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The U.S. Export-Import Bank: Review of a
Proposal to Finance Military Exports

Statement of
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Before the
Subcommittee on International Development,
Finance, Trade and Monetary Policy
Committee on Banking, Finance and Urban Affairs
House of Representatives



Madam Chairwoman and Members of the Subcommittee:

I am pleased to be here today to testify before this Subcommittee on the issue of the U.S. Export-Import Bank's (Eximbank) financing of military exports. At the April 11 hearing held by the Subcommittee, we outlined issues to consider when renewing the Eximbank's charter.¹ At that time, you asked that we look first at the issue of Eximbank financing of military exports and the legislation proposed in March 1991 by the Eximbank to create a pilot program to finance such exports.

Although Eximbank officials have stated that the Eximbank has the legal authority to finance military exports to certain countries, it has chosen not to do so. The proposed legislation gives the Congress the opportunity to reevaluate the Eximbank's role in financing military exports. Based on our review of the history of the issue, prior GAO reports, and information provided by the Eximbank and the Office of Management and Budget (OMB),² we do not

¹The U.S. Export-Import Bank: Reauthorization Issues (GAO/T-NSIAD-91-17, Apr. 11, 1991).

²An OMB report, "Financing Defense Exports," released in December 1990, considered many issues related to financing military exports but came to no real conclusions on the matter. The report was reviewed by policy officials of the Departments of Commerce, Defense, State, and Treasury, as well as the Eximbank, the Arms Control and Disarmament Agency, the Council of Economic Advisers, the National Security Council, and the Office of the U.S. Trade Representative.

believe that a case has been made demonstrating a need for the proposed legislation.

BACKGROUND

There is uncertainty about the level of future U.S. military exports. Although the U.S.' market share of the world defense market grew from 18 percent in 1980 to 29 percent in 1988, world defense exports have been decreasing and the market is becoming more competitive, according to the most recently available data. Important changes contributing to this circumstance include the end of the Cold War and the resultant reductions in defense spending by many countries and overcapacity in the defense industry. Additional factors affecting the defense market include the European Community's collaborative efforts to restructure European defense industries, the cyclical nature of the market for major weapon systems, and U.S. restrictions on where and how defense equipment can be used.

The Eximbank's involvement in defense exports began in the early 1960s. In 1962 the Eximbank started financing military exports to certain financially strong and friendly industrialized countries. In 1964 and 1965 the Congress amended the Foreign Assistance Act to permit the Department of Defense (DOD) to guarantee credits provided by the Eximbank for military export sales. To implement these amendments an arrangement was worked out between the two

agencies. Under the arrangement the Eximbank financed sales-- negotiated by DOD--to developing countries to which the Eximbank was otherwise not prepared to extend credit for military goods. The Eximbank provided the financing but did not deal with the buyer and was not even informed of the buyer's identity. These transactions became known as "country X loans." In fact, the former House Banking and Currency Committee, the Eximbank's oversight committee, was not told of the program's existence until the 1967 Eximbank charter renewal hearings. The hearings, which included testimony from the Eximbank Chairman and officials of the Treasury, State, and Defense Departments, resulted in the 1968 law that prohibited the Eximbank from financing military exports to any developing country. However, the Eximbank was not prohibited from extending such financing to developed countries.

In 1974 the Eximbank decided as a matter of policy to discontinue all support for military exports. Since then, two legislative initiatives have prompted exceptions to this policy.

-- In 1988 the Congress passed legislation authorizing the Eximbank to finance defense exports to developing countries provided that the exports were for antinarcotics purposes.

-- In 1989 the Foreign Operations, Export Financing, and Related Programs Appropriations Act for fiscal year 1990 provided a 1-year exception to the prohibition against Eximbank financing of

commercial sales of defense articles and services destined for Greece and Turkey. Under this act, the Eximbank authorized more than \$1 billion in loan guarantees to Turkey in August 1990 for the purchase of U.S. Blackhawk helicopters.

THE PROPOSED LEGISLATION

On March 7, 1991, the Chairman of the Eximbank submitted to the Congress draft legislation to amend the Export-Import Bank Act of 1945. The proposed legislation would establish a pilot program for the Eximbank to provide support in the form of guarantees or insurance for military exports to members of the North Atlantic Treaty Organization and to Japan, Israel, and Australia. It would also permit the Eximbank to support such sales to any other country if the President determines that the sales are in the national interest.

The proposed legislation would provide explicit authority to finance military exports through fiscal year 1992 and make three changes to existing Eximbank legislation regarding such financing.

1. It would permit the Eximbank to finance military exports to a developing country if the President determines such financing to be in the national interest. Current legislation permits the President to waive the ban on financing military exports to

developing countries only in cases in which the exports will be used for antinarcotics purposes.

