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UNITED STATES GENERAL ACCOUNTING OFFICE

REPORT TO THE CONGRESS

Audit Of The Export-Import Bank Of The United States Fiscal Year 1970

B-114823

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BY THE COMPTROLLER GENERAL OF THE UNITED STATES

JUNE 21, 1971

COMPTROLLER GENERAL OF THE UNITED STATES
WASHINGTON, D.C. 20548

B-114823

To the President of the Senate and the
Speaker of the House of Representatives

This is our report on the audit of the Export-Import Bank of the United States for the fiscal year ended June 30, 1970.

Copies of this report are being sent to the Director, Office of Management and Budget; the Secretary of the Treasury; and the President, Export-Import Bank of the United States.

Elmer B. Staats

Comptroller General
of the United States

D I G E S T

WHY THE AUDIT WAS MADE

The Government Corporation Control Act requires the Comptroller General to make an annual audit of the Export-Import Bank of the United States (hereinafter referred to as Eximbank).

FINDINGS AND CONCLUSIONS

In the General Accounting Office's (GAO) opinion, the financial statements--except for the treatment of sales of certificates of beneficial interest--present fairly Eximbank's financial position as of June 30, 1970, and the results of its operations and the source and application of its funds for the year then ended, in conformity with generally accepted accounting principles applied on a basis consistent with that of the preceding year and with applicable Federal laws. (See p. 53.)

Eximbank has sold financing instruments called certificates of beneficial interest which are based on financial participation in specific loans. GAO believes that these instruments should be considered as borrowing or financing transactions rather than as sales of assets--as Eximbank treats them--because

- --the buyer of a certificate does not actually take possession of the loan instrument executed by the original borrower and
- --the buyer is not free to dispose of the instrument without restrictions.

Had Eximbank reported certificates of beneficial interest as borrowing, its total assets and liabilities would have increased by about $400 million as of June 30, 1970. (See p. 9.)

Eximbank finances its operations, in part, by borrowing in the private market rather than through the Treasury--apparently because Eximbank believes that this type of financing results in benefits in computing the overall Federal budget surplus (or deficit) and relieving pressures on the statutory debt limit. GAO believes that these benefits are questionable and that Eximbank's private borrowing results in substantially increased interest costs when compared to the costs of direct Treasury borrowing. During fiscal years 1962 through 1970, private financing cost $43.2 million more than borrowing through the Treasury would have cost; and additional costs of $29.6 million will be incurred over the remaining life of Eximbank's own securities. (See p. 13.)

Tear Sheet

JUNE 21, 1971

Also, arrangements in effect for some years permit Eximbank to borrow substantial amounts from the Treasury at reduced rates. Had the Treasury charged Eximbank interest rates approximating the full cost of the funds, Eximbank's interest and other financial expenses would have increased by about $16.8 and $6.9 million in fiscal years 1970 and 1969, respectively. Eximbank's justification for the reduced interest rates is that they serve to compensate Eximbank for actions taken in furtherance of overall Government policy. (See p. 21.)

Eximbank's current procedures do not measure with certainty the potential long-term benefits derived from individual transactions under the export expansion facility which provides financial support for U.S. exports involving greater than normal risks. This program would be more effective if long-term trade goals of the United States were identified on a geographical and/or industry basis and if only transactions which met these goals were approved. (See p. 48.)

RECOMMENDATIONS AND SUGGESTIONS

Eximbank should increase borrowing from the Treasury so that the substantially increased costs of borrowing in the private market can be avoided. (See p. 15.)

The Secretary of the Treasury and the President of Eximbank should renegotiate the agreement concerning reduced interest rates charged on certain Treasury borrowing. (See p. 29.)

Eximbank should document and describe in its annual reports to the Congress any activities performed in the national interest that would not be performed in the ordinary course of its business. Eximbank's annual financial statements would be more informative if the financial results of such activities were disclosed separately in the statements. (See p. 30.)

AGENCY ACTIONS AND UNRESOLVED ISSUES

Eximbank and Treasury agreed with the facts concerning the additional costs Eximbank incurred by borrowing in the private market. Treasury did state, however, that the policy changes implied in the recommendation to increase Eximbank's borrowing from the Treasury might have considerable impact on the debt ceiling, the Federal budget, and the adequate funding of Eximbank's operations. (See p. 15.)

The President of Eximbank said that, as a result of a draft of this report and its recommendations, he had proposed a new agreement to the Treasury relating to reduced-rate borrowing. In GAO's opinion the effect of this proposed new agreement will partially eliminate Eximbank's low-cost borrowing from the Treasury and further action is required to fully eliminate the low-cost borrowing. (See p. 28.)

During the course of the GAO audit, bills were introduced in the Congress which provided that receipts and disbursements resulting from Eximbank's activities would no longer be included in totals of the Federal budget. Although such action would remove restrictions on Eximbank's activities that were due to Federal budgetary consideration, it might lead to substantial increases in the cost of financing Eximbank's activities. In addition, congressional approval of such a bill might set an undesirable precedent for removing other Federal loan programs from the budget. GAO believes that all Federal programs should be funded on the basis of their relative priority in an all-inclusive Federal budget.

The manner of treatment of certificates of beneficial interest by the Eximbank on its financial statements is unresolved.

A draft of the section of this report concerning Eximbank's methods of financing was also sent to the Director of the Office of Management and Budget on December 15, 1970, for comment. No comments have been received, so the report is being issued without their comments. (See p. 15.)

MATTER FOR CONSIDERATION OF THE CONGRESS

The Congress may wish to require Eximbank to obtain its funds from the least costly source. (See p. 20.)

Tear Sheet

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ABBREVIATIONS

CBI	Certificate of beneficial interest
Eximbank	Export-Import Bank
FCIA	Foreign Credit Insurance Association
GAO	General Accounting Office

COMPTROLLER GENERAL'S REPORT TO THE CONGRESS

AUDIT OF THE EXPORT-IMPORT BANK OF THE UNITED STATES, FISCAL YEAR 1970, B-114823

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CHAPTER 1

INTRODUCTION

The Export-Import Bank of the United States, originally created in 1934, was made an independent agency by the Export-Import Bank Act of 1945 (12 U.S.C. 635). The principal activities of Eximbank have been to aid in financing and facilitating exports from the United States to foreign countries.

