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UNITED STATES GENERAL ACCOUNTING OFFICE
WASHINGTON, D.C. 20548

NATIONAL SECURITY AND
INTERNATIONAL AFFAIRS DIVISION

B-214443

APRIL 13, 1984

The Honorable Stephen L. Neal, Chairman
Subcommittee on International Trade
Investment and Monetary Policy
Committee on Banking, Finance and
Urban Affairs
House of Representatives



Dear Mr. Chairman:

Subject: Eximbank Financing Support for Exports of
Defense-related Products (GAO/NSIAD-84-66)

In response to your June 20, 1983, request and subsequent discussion with your office, we reviewed Export-Import Bank of the United States (Eximbank) financing of exports of defense-related equipment.

As you know, Eximbank provides loan, loan guarantee, and insurance programs to supplement and facilitate private sector financing of U.S. exports. Although Eximbank is prohibited by law from financing military sales to developing countries, it does support defense-related sales when there is a civilian or commercial use. (See enc. I.)

U.S. exporting firms we contacted assert that there is a lack of competitive financing available to promote exports of military and defense-related products for certain developing countries. However, these firms could not document specific cases showing that the lack of Eximbank financing was causing lost sales. In fact, a number of sources mentioned that they would be very surprised if we were able to identify such a case since the problem with defense-related, dual-use items is that other factors besides financing availability often intervene in the export process.

Regarding our foreign competitors' export programs, except for Japan, credit agencies in major competitor nations do not have legal restrictions on financing military sales similar to those imposed on Eximbank.

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As described in this report, defense-related products are either items purchased by military buyers or military or "dual use" items purchased by commercial or government buyers. This covers a wide range of products, including aircraft, hospital equipment, trucks, electronic equipment, jeeps, boats, electric equipment, machine tools, and construction equipment.

In our survey, we spoke with officials of Eximbank; the Departments of the Treasury, State, Commerce, and Defense, and the U.S. Trade Representative. We also held discussions with 15 U.S. exporting companies and trade associations and with the Washington representative of the Export-Import Bank of Japan. We reviewed the House and Senate 1983 hearings on reauthorizing Eximbank authority and the subsequent legislation passed by the Congress.

We did not examine the major U.S. government program for financing military products--the Foreign Military Sales program. This program is based on a country-by-country determination of mutual security objectives which was beyond the scope of our survey.

This report also does not include a comparative review of the major foreign programs for financing defense-related equipment, because, as we explained to your staff, little information was available on this subject from the U.S. government agencies or private industry groups we contacted. This reason also precludes us from responding to your request that GAO suggest a series of options that Congress might consider to help disadvantaged U.S. suppliers compete with foreign producers.

We did not obtain official comments on these matters from Eximbank or other U.S. government agencies because of the informational and non-critical nature of our findings. However, we went over a draft of the report with Eximbank officials and their comments were considered in preparing the final report.

At the time this report is issued we will send copies to interested parties and will make copies available to others upon request.

Sincerely yours,



Frank C. Conahan
Director

FINANCING SUPPORT FOR EXPORTS
OF DEFENSE-RELATED PRODUCTS

Eximbank provides loan, loan guarantee, and insurance programs to supplement and facilitate private sector financing of U.S. exports. Although Eximbank is prohibited by law from financing military sales to developing countries, it does support defense-related sales when there is a civilian or commercial use.

RESTRICTIONS ON EXIMBANK
FINANCING OF MILITARY SALES

In 1967 hearings¹ the Congress raised questions about Eximbank financing of military sales. Beginning in 1962, Eximbank financed, at its own risk, military exports to certain financially strong and friendly industrialized countries. In 1964 and 1965, the Congress amended the Foreign Assistance Act in a manner that permitted the Department of Defense (DOD) to guarantee credits provided by Eximbank for military export sales. To implement these amendments an arrangement was worked out between the two agencies whereby Eximbank would acquire from DOD obligations, guaranteed by DOD, arising from sales negotiated by DOD with certain countries to which Eximbank was otherwise not prepared to extend credit for military goods. These countries constituted the developing, (i.e., less credit-worthy) nations. Under the arrangement, Eximbank provided the financing but did not deal with the buyer and was not informed of the buyer's identity. These transactions became known as "country X loans". From 1962 to mid-1967 Eximbank authorized a total of about \$1.9 billion in loans to assist in financing military exports. Some 70 percent of these loans, or \$1.3 billion, was made directly by Eximbank to certain industrialized nations without a DOD guarantee. The balance of about \$600 million represented credits to developing countries guaranteed by DOD.

At the Senate 1967 hearings, reservations were expressed about Eximbank financing of military equipment to developing countries and the Senate Committee recommended that congressional policy be expressly stated against such financing to less developed countries. Congress subsequently passed legislation²

¹Hearing before the Senate Committee on Banking and Currency on Eximbank's participation and financing in credit sales of defense articles, July 25, 1967, and hearing before the House Committee on Banking and Currency on Eximbank and Credit Sales of Defense Articles, July 17, 1967.