2. Israel, Greece, Turkey, and Iceland would become eligible for Eximbank-financed military exports without a specific presidential determination. Under the current law, countries that are not on a 1966 Internal Revenue Service list of developed countries are not eligible for military export financing.
3. It would limit the Eximbank's financing of military exports to \$1 billion in any fiscal year. The Eximbank's general authority currently does not specify a limit for military export financing.

In evaluating the proposed legislation, we examined (1) the need for Eximbank involvement in military export financing, (2) the potential for "crowding out" of civilian export financing, and (3) concerns about the appropriateness of Eximbank involvement in military export financing.

DETERMINING THE NEED FOR EXIMBANK INVOLVEMENT IN DEFENSE FINANCING

According to Eximbank officials, the proposed legislation is intended to provide a "level playing field" for U.S. military exporters facing foreign competitors who are assisted by their

governments' export credit agencies. Many countries offer financial support for military exports through both public and private agencies, but the extent of the support and the form of financing differ among countries. Some countries offer insurance against commercial and political risk, while others provide a combination of reinsurance and interest buydown programs. The OMB report listed several countries that offer government-supported financing, including France, Germany, the United Kingdom, Belgium, Brazil, Canada, Italy, the Netherlands, and Spain.

Eximbank financing might provide a level playing field for U.S. military exporters if financing were, in fact, the major factor in deciding between competitors. While it is hard to quantify the impact of Eximbank financing on sales of any product, it is especially difficult to quantify the impact on defense items because of all the other factors involved in the decision-making process. Other factors, besides financing, that affect the decision to buy one defense-related product over another include such things as

- price,
- technical sophistication of the equipment,
- operating cost,
- availability of follow-up support,
- system performance,
- lead time from placement of order to delivery,

- availability of training,
- political influence, and
- the financial and economic conditions of the purchasing countries.

In addition, some countries consider "offsets" more important than financing in the decision-making process. Offsets are a range of industrial and commercial compensation practices required by foreign governments and firms as conditions for the purchase of military exports. Some potential buyers of U.S. defense goods that have domestic defense industries may demand offset arrangements as part of the transaction. Types of offsets include coproduction agreements and technology transfers. Military exporters often comply with the demand for offsets in order to enhance the sale of their products. In fact, some military exports depend on such arrangements, and sales would not occur without the accompanying offsets requested by the purchaser.

In cases where financing is a major factor, there already are financing resources available to U.S. military exporters, including government programs and commercial financing. The United States provides financing for military sales and other related assistance to eligible foreign countries through DOD programs. Two major DOD programs include (1) the Foreign Military Sales Financing

Program and (2) the Military Assistance Program.³ The Foreign Military Sales Financing Program budget authority for fiscal year 1990 was \$4.8 billion. The proposed legislation could result in program overlap and add to the complexities of congressional monitoring and oversight of defense financing programs. Besides DOD programs, commercial financing is also available for and by the defense industry.

"CROWDING OUT" AS AN ISSUE

Some exporters of civilian products fear that they will be "crowded out" by military exporters for limited Eximbank financing if the proposed legislation is passed. Two very large firms that have received Eximbank support for civilian exports and have both defense and civilian divisions, reportedly have reservations about the proposal because of concerns about having to compete for Eximbank financing within the firm. Eximbank officials stated that they do not believe crowding out is an issue because they said that OMB included an additional \$1 billion in the Eximbank's requested fiscal year 1992 budget authority to be used for military exports. However, there is no mention of an "additional" \$1 billion in the President's budget or the proposed legislation, only that there is a \$1-billion limit on the amount that the Eximbank can spend on

³Security Assistance: Update of Programs and Related Activities (GAO/NSIAD-89-78FS, Dec. 28, 1988) provides more detailed descriptions of these programs.

financing military exports. In fact, the Eximbank's requested budget authority is less in fiscal year 1992 than it was in fiscal year 1991--\$9.5 billion and \$11.2 billion, respectively. Thus, military exporters could potentially crowd out civilian exporters for Eximbank funds. On the other hand, the Eximbank has not used all of its regular budget authority in any of the last 10 years, suggesting that crowding out might not occur.

"APPROPRIATENESS" OF EXIMBANK INVOLVEMENT IN MILITARY EXPORT
FINANCING

Some opponents of the proposed legislation do not believe that the Eximbank should finance military exports, particularly since the proposal includes a "presidential determination" clause that could potentially allow Eximbank-financed defense items to be exported to any nation if such a transaction were determined to be in the national interest. They contend that where military exports are considered necessary to serve U.S. security interests, the Foreign Military Sales Financing Program, administered by DOD in coordination with the State Department, is the appropriate vehicle because DOD and State have the necessary experience, technical expertise, and knowledge of national security policy.

In conclusion, let me repeat that based on our review we do not believe a case has been made to demonstrate the need for the proposed legislation.

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Madam Chairwoman and Members of the Subcommittee, this concludes my prepared statement. I will be happy to try to answer any questions the Subcommittee may have.