In furtherance of its objectives and purposes, Eximbank makes loans to foreign obligors to finance the export of capital equipment and services, military equipment and services, and agricultural commodities; provides exporter credit financing; provides emergency standby balance-of-payment credits to foreign governments to alleviate their shortages of foreign exchange; makes loans to commercial banks against their holdings of export debt obligations; and guarantees and insures commercial banks and U.S. exporters against commercial-credit and political risks of loss arising in connection with exports.

Pursuant to the act of March 13, 1968 (82 Stat. 47), the name of Eximbank was changed from the Export-Import Bank of Washington to the Export-Import Bank of the United States; the life of Eximbank was extended from June 30, 1968, to June 30, 1973; the limitation on the aggregate amount of loans, guarantees, and insurance that Eximbank could have outstanding at any one time was increased from $9 billion to $13.5 billion; and the limitation on the amount of guarantees, insurance, and reinsurance outstanding for which fractional reserves are maintained was increased from $2 billion to $3.5 billion. At June 30, 1970, Eximbank had uncommitted lending authority of about $3.8 billion.

Eximbank's basic legislation provides for Eximbank to supplement and encourage and not compete with private capital and also provides lending criteria for making loans which, in the judgment of the Board of Directors, offer "reasonable assurance of repayment." Subsequently, the act of July 7, 1968 (82 Stat. 296), liberalized Eximbank's lending criteria by providing Eximbank with authority to use up to $500 million to facilitate export transactions which, in the judgment of the Board of Directors, offer "sufficient likelihood of repayment" to more actively foster U.S. foreign trade and long-term commercial interest and, thus, improve the U.S. balance of payments.

MANAGEMENT OF EXIMBANK

In accordance with the Export-Import Bank Act of 1945, as amended, the management of Eximbank is vested in the Board of Directors, consisting of Eximbank's president and first vice president serving as the chairman and vice chairman, respectively, and three additional members, appointed by the President of the United States by and with the advice and consent of the Senate. The Board is required by this act to adopt such bylaws as are necessary for the proper management and functioning of Eximbank and shall in such bylaws designate the vice presidents and other officers and prescribe their duties.

In accordance with the act, Eximbank also has an advisory committee of nine members, appointed by the Board of Directors to advise the Board on Eximbank's operations.

Eximbank's activities are conducted principally through its office in Washington, D.C. At June 30, 1970, Eximbank had 358 employees--an increase of 30 during the fiscal year.

The scope of our audit of Eximbank's financial statements is described on page 53 of this report. In addition, we have included comments on certain operations of Eximbank which we believe to be of interest to the Congress.

CHAPTER 2

METHODS OF FINANCING EXIMBANK'S OPERATIONS

Financial resources for Eximbank's activities are derived mainly from (1) borrowings from the U.S. Treasury, (2) the sale of its own securities in the private market, (3) repayments of loan principal, and (4) income from operations. A statement of Eximbank's source and application of funds for fiscal year 1970 is included as schedule 3.

Since fiscal year 1962 Eximbank has financed a substantial part of its lending operations outside the Treasury by selling various types of securities in the private market in order to lessen the effect of its operations on the Federal budget and the statutory debt limit. Eximbank's practice of obtaining financing in the private market has cost about $43.2 million more, since fiscal year 1962, than if the funds had been borrowed through the Treasury, and an additional cost of $29.6 million will be incurred over the remaining life of Eximbank's own securities.

Because Eximbank financed some of its operations in the private market at interest rates higher than the Treasury's and made certain low-interest-rate loans in furtherance of national policy, Eximbank is receiving concessionary interest on a significant part of its borrowings from the Treasury. Had the Treasury charged Eximbank interest rates approximating the full cost of the funds, Eximbank's interest and other financial expenses would have been increased by about $16.8 and $6.9 million in fiscal years 1970 and 1969, respectively.

These matters are discussed in detail below.

EXIMBANK'S UTILIZATION OF PRIVATE MARKET TO FINANCE ITS ACTIVITIES

Prior to fiscal year 1962, Eximbank supplemented its financial resources from operations, mainly through borrowing from the Treasury pursuant to Eximbank's $6 billion line of credit established by the Export-Import Bank Act of 1945, as amended. Since fiscal year 1962 Eximbank has utilized borrowings other than Treasury notes for financial resources, such as participation certificates, short-term discount notes, debentures, and certificates of beneficial interest.

Following is a summary of Eximbank's major sources of funds other than Treasury borrowing.

Fiscal years	Participation certificates	Certificates of beneficial interest	Short-term discount notes	Debentures
	(millions)			
1962-67	$3,544.2	$ -	$ -	$ -
1968	570.0	-	487.2	-
1969	-	300.0	1,053.1	400.0
1970	-	400.0	-	-
Total	$4,114.2	$700.0	$1,540.3	$400.0

The underlying reason for Eximbank's financing its loan programs through the issuance of participation certificates and certificates of beneficial interest and its accounting for its sales of such instruments as sales of assets is the positive effect such sales of assets have on the overall Federal budget. Participation certificates and certificates of beneficial interest, when treated as sales of assets in the Federal budget, are offsets to expenditures and have the same positive effect on the final budget surplus or deficit as tax receipts. On the other hand, if participation certificates and certificates of beneficial interest are considered to be borrowing or financing transactions, they have the effect of increasing Federal budget deficits.

Eximbank, as well as several other Government agencies, have financed their operations in the private market instead of through Treasury borrowings, under the direction of the Office of Management and Budget (formerly the Bureau of the Budget) and the Treasury.

Participation certificates

During the period from fiscal year 1962 through fiscal year 1968, Eximbank sold about $4 billion worth of participation certificates, which were accounted for as sales of assets rather than as a means of financing in the Federal budget. It should be noted, however, that, on Eximbank's own financial statements, sales of these instruments were accounted for as borrowing transactions.

Eximbank's participation certificates are interest-bearing instruments representing sales of beneficial interest in portfolios or pools of Eximbank's loans. In a practical sense, however, these instruments have little of the attributes of an interest in Eximbank's loan portfolio.

Although lists of loan maturities pledged and the related interest payable are maintained for each portfolio fund, Eximbank has guaranteed the timely payment of principal and interest in the event that payment of principal and interest on the loans pledged is insufficient to meet the interest and principal due on the participation certificates. Eximbank is at liberty to freely substitute other loans or to use any other source of funds in redeeming the participation certificates.