²Public Law 90-267, March 13, 1968 (82 Stat 48) (Codified at 12 U.S.C. 635(b)).

providing that Eximbank shall not support any credit sales of defense articles and services to economically less developed countries [as defined in the Internal Revenue Code] unless the President determines that such support would be in the national interest and reports his determination to the Congress. In making such a determination, the President is to "take into account, among other considerations, the national interest in avoiding (1) arms races among countries not directly menaced by the Soviet Union or by Communist China, (2) arming military dictators who are denying social progress to their own peoples, and (3) expenditures by developing countries of scarce foreign exchange needed for peaceful economic progress."

The Congress further tightened military financing restrictions in 1968³ to prohibit Eximbank from extending credit for sales of defense articles and services to developing countries.

EXIMBANK PROCESSING OF REQUESTS FOR
FINANCING DEFENSE-RELATED PRODUCTS

Requests received by Eximbank for financing defense-related equipment are referred to the Office of the General Counsel for initial decision on whether or not Eximbank has legal authority to provide such financing. Decisions are made on a case-by-case basis taking into account such factors as the nature of the product, relationship between the foreign buyer and its government, type of business in which the foreign buyer is engaged, stated end use of the product, and adaptability of the product to military uses and likelihood that it will be so adapted. When the buyer or user of the product is a military entity and the product is not inherently military, or when the buyer or user is non-military but the product is of a military character, Eximbank looks for a credible civilian or commercial end use for the products.

As defense-related requests are reviewed, Eximbank obtains information, as appropriate, from other U.S. government sources to help in reaching a decision. For example, U.S. embassies abroad are asked to confirm information, such as the proposed end use of a product and the State Department's Office of Munitions Control is consulted about possible military applications of a proposed export.

Eximbank's General Counsel makes one of three decisions on each request reviewed.

³Foreign Military Sales Act of 1968 (82 Stat 1321) (Codified at 22 U.S.C. §2772).

1. No legal objections to the proposed transaction. Military-related questions have been satisfactorily answered and the case is eligible for normal processing by Eximbank.
2. No legal objections provided that the purchaser certify that the products will not be used for offensive or defensive military purposes. The certification is then made a special condition to be satisfied before Eximbank can complete financing arrangements.
3. Eximbank is prohibited by law from assisting in financing the proposed transaction. The applicant is then notified of this legal decision and given an opportunity to modify or withdraw the request or have it presented to the Eximbank Board of Directors for a formal decision.

According to an Eximbank General Counsel listing of military clearances, Eximbank processed 182 defense-related requests during the 6 years 1978 through 1983⁴. For 125 requests or 69 percent of the total, Eximbank decided that there were no legal objections to the proposed transactions. For another 28 requests or 15.5 percent there were no legal objections provided there was certification of non-military use; 28 requests or 15.5 percent were turned down as being prohibited by law for financing. For one 1980 request, the legal decision was not identified. For 1983, there were 33 defense-related requests of which 13 were cleared without legal objection, 14 required a certification for clearance and 6 were prohibited from financing. Our review of documentation for the 1983 requests showed that they covered a wide variety of U.S. export products, including aircraft, hospital equipment, trucks, electronic equipment, jeeps, boats, electrical equipment, machine tools and construction equipment. In 1983, 22 of the 33 requests processed involved U.S. exports to Latin American countries. Six requests for Colombia in 1983 illustrate the kinds of defense-related requests processed by Eximbank.

1. A U.S. exporter asked Eximbank's assistance in financing computerized police radio dispatch

⁴An Eximbank General Counsel official told us that these requests were only part of Eximbank's workload on defense-related products. Eximbank also receives exploratory telephone and written inquiries from U.S. banks and exporters concerning the availability of financing, some of which become formal defense-related requests.

systems valued at \$25 million for the national police force in three Colombian cities. The exporter had furnished a similar system for the Colombian capital city police force in 1981 and advised Eximbank that the proposed equipment was non-tactical and would be used in applications identical to those of U.S. police forces. After requesting information from the U.S. embassy in Colombia, and having the Eximbank engineering staff verify the non-military nature of the proposed equipment, Eximbank's General Counsel had no legal objections to the transaction. Eximbank proceeded to make preliminary commitments for financing to several U.S. exporters bidding on the sale. The availability of Eximbank financing expires on March 31, 1984.

