Bank programs are more attractive than those offered by other ECA's, other aspects of Ex-Im Bank programs are less attractive than those offered by other ECA's. Additionally, unlike Ex-Im Bank, many other competing ECAs are instruments of industrial and/or foreign policy. Therefore, focusing primarily on the competitiveness of fees charged sovereign borrowers does not accurately reflect the overall competitiveness of Ex-Im Bank programs, of which fees charged sovereign borrowers are only one element.

See comment 7.

Ex-Im Bank greatly enjoyed working with the highly professional GAO staff assigned to this project and looks forward to working with them again in the future. Thank you again for the opportunity to comment on this draft.

Sincerely,



James K. Hess
Chief Financial Officer

The following are GAO's comments on the Eximbank's letter dated November 6, 1996.

GAO's Comments

1. The Eximbank's portfolio reestimates are not directly comparable to the Eximbank's credit reform estimates made for fiscal year 1996. Portfolio reestimates are conducted for the Eximbank's past commitments that are still on the books, typically spanning a number of years. These projections are also estimates and the actual costs of a particular commitment may ultimately be higher or lower. Credit reform subsidy allocations reflect only those commitments made in a given fiscal year.
2. The report noted that it is difficult to estimate the full impact of fee changes on exporter behavior and states that U.S. exporters' sensitivity to a fee increase would depend on several factors, including the size of the fee increase, the volume of U.S. exports to a particular market, and the credit risk of the importing market. We did acknowledge that raising fees for financing transactions in the higher-risk markets, such as the newly independent states of the former Soviet Union (NIS), could lead to a decline in U.S. exports to these markets.
3. The report notes that to minimize the possible competitive impact on U.S. exporters, any proposed Eximbank fee increases should only be undertaken in the broader context of ongoing Organization for Economic Cooperation and Development (OECD) efforts to reduce government export subsidies.
4. Export financing commitments could still be made in high-risk markets even under the subsidy cap option we have identified. This option would not necessarily eliminate the financing of transactions to high-risk markets—just those with a subsidy rate exceeding a certain threshold. Furthermore, transactions with subsidy rates exceeding the threshold could potentially be restructured. Moreover, the foreign policy concerns associated with reducing Eximbank coverage to the NIS could at least partially be mitigated by numerous other U.S. assistance programs that we identified.
5. The scope of our review did not include a consideration of this option. Thus, we cannot comment on the feasibility or the full implications of this option contained in the Eximbank's comments.

6. As we noted in the report, our fee comparisons were based solely on sovereign lending rates—the only type of lending where comparative data was available.

7. We acknowledge that several factors may play a role in determining the overall competitiveness of the Eximbank's programs. However, fees are generally the most significant difference between the Eximbank and other export credit agency (ECA) programs. Other factors, such as interest rates and repayment terms, are highly constrained by OECD agreements.

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