When certificates of participation in the pools of loans are sold, the ownership of the loans is still retained by Eximbank; interest and principal repayments continue to flow to Eximbank and are commingled with other cash; Eximbank continues to service the loan; and Eximbank assumes the risk of default on any individual loan insofar as the investor in the participation certificate is concerned.

As a practical matter, the sale of participation certificates is a means of financing a portion of Eximbank's operations; and, should it be unable to meet the principal or interest payments from its own resources, Eximbank would have to resort to Treasury borrowings to make the payments.

The "Report of the President's Commission on Budget Concepts,"[1] October 1967, states that there has been

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[1] The President of the United States appointed this Commission on March 3, 1967, to make a thorough study of the Federal budget and the manner in which it is presented to the Congress and the public.

substantial agreement that participation certificates are a means of financing very similar to direct borrowing from the Treasury. The Commission therefore recommended a change in the accounting treatment in the budget for the sales of participation certificates--that participation certificates be treated in the budget as a means of financing, not as an offset to expenditures which, in effect, reduces the budget deficit.

Through fiscal year 1968 Eximbank sold participation certificates at the direction of the Bureau of the Budget because the method of accounting for them in the Federal budget resulted in reducing the annual budget deficit or increasing any budget surplus. Subsequent to issuance of the "Report of the President's Commission on Budget Concepts," Eximbank stopped selling participation certificates; however, it began to sell instruments called certificates of beneficial interest which are substantially the same as participation certificates.

Certificates of beneficial interest

Eximbank's certificates of beneficial interest represent an interest in an individual loan or, for some certificates, interest in several identified loans, as opposed to pools of loans in participation certificates. The original note signed by the borrower remains with Eximbank; the purchaser of the certificate cannot sell, assign, or otherwise dispose of the certificate except as permitted by Eximbank. Eximbank assumes fully the risk of default as far as the investors in either type of instrument are concerned.

After adoption of the recommendation of the President's Commission on Budget Concepts, Eximbank greatly expanded its use of the instruments called certificates of beneficial interest to finance its loan program. During fiscal years 1969 and 1970, this method of financing amounted to about $300 million and $400 million, respectively; and the current plans for fiscal year 1971 indicate that Eximbank will issue an additional $420 million worth of these instruments.

The Bureau of the Budget in April 1968, in response to Eximbank's request, ruled that the sales of certificates of beneficial interest effectively constituted the sale of an asset rather than a form of financing and should be treated accordingly for budget purposes. In a letter dated December 31, 1969, the Director, Bureau of the Budget, advised us that he considered transactions involving certificates of beneficial interest to be sales of assets because the purchaser of the beneficial interest becomes a party to the underlying loan.

1. The purchaser buys an interest in a specific loan and knows who the borrower is, and the borrower knows who the purchaser is--as distinguished from buying a general obligation of the Eximbank.

2. The terms and conditions of the underlying loan cannot be changed without the purchaser's consent.

3. There can be no substitution of one loan for another during the course of events.

Accordingly sales of such instruments are treated as sales of assets in the Federal budget just as participation certificates were treated prior to the recommendation of the President's Commission on Budget Concepts. It should be noted that, in fiscal years 1969 and 1970, Eximbank treated certificates of beneficial interest as sales of assets in its financial statement whereas participation certificates were treated as borrowing transactions.

We recognize that some fine legal distinction can be made between sales of participation certificates and sales of certificates of beneficial interest in specific loans; however, we do not believe that the distinction between the two is sufficient to warrant a different treatment in the budget or financial statements of Eximbank.

As we stated in our reports[1] on the Eximbank's activities for fiscal years 1968 and 1969, we believe that two basic tests should be met in determining that a loan is actually sold.

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[1]Audit of the Export-Import Bank of the United States--Fiscal Years 1968, 1969; B-114823, dated May 29, 1969, and May 19, 1970.

1. The buyer actually takes possession of a loan instrument executed by the original borrower.

2. The buyer is free to dispose of this instrument without restriction by the U.S. Government.

We believe that, since the certificates of beneficial interest do not meet these tests, they should be considered as borrowing or financing transactions. In our opinion, such treatment would be in line with the recommendations of the President's Commission on Budget Concepts.

If certificates of beneficial interest sold by Eximbank in fiscal years 1969 and 1970 were treated as borrowing or financing, the deficit impact of Eximbank's activities on the Federal budget would have been increased, as follows:

	Fiscal year 1969	Fiscal year 1970
	(millions)	
Deficit(-) treating certificates of beneficial interest as sales of assets and offsets to expenditures	$246.3	$219.1
Addition to deficit if certificates of beneficial interest were accounted for as borrowings rather than offsets to expenditures	300.0	400.0
Total	$546.3	$619.1

Similarly, if certificates of beneficial interest were treated as borrowing or financing transactions on Eximbank's financial statements, as we believe to be proper, Eximbank's reported assets and liabilities as of June 30, 1970, would each be increased by about $400 million. Except for the method used by Eximbank to report certificates of beneficial interest, Eximbank's June 30, 1970, financial statements present its financial position fairly. (See ch. 6, "Opinion on Financial Statements," p. 53.)

Debentures and short-term discount notes

Eximbank's ability to raise money in private capital markets through issuance of its own debt obligations has been used as a safety valve for pressures on the statutory debt ceiling; if Eximbank borrows directly from the private market, Eximbank's related obligations are not counted against the debt ceiling. Since the debt ceiling is considered a chronic problem, the Treasury in previous years has sought to keep Eximbank's Treasury borrowing to a minimum and to have Eximbank as self-financing as possible. As a result of this policy, Eximbank, during the latter part of fiscal year 1968 and most of fiscal year 1969, issued substantial amounts of short-term discount notes and in October 1968 sold $400 million of 4-1/2-year debentures. The interest rates on these Eximbank securities have generally been about 1/2 of 1 percent above the Treasury borrowing rate.

INCREASED COST OF PRIVATE FINANCING OVER COST OF TREASURY SECURITIES

Financing in the private market for Federal budget purposes through the issuance of participation certificates and certificates of beneficial interest costs Eximbank a minimum of 1/2 of 1 percent, and sometimes as much as 1-1/2 percent, above comparable Treasury borrowing rates. Eximbank's debentures and short-term discount notes issued to relieve pressures on the statutory debt ceiling cost at least 1/2 of 1 percent more than comparable Treasury borrowing.