2. Eximbank received a request for credit insurance support for a \$7.8 million sale of construction equipment to Colombian army engineers for use in constructing access roads, schools, and hospitals. The U.S. embassy in Colombia confirmed that the primary mission of the engineering battalions was civic action and urged Eximbank to support the U.S. export. Eximbank's General Counsel concluded that there were no legal objections provided that the purchaser submitted a certification of non-military use. Eximbank approved the request for insurance coverage with the special condition that the purchaser furnish the certification.
3. A U.S. bank asked Eximbank for a loan guarantee on a \$9.3 million sale of night vision goggles for the Colombian national police. Eximbank was advised that the Colombian government was purchasing the goggles for use in a campaign against illicit drug traffic within its territory. The U.S. embassy in Colombia provided information supporting Eximbank's assistance in the proposed transaction and Eximbank's General Counsel had no legal objections provided that the purchaser provide a certification of non-military use. Eximbank approved the transaction with this special condition. The availability of Eximbank financing expires on March 31, 1985.
4. A request was processed for a loan guarantee on a \$1.3 million sale of trucks and jeeps for the Colombian army engineers for use on road construction projects. Eximbank's General Counsel

obtained information about the civic action programs of the engineers from the U.S. embassy and had no legal objections provided that the purchaser certify non-military end use. Eximbank approved the guarantee with this special condition. The availability of Eximbank financing expires on June 30, 1984.

5. A U.S. exporter asked Eximbank for loan assistance in financing 10 helicopters for use by the Colombian national police and the Office of the President. Eximbank was advised that these were commercial helicopters and not armed or built for military purposes. Eximbank's General Counsel had no legal objections provided there was a certification of non-military use by the purchaser and Eximbank approved a preliminary commitment on this basis. The availability of Eximbank's financing expires on March 31, 1984.
6. Eximbank received a request for credit insurance support for a \$2.7 million sale of radio and cable sets to the Colombian military forces to be used for short distance tactical voice communications, typically used by military personnel in the field. Eximbank's General Counsel advised that Eximbank was prohibited by law from assisting in financing the proposed transaction and the U.S. exporter's application was withdrawn.

DEVELOPED vs DEVELOPING COUNTRY
APPLICATIONS FOR EXIMBANK FINANCING

Eximbank is not prohibited from financing defense articles or services for developed countries. However, Eximbank officials told us that it is Eximbank's policy not to finance military products even for developed countries. An Eximbank official noted further that Eximbank has not made a military financing loan since the early 1970s.

By law, Eximbank uses the definition of a less developed country set forth in section 4916(b) of the Internal Revenue Code of 1954 (Public Law 88-563, 78 Stat. 827). Section 4916(b), in turn, uses as less developed those countries named in Executive Order 11285 of June 10, 1966. (See enc. II.)

From 1978 through 1983, 35 of the defense-related requests processed by Eximbank involved developed countries, 146 involved developing countries and one request identified the countries as "various" and could not be categorized. In 1983, 6 requests involved developed countries. We reviewed Eximbank's processing

of these requests and noted that 2 involved financing of commercial products to military end users. One was for electrical equipment for a military housing project in Saudi Arabia and the other a commercial aircraft for basic training of military pilots in Ireland. Eximbank made financial guarantees available in support of these two potential sales. Three of the other requests involved military sales and actions taken on them are summarized below.

1. The Foreign Credit Insurance Association (FCIA)⁵ asked Eximbank about the feasibility of providing insurance coverage to a U.S. exporter negotiating the sale of its tactical aircrew combat training system to the Spanish Air Force. The system, which would be used to train aircrews in simulated defense situations had been sold to the U.S. and Canadian Air Forces and the U.S. Navy. Eximbank's General Counsel noted that there was no legal objection to this defense article but that the Eximbank Board had consistently denied such cases on policy grounds. Eximbank conveyed this information to FCIA and said that Eximbank could not encourage the transaction.
2. FCIA requested a clearance from Eximbank's General Counsel for insurance coverage for a thermal imaging night surveillance equipment sale to distributors in four West European countries. The request noted that this equipment is generally mounted on helicopters and probably would be used by a government or military agency. Because the request did not identify the end users and the specific uses of the equipment, Eximbank told FCIA that law prohibited Eximbank from assisting in financing the transaction.
3. Eximbank was asked if FCIA could provide insurance for a sale of high voltage power supplies to a Danish company. The supplies would eventually be included in the instruments of a military aircraft. Eximbank's General Counsel determined that these power supplies were defense articles

⁵The export credit insurance program is operated in cooperation with a private association of U.S. insurance companies known as the FCIA. This group helps U.S. exporters to be competitive by insuring U.S. exports against commercial and political risks.

and that, since Denmark was a developed country there was no legal objection; however the Eximbank Board of Directors had consistently declined these cases in developed countries. General Counsel said the applicant should be so advised. Eximbank conveyed to FCIA that there was no legal objection but omitted the usual statement about the proposed insurance coverage being contrary to Eximbank policy for a military sale. FCIA issued insurance coverage to the U.S. exporter in support of this sale even though this was inconsistent with Eximbank policy on military sales.