Using rates provided to us by the Treasury Department, we estimate that, since fiscal year 1962, the additional interest cost and the amortized portion of commissions paid on these securities through June 30, 1970, amounted to $43.2 million and that additional costs of $29.6 million will be incurred over the remaining life of Eximbank's own securities.

Fiscal year	Participation certificates	Certificates of beneficial interest	Short-term notes	Debentures	Total
1962-67	$12,678,034	$ -	$ -	$ -	$12,678,034
1968	7,401,033	-	689,253	-	8,090,286
1969	8,865,691	144,202	1,873,618	1,244,444	12,127,955
1970	8,089,084	319,062	2,655	1,866,667	10,277,468
Total as of FY 1970	37,033,842	463,264	2,565,526	3,111,111	43,173,743
1971 to maturity	23,458,112	866,495	-	5,288,889	29,613,496
	$60,491,954	$1,329,759	$2,565,526	$8,400,000	$72,787,239

Our determination of the additional costs incurred and to be incurred are based on estimates of the interest rates that the Treasury would have paid if the Treasury had issued securities at the same time and having the same maturities as those of Eximbank. These estimates are based on market yields supplied by Treasury officials on existing securities and include approximately 1/8 of 1 percent as an estimate of the additive that would have been required to bring new buyers into the market to purchase these securities.

In addition to easing the effect that Eximbank's operations have on the Federal budget and the statutory debt limit, reasons also advanced for the sale by Eximbank of its own securities are:

--Issues sold to foreign governments and public issues sold to foreign investors have been made to assist in the U.S. balance-of-payments problems. These benefits would be limited to the short run since repayments would operate in the opposite direction.

--Participation certificates have been sold to encourage private participation in specific programs. The Attorney General has ruled, however, that the agency's guarantee of participation certificates brings into being a general obligation of the United States backed by its full faith and credit. Thus, the distinction between financing through private participation in these programs and financing through the Treasury appears to be diminished.

Conclusion

We believe that Eximbank finances its operations in the private market rather than through the Treasury because it believes private financing has benefits in computing the overall Federal budget surplus or deficit and relieving pressures on the statutory debt limit. As discussed above we believe that these benefits are questionable.

Certificates of beneficial interest, although considered by the Office of Management and Budget as sales of assets, are substantially the same as participation certificates which are now treated as financing or borrowing transactions in the Federal budget on the basis of the recommendation of President's Commission on Budget Concepts. In addition, securities issued by Eximbank are backed by the full faith and credit of the U.S. Government as are securities issued by the Treasury. The President's Commission on Budget Concepts believes that the concept of the Federal debt should be expanded to include securities issued directly by Eximbank.

In view of the foregoing facts and the substantially increased costs incurred or to be incurred by Eximbank--$72.8 million--in financing its operations in the private market rather than through Treasury borrowing, we pointed out--in a draft of this report furnished to responsible officials of the Office of Management and Budget, the Treasury, and Eximbank in December 1970--that we believed that they should take the steps necessary to increase Eximbank's borrowings from the Treasury in order to avoid the increased costs of borrowing in the private market.

GAO analysis of agency comments

Although we submitted a draft of the above segment of this report to all three agencies concerned--Treasury, Eximbank, and the Office of Management and Budget--for comment in December 1970, we received replies from only Treasury and Eximbank. We again requested the Office of Management and Budget's comments on February 19, 1971. No comments have been received, so this report is being issued without their comments.

Eximbank did not comment directly on our recommendation that Eximbank's borrowing from the Treasury be increased to avoid the additional cost of borrowing in the private market but pointed out that use of participation certificates and certificates of beneficial interest were consistent with Government policy. Eximbank did agree that the use of these methods of financing did increase these cost of operations by $72.8 million.

Treasury, in its comments, stated that, although it was difficult to fault GAO's recommendation on the grounds of budgetary analysis, they believed that (1) treating certificates of beneficial interest as borrowings and accounting for securities issued by Eximbank on its own behalf against the statutory debt limit would have serious restrictive effects on Eximbank's operations, (2) should certificates of beneficial interest no longer serve to offset expenditures in the Federal budget, the resulting slack would have to be taken up by decreased Eximbank authorizations, a larger budget deficit, or both, and (3) the balance-of-payments impact of the sales of certificates of beneficial interest to foreigners would be lost. Treasury stated also that they believed that the disagreement between the Office of Management and Budget and GAO concerning the method of accounting for sales of certificates of beneficial interest in the Federal budget should become far less significant if Eximbank were exempted from the budget.

In our opinion, restrictions on Eximbank's activities because of Federal budget or statutory debt considerations would result only after a judgment had been made at the highest levels of Government that Eximbank's export activities were not of sufficient priority to justify support at the reduced levels of Government expenditures required by budgetary or statutory debt limit considerations. With respect to balance-of-payments benefits resulting from sales of certificates of beneficial interest to foreigners, it should be noted that for the most part these benefits are limited to the short run since repayments, repurchases due to "put" provisions, and the cost of such sales will, in fact, have a negative impact on the U.S. balance-of-payment position.

Furthermore, we do not believe that exempting Eximbank's operations from the restrictions of the Federal budget will eliminate the problem. As shown above, financing in the private market outside the Treasury has cost Eximbank $43.2 million in additional financing costs since fiscal year 1962 and additional costs of $29.6 million will be incurred over the remaining life of Eximbank's own securities. In our opinion elimination of Eximbank from the Federal budget would result in an increase in Eximbank's financing its operations outside the Treasury, at substantially increased costs.

Moreover, to exclude the receipts and disbursements of Eximbank from the totals of the Federal budget would constitute the first departure from the unified budget adopted as the result of the work of the Commission on Budget Concepts. It should be noted that approval of bills in the Congress to eliminate Eximbank's operations from the Federal budget may well set a precedent for eliminating other agencies' lending activities from the Federal budget.

In its deliberations concerning whether to exclude lending programs from the Federal budget, the Commission on Budget Concepts considered the following arguments set forth in a staff paper presented to the Commission.