The final request involved the proposed sale of a simulator for training Portuguese air force pilots in spatial disorientation. There was no legal objection to the proposed transaction but the U.S. bank withdrew the application before Eximbank completed processing on it.

Most Foreign Competitors Not Subject to Legal Restrictions on Financing

During our survey, we asked Eximbank officials whether their counterpart foreign credit agencies were restricted by law or in practice from financing exports of military products and services. These officials raised this question at an October 1983 meeting of the International Union of Credit and Investment Insurers (The Berne Union). Japan's representative said that Japan has legal restrictions on financing military exports. Representatives of Great Britain, Spain, West Germany, France, and Belgium responded that they have no such restrictions and that they can support such transactions subject to foreign policy determinations and certain special conditions.

EXPORTERS' PERSPECTIVES ON FINANCING DEFENSE-RELATED PRODUCTS

All of the 12 firms contacted during our review have a common interest in defense products and exports. Two primary themes emerged during our discussions with these exporters and were restated by representatives of the three trade associations we contacted--first, a strong assertion concerning the limited availability of competitive financing to promote exports of military and defense-related items for certain developing countries and second, an inability to document any cases which could isolate the lack of Eximbank financing as the cause of a lost sale of a defense-related item to an importing country.

Concern regarding the availability of export financing funds was raised repeatedly. Although we heard numerous complaints about Eximbank's lack of competitiveness compared with foreign competition, the overall concern seemed more broad-based.⁶ The availability of foreign military sales dollars for selected developing countries, increased credit risk of many of these countries, and an increasingly dim international banking and credit picture on the whole were cited as reasons behind the increased need for Eximbank financing.

Neither the firms nor the associations were able to document an example of a lost sale of a defense-related item due to a denial of Eximbank financing. In fact, a number of sources mentioned that they would be very surprised if we were able to identify such a case since the problem with defense-related, dual-use items is that other factors besides financing availability often intervene in the export process. Financing can become a scapegoat for a lost sale due to pricing or quality of the product.

When a genuine civilian application of an item can be demonstrated, one firm acknowledged that Eximbank will generally offer financing. Eximbank makes case-by-case decisions on these matters, which allows flexibility of decision-making at the cost of a standardized, promulgated policy.

A main problem for exporters, related tangentially to financing, is foreign competition. What we heard from these exporters and associations paralleled what was stated to Congress during Eximbank reauthorization hearings--foreign competition is increasing. As part of Eximbank's reauthorization, Congress clearly stressed Eximbank's mandate for competitive export financing. Beyond the need for competitive export financing, a major complaint of exporters was the allegation that the competition holds an unfair advantage because of government subsidization of exports. U.S. exporters said that trade intervention activities seem to be on the rise.

⁶GAO has commented on Eximbank's competitiveness regarding export financing in two reports: To Be Self-Sufficient or Competitive? Eximbank Needs Congressional Guidance (ID-81-48, June 24, 1981) and Financial and Other Constraints Prevent Eximbank from Consistently Offering Competitive Financing for U.S. Exports (ID-80-16, Apr. 30, 1980).

The 1983 Eximbank reauthorization legislation⁷ passed by the Congress addresses the concern of U.S. exporters about lack of competitive financing. The legislation directs that Eximbank interest rates and loan terms be competitive with foreign trading partners, adds new provisions on financing for small businesses, and creates a mixed credit⁸ financing program. The legislation, however, makes no changes in the prohibition against the financing of defense articles and services to less developed countries.

⁷Public Law 98-181, 97 Stat 1254 et seq.

⁸A program that may include the combined use of credits, loans, or guarantees offered by Eximbank with the assistance of the Agency for International Development or private financial institutions or entities. The purpose is to offer or arrange financing for U.S. exports which is substantially as concessional as foreign financing being offered or arranged for a bonafide foreign competitor for a U.S. export sale.

DETERMINATION OF LESS DEVELOPED COUNTRIES

By law, Eximbank refers to section 4916(b) of the Internal Revenue Code of 1954 and Executive Order 11285 of June 10, 1966 in making an economically less developed country determination. By this guidance, less developed countries are all those foreign countries (including territories, departments, provinces and possessions) except:

Abu Dhabi	Kuwait-Saudi Neutral Zone
Australia	Libya
Austria	Liechtenstein
The Bahamas	Luxembourg
Bahrain	Monaco
Belgium	Netherlands
Bermuda	New Zealand
Canada	Norway
Denmark	Portugal
The Federal Republic of Germany	Qatar
France	San Marino
Hong Kong	Saudi Arabia
Iran	Sino-Soviet Bloc Countries
Iraq	Spain
Ireland	Sweden
Italy	Switzerland
Japan	South Africa
Kuwait	The United Kingdom