"<u>The case for excluding loans from the budget</u>

"Several reasons have been given at one time or another for treating loans at the very least as something other than ordinary budget expenditures or for excluding them altogether from the calculation of budget surplus or deficit. The reason for excluding loans in the NIA budget [note 1]--that these are not income items in ordinary accounting practice--has already been stated.

"The same conclusion seems to be suggested if we consider the net economic effect if the Federal Government simultaneously makes a loan and finances the loan by borrowing. We will set aside for the moment the case where bonds are sold to the central bank, which is the financial equivalent of printing new money. If the Government borrows by selling bonds, its lending and borrowing of equal amounts very largely wash out in net economic effect, depending somewhat of course on the type of security sold and the type of loan made.

"Much of the Federal Government's borrowing and relending is a form of activity quite different in economic character from the levying of taxes and the purchase of goods and services for public programs. In many cases, the Government is simply acting as a conduit for funds borrowed from areas or capital markets with loanable funds to spare, passing them on to private, State and local government, or foreign parties who are not able to borrow directly themselves. In this sense, the Government is engaging in financial intermediation, like a bank, a savings and loan

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[1]National Income Account.

association, or other financial intermediary. By borrowing and relending, these institutions bring the interests of savers (lenders) and borrowers into balance. When Government lending activity is viewed this way, then it seems logical to treat loans differently from ordinary taxes and expenditures--indeed even exclude them completely--in calculating the budget surplus or deficit."

* * * * *

"<u>The case for including loans in the budget</u>

"Advocates of including loans in the calculation of budget surplus or deficit point out that when the Government makes loans, it is not just acting as a bank or financial intermediary. If financial intermediation were all that were required, the private sector could well take care of balancing the interests of borrowers and lenders in a country with such highly developed capital markets as ours. Clearly something else is involved, specifically a recognition that without Federal intervention, important public objectives would not be accomplished through the ordinary working of the capital markets.

"From this point of view, Federal loan programs represent a redirection of national resources to comply with social priorities. They establish claims on resources and demands for current output of the economy that are very hard to distinguish from the demands and claims that arise from Federal expenditures for grants, transfer payments, or subsidies--transactions which are clearly included in anyone's measure of Government 'expenditures.' 'Soft' loans by the Agency for International Development to developing countries repayable in local currency, and nonrecourse loans to farmers made by the Commodity Credit Corporation (CCC) for which there is no legal obligation to repay if the farmer prefers to forfeit his collateral, are only extreme examples of so-called 'loans' which are particularly hard to distinguish from ordinary Government expenditures. In any event, the burden on the Treasury to finance loans through taxes or borrowing is not less than--or different from--the burden associated with financing any other Government expenditures."

* * * * *

"To some, the pressures to minimize budget expenditures and the budget deficit provide an argument for excluding loans so that the choice between direct and indirect loans can be made solely on their respective merits. But if loans were excluded from the budget, these same pressures might well lead to an even worse distortion of program choices. The misnaming of grants, transfer payments, and subsidies--to get them out of the budget totals--might be greatly stepped up."

The sum and substance of the staff paper was the argument that loans made by the Government would not be made if adequate credit resources were available on the same terms in the private sector. Accordingly, the budget itself should provide for any redirection of economic resources through governmental action. The effect of any such programs should be reported on a net basis, not on a gross basis, and should be included in the calculations of budget surplus or deficit.

In concluding that lending operations should be included in the Federal budget totals, the Commission stated:

"In line with the Commission's conviction that a unified budget system is essential, and that a comprehensive definition of the budget is very important, the inclusion of net lending as well as other expenditures in the budget has particular significance. With both in the budget, there should be no pressure by special interest or program partisans to redesign other expenditure programs to give them the appearance of direct loans in order to get them out of the budget."

Matter for consideration of the Congress

In view of the substantial additional costs incurred--$43.2 million since fiscal year 1962--and the additional costs of $29.6 million which will be incurred over the remaining life of Eximbank's own securities because Eximbank has financed its operations in the private market to avoid restrictions on its activities because of Federal budget and statutory debt limit considerations, the Congress may wish to consider whether to require Eximbank to obtain its funds from the least costly source. Normally, the source will be the Treasury; however, there may be some instances in which Eximbank may be able to borrow funds in the private market at less cost than from the Treasury. We therefore believe that Eximbank should retain the latitude to borrow in the private market only when it can do so at less cost than through the Treasury.

CONCESSIONARY INTEREST RATES ON BORROWINGS FROM THE TREASURY

Eximbank has received concessionary interest rates on a significant part of its borrowings from the Treasury and thereby has substantially increased its reported net income and retained earnings over what would have been reported had the borrowings been made at regular Treasury rates. The special borrowing arrangements with the Treasury were made at Eximbank's request and have been in effect periodically since Eximbank was organized in its present corporate structure, in 1945.

A review of Eximbank's financial records on its borrowings from the Treasury showed that the savings realized by Eximbank as the result of the concessionary interest rates amounted to about $16.8 and $6.9 million in fiscal years 1970 and 1969, respectively. These savings had the following effect on Eximbank's net income.

	Reported net income	Savings due to concessionary rate	Net income without concessionary rate	Percentage of difference
	(millions)			
FY 1970	$110	$16.8	$93.2	15.3
FY 1969	104	6.9	97.1	6.6

As shown in the schedule, Eximbank would have reported a decrease in net income for fiscal year 1970 instead of the reported increase if borrowings from the Treasury had been made at regular rates.

Eximbank officials have advised us that the reason for the special interest rates is that the savings in interest expense serve to compensate Eximbank for actions taken in furtherance of overall Government policy, including the selling of participation certificates for budgetary purposes and the granting of low-interest-rate loans negotiated by the Department of Defense with foreign governments to finance sales of U.S. military equipment. Without a concessionary rate from the Treasury, these actions would have resulted in net charges against Eximbank's regular operations.

The Export-Import Bank Act of 1945, as amended, authorizes Eximbank to borrow from the Treasury up to $6 billion outstanding at any one time. The act provides, in part, that:

> "Each such obligation shall bear interest at a rate determined by the Secretary of the Treasury, taking into consideration the current average rate on outstanding marketable obligations of the United States as of the last day of the month preceding the issuance of the obligation of the Bank."

Eximbank has utilized its borrowing authority from the Treasury as one of its principal means of financing its operations. Most of its borrowings have been made at rates determined by the Treasury in accordance with the suggested formula outlined in the act of 1945. However, substantial sums have been borrowed at concessionary rates, generally to compensate Eximbank for certain programs or loans undertaken by it in the interest of national policy, which otherwise would have had an adverse effect on Eximbank's operating results.

At June 30, 1970, Eximbank's borrowings with the Treasury were:

		(millions)
Loans made at regular Treasury rates		$1,005.5
" " at concessionary rates:		
Discount program support loans	$ 74.9	
Special loan A	44.0	
" " B	451.0	
" " C	11.0	
Total concessionary loans outstanding		580.9
Total loans outstanding		$1,586.4

Each type of concessionary-rate loan is discussed in detail below.

Discount program support loans--These loans were made in connection with Eximbank's discount loan program, which involved the granting of loans to commercial banks on the basis of their holdings of export debt obligations. In April 1968 Eximbank made several revisions to the program in order to encourage additional activity on the part of commercial banks. One revision involved a decrease in the interest rate charged commercial banks for net increase loans, one of the two types of loans available under the program. The concessionary rates granted to Eximbank by the Treasury on loans to finance this program were arranged to offset the decrease in interest rates charged by Eximbank. The arrangement permits the Treasury to provide financing to Eximbank at the same rate that Eximbank is charging the commercial banks. It also permits each loan from the Treasury to be tied directly to specific discount loans made by Eximbank.

At June 30, 1970, Eximbank's borrowings outstanding with Treasury for this program amounted to $74.9 million. Treasury rates on loans to Eximbank during fiscal year 1970 in support of the discount loan program ranged from 5-1/8 to 6 percent, while Treasury's regular rates for this period ranged from 5-3/8 to 6-3/4 percent. The interest-rate concession on these loans ranged from 1/8 to 1-1/2 percent, resulting in an interest savings to Eximbank of approximately $714,000 in fiscal year 1970. In fiscal year 1969 the interest savings amounted to $203,000. These amounts were computed by comparing Treasury's regular rate of interest with the rate charged Eximbank at the time the funds were disbursed.

It should be noted that the concessionary-rate arrangement in this case was made to offset a decrease in interest income resulting from a decision by Eximbank to revise one of its programs. This decision was made by Eximbank to improve one of its programs rather than to carry out overall Government policy.

In July 1969 Eximbank made further revisions to its discount loan program. It no longer uses concessionary-interest loans from the Treasury to make new loans under the program. As of June 30, 1970, however, borrowings still outstanding with the Treasury with concessionary-interest rates resulting from discount loan operations during the period April 1968 to June 1969 amounted to $74.9 million.

Special loans A and B--These two loans were negotiated with the Treasury in July 1964. They differ from the concessionary-rate loans granted by Treasury to support the discount program, in that Eximbank may draw down and repay repeatedly at the original rate of interest. Also, although the notes given to Treasury for these loans carry maturity dates, the understanding with Treasury permits Eximbank to renew these loans at maturity, at the same rate of interest. The understanding also provides that, should Eximbank repay these loans earlier than scheduled, it may at any later time borrow from the Treasury at the same interest rates in amounts up to the original maximum amounts. In effect, these loans are a maximum line of credit at fixed interest rates--3 percent on amounts up to $451 million and 3-1/8 percent on an additional $44 million--which is available to Eximbank indefinitely.

The available records on the negotiations leading up to these loans are not entirely clear. It appears, however, that the loans were meant to compensate Eximbank for actions taken by it in carrying out national policy, which adversely affected Eximbank's operating results, such as the selling of participation certificates and the granting of low-interest loans to foreign governments to finance purchases of military equipment in the United States.

Participation certificates in Eximbank's loan portfolio were sold starting in 1962. In negotiating the concessionary-rate loans with the Treasury, Eximbank stated that the sales of participation certificates were carried out at the direction of the Bureau of the Budget for budgetary purposes and that the sales had an adverse effect on Eximbank's net income. Eximbank pointed out that the end result of the sales was that Eximbank was raising cash in excess of its needs at a cost of 5- to 5-1/2-percent interest and using the proceeds to prematurely retire Treasury loans made several years earlier which carried interest rates of 3 and 3-1/2 percent. In the case of the military sales loans, Eximbank was directed to grant loans, negotiated by the Department of Defense, at low-interest rates. Without the concessionary rate granted by the Treasury, Eximbank would have incurred a net loss in making these loans.

At the time this concessionary-rate agreement was negotiated with the Treasury in July 1964, the Treasury's regular rate on borrowings was approximately 4-1/4 percent, thus Eximbank was given a concession of 1-1/4 percent on $451 million and 1-1/8 percent on an additional $44 million. Eximbank's records show that the amounts outstanding under this agreement have fluctuated in line with Eximbank's cash position. At one point in 1967, all Eximbank borrowings from the Treasury, including loans carrying concessionary interest rates, were liquidated as the result of the large influx of cash from heavy sales of participation certificates. Subsequently, when Eximbank again needed cash to finance its operations, new loans were obtained from Treasury at the 3- and 3-1/8-percent rate.

At June 30, 1970, the maximum amounts authorized by the concessionary-rate agreement outstanding were $451 million at 3 percent and $44 million at 3-1/8 percent. The interest savings realized by Eximbank under this agreement amounted to $15,644,625 in fiscal year 1970 and $6,352,148 in fiscal year 1969. These amounts were computed on the basis of the difference between the Treasury's regular rate and the concessionary rate at the date of disbursement. This difference ranged from 3 to 3-1/4 percent on disbursements entering into the computation for interest savings realized by Eximbank in fiscal year 1970.

Special loan C--Eximbank's records indicated that this loan was made in relation to lend-lease termination loans extended by Eximbank to several European Countries immediately following World War II. These loans were made by Eximbank at 2-3/8 percent and were originally financed with borrowings from Treasury at a rate of 1 percent. The original loans from Treasury, however, carried shorter maturities than the related lend-lease loans, necessitating the refinancing of outstanding balances with new loans from

Treasury in 1959. The Treasury agreed to refinance maturing loans with Eximbank at an interest rate of 2-3/8 percent, the same rate Eximbank was earning on its loans to the European countries. This rate represented a concession of less than 1 percent from Treasury on the basis of the regular Treasury rate in effect at that time. Outstanding balances on these loans have fluctuated as the result of prepayments by Eximbank and subsequent reborrowing.

For example, in 1967 Eximbank repaid the outstanding balances due the Treasury in full but subsequently borrowed additional amounts at the 2-3/8-percent rate. The agreement with Treasury on these loans provides that the total borrowings by Eximbank outstanding at any one time at 2-3/8 percent cannot exceed the outstanding balance due Eximbank under the 2-3/8-percent lend-lease loans.

At June 30, 1970, Eximbank's outstanding balance with Treasury at 2-3/8 percent amounted to $11 million. The interest savings realized by Eximbank on these loans, using the amount of concession at the date of disbursement, was $435,000 in fiscal year 1970 and $333,000 in fiscal year 1969.

Conclusion

The concessionary-interest-rate arrangements with the Treasury do not result in any real savings to the Government because of the interagency nature of the transaction. As previously discussed, Eximbank has justified its practice of obtaining concessionary interest rates to compensate for financing its operations through the sale of participation certificates and certificates of beneficial interest and for having made certain relatively low-interest-rate loans, all in furtherance of national policy. Since these actions would not have been taken on Eximbank's own initiative, Eximbank does not believe it should be called upon to absorb the net additional costs involved.

Although Eximbank's position does have some merit if such loans were made in the national interest and not in the ordinary course of Eximbank's business, the argument against the practice of adjusting costs through the use of concessionary interest rates appears to be more persuasive from the standpoint of good accounting. This argument, simply stated, is that an accurate measurement of the financial results of an activity can only be obtained if the full costs of carrying out that activity are applied against the revenues generated.

In the case of Eximbank, it must be recognized that, even though Eximbank is a Government corporation with wide discretionary authority, it is at the same time a part of the executive branch. It may therefore be called upon to take certain actions in the interest of overall Government policy that will incidentally have an adverse effect on Eximbank's net income. When such actions are taken by Eximbank, they become part of the operating record and any financial statements purporting to show the overall financial results of Eximbank's operations should reflect the full financial effect of those actions.

We believe that, if Eximbank were charged the current average Treasury borrowing rate on all of its loans from Treasury, a more accurate measurement of the Government's cost of carrying out Eximbank's activities would result. Therefore, in a draft of this report furnished to the Secretary of the Treasury and to the President of Eximbank, we stated that we believed that they should renegotiate the agreement concerning concessionary interest rates charged Eximbank on certain Treasury borrowings so that the interest rates charged would approximate the current average borrowing costs paid by Treasury.

Analysis of agency action and comments

In commenting on our draft report, both Eximbank and Treasury stated that they did not believe that the "cost" of Eximbank's low-yield loans made in the national interest should be borne by Eximbank. The President of Eximbank in his comments dated February 9, 1971, stated that he believed the criteria for reporting such costs should not be dictated by the immediate source of funds but, rather, should be related to the purpose served by the granting of the respective loans. The Assistant Secretary of the Treasury for International Finance in his comments dated February 2, 1971, stated that:

1. "It would seem that when acting for the Government in a role which it [Eximbank] would not be likely to undertake on its own, some sort of concessionary rate is justified, and ***"

2. "It is quite reasonable that the concessionary borrowing lines should not exceed the outstanding amount of underlying low-interest paper, but to eliminate them seems punitive."

Although the President of Eximbank expressed some disagreement with our recommendation he did advise us that:

> "As a result of your draft report and its recommendation in this regard, we have thoroughly researched these so-called 'concessionary' borrowings and the reasons therefor. In summary, we have found that the Bank's low-cost borrowings were originally intended to offset its low-yield loans made in the over-all national interest and that this contra relationship between source and application of particular Bank funds has inadvertently been lost over the years.
>
> "Accordingly, we have proposed to Treasury a new agreement in this regard whereby our low-interest borrowings from Treasury would be tied-in directly to the rate, term, and amount of the outstanding balances of those loans which we have made at concessionary terms in the national interest. Thus, such borrowings from Treasury would be paid-down as Eximbank in turn received payments on its contra loans outstanding (this has not generally been the case heretofore).
>
> "We believe such an agreement would be a fair one and would establish a direct and logical relationship between the Bank's low-interest Treasury borrowings and its concessionary national-interest loans; we are hopeful that such an agreement will be reached in the very near future."

Subsequent to our review, Eximbank officials advised us that Eximbank and Treasury began to implement the borrowing arrangement outlined above; and, as of March 22, 1971, $278.6 million had been borrowed by Eximbank in the manner described above. The effect of this revision will be to eliminate a portion of the concession given to Eximbank because of its low-cost borrowings from the Treasury. In view of the fact, that the low-interest-rate loans made by Eximbank in the national interest yield less than the rate at which the Treasury is able to borrow funds, the Treasury will be absorbing the cost of these national interest loans. This cost will be buried in the interest cost on the national debt.

We believe that the full cost of all Eximbank activities, both those which it incurs in the national interest and in the ordinary course of its business, should be borne by Eximbank and should be reflected on any financial statements purporting to account for all of its operations. In our opinion, moreover, the record is not clear concerning the purpose of the low-interest-rate loans which Eximbank officials claim were made in the national interest. Our examination of the resolutions of Eximbank's Board of Directors showed that the loans, although made for military equipment and services at less than Eximbank's going interest rates, were approved on the basis that they would facilitate U.S. exports and were charged against the authority provided by the Congress to Eximbank to make loans to finance and facilitate the making of U.S. exports.

We continue to believe therefore that, if Eximbank were charged the current average Treasury borrowing rate on all its loans from the Treasury, a more accurate measurement of the Government's cost of carrying out Eximbank's activities, both its normal export activities and those it takes in the national interest, would result.

Recommendations

Therefore, we recommend that the Secretary of Treasury and the President of Eximbank renegotiate the agreement concerning concessionary interest rates charged Eximbank on certain Treasury borrowing so that the interest rates charged will approximate the current average borrowing costs paid by Treasury.

Moreover, so that the Congress may be fully informed of all of Eximbank's activities, we recommend that Eximbank fully document and describe in its annual reports to the Congress any activities it performs in the national interest that it would not perform in the ordinary course of its business. We also believe that Eximbank's annual financial statements would be more informative if the financial results of such activities were disclosed separately on Eximbank's annual financial statements.

CHAPTER 3

LOAN OPERATIONS

LOAN AUTHORIZATIONS

During fiscal year 1970, Eximbank authorized new loans totaling $2,093.6 million, net of cancellations and participations in current authorizations, which were classified by Eximbank as follows:

Type of credit	Number of authorizations	Amount (millions)
Long-term capital loans	150	$1,514.1
Commodity loans (note a)	1	75.0
Discount loans	765	504.5
Total	916	$2,093.6

[a]A 1-year credit made annually to support the export of U.S. cotton to Japan.

Long-term capital loans are dollar credits extended directly to borrowers outside the United States, generally on repayment terms of 5 years or longer (average 6-1/2 to 8-1/2 years) for purchases of U.S. goods and services. The current interest rate charged on direct loans is 6 percent per annum, and repayment is normally made in semiannual installments beginning 6 months after delivery of purchases or completion of the project financed.

In February 1970 Eximbank adopted a policy with respect to loans to developed countries for military equipment and services of charging interest rates equivalent to the rate charged Eximbank on its borrowing from the Treasury. During fiscal year 1970 this rate ranged from 6-5/8 percent to 7-7/8 percent. Eximbank also charges the borrower a commitment fee equal to 1/2 of 1 percent per annum on the undisbursed balance of the loan.

The principal items being financed with the $1,514.1 million of long-term capital loans authorized in fiscal year

1970 are jet aircraft, $588.3 million or 39 percent of authorizations; atomic and thermal electric power projects, $311.6 million or 20 percent of authorizations; and defense articles and services, $286.4 million or 19 percent of authorizations.

With respect to loans for defense articles and services, the Foreign Military Sales Act of 1968 (22 U.S.C. 2751-2772) prohibits Eximbank from extending loans in connection with sales of defense articles and services to any economically less developed country. Three countries, Australia, Italy, and Spain, which received loans for defense articles and services from Eximbank during fiscal year 1970 are considered developed countries.

To ensure that Eximbank's financial resources supplement, rather than compete with, private sources of export financing and that Eximbank's resources are extended to the largest possible number of projects, Eximbank has adopted a policy of seeking, at all times, private financial participation in any transaction requiring Eximbank direct lending.

This policy, termed participation financing, is the combining of Eximbank's direct lending with loans provided by private sources of funds. It is the "blending" of Eximbank's direct loans provided at the current interest rate of 6 percent per annum with the privately supplied funds at the commercial rate of interest. This policy moderates the effective rate the borrower must pay to finance the transaction and is usually competitive with the rate of interest offered by non-U.S. suppliers on comparable sales.

Under its other major lending program, the discount loan program, Eximbank will lend to U.S. commercial banks and Edge Act corporations[1] up to 100 percent on their eligible export debt obligations. Debt obligations which are not eligible include (1) exports of military articles or services, (2) transactions fully guaranteed outside of Eximbank's

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[1]Corporations organized for the purpose of engaging in international or foreign financing or banking activities under the Edge Act (12 U.S.C. 611).

medium-term guarantee and insurance programs,[1] (3) transactions negotiated in cooperation with Eximbank and with respect to which Eximbank has either made a loan or given a financial guarantee on a loan made by a commercial bank, and (4) exports to, or for use in, any nation which engages in armed conflict with the U.S. or which furnishes items to such a nation.

The interest rate charged on discount loans is 1/2 of 1 percent less than the yield to the commercial banks when the underlying debt obligations are guaranteed or insured by Eximbank under the medium-term guarantee or insurance programs and 1 percent less than the yield to the commercial banks when they are not guaranteed or insured. In no event, however, will Eximbank's rate be less than 6 percent per annum.

The discount loan program was initiated in September 1966 to assist commercial banks to increase their financing of the export of U.S. products and services. The program is designed to provide credit for exports during periods of tight money. On July 1, 1969, Eximbank revised the terms of the program substantially in order to alleviate the shortage of funds which were constraining commercial bank financing of exports sold on medium terms. As a result, in fiscal year 1970, net new discount loan authorizations amounted to $504.5 million, or 24 percent of the total net new loan authorizations; a considerable increase from the net discount loans of $58.4 million authorized in fiscal year 1969.

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[1]See ch. 4 of this report for descriptions of these programs.

RESULTS OF LOAN OPERATIONS

Following are the results of loan operations (excluding discount loans) during fiscal years 1970 and 1969.

	1970	1969
	(000 omitted)	
Interest and fee income	$300,590	$266,948
Other income	7	177
Total	300,597	267,125
Less:		
Interest expense	189,324	162,148
Administrative expenses	3,922	3,016
Other expenses and losses	200	101
Total	193,446	165,265
Net gain	$107,151	$101,860

The net results for the discount loan operations for fiscal years 1970 and 1969 were as follows:

	1970	1969
	(000 omitted)	
Interest income	$16,532	$11,303
Less:		
Interest expense	14,118	10,403
Administrative expense	30	6
Total	14,148	10,409
Net gain	$ 2,384	$ 894

NEW TYPES OF LOANS

During fiscal year 1970 Eximbank developed two new types of loan programs designed to assist U.S. export markets;

namely the Relending Program and the Cooperative Financing Facility.

Relending loans

Under Eximbank's relending program, direct loans are made to foreign lending institutions for the purpose of relending to small and medium-size establishments desiring to purchase U.S. products but lacking the experience or financial strength to deal directly with Eximbank. Eximbank has made this type of loan for several years; however, in August 1969 the relending program was restructured, so that, the primary thrust was that of export promotion. Under the program, Eximbank makes export financing available to small buyers and attempts to enhance the competitive position of U.S. exports in foreign markets. In restructuring the program, Eximbank also extended the definition of eligible borrowers to include foreign branches of U.S. financial institutions and both U.S. and foreign trading companies.

During fiscal year 1970 Eximbank authorized 24 relending loans amounting to $76.1 million in favor of foreign financial institutions in eleven countries. These loans ranged from $500,000 to $6,000,000.

In July 1970 Eximbank further revised the Relending Program by (1) standardizing the interest rates charged on subloans, (2) authorizing credits in multiples of $1 million, and (3) charging the relending institution a commitment fee of 1/2 of 1 percent per annum on the undisbursed balance of the loan.

On the basis of limited experience and the amount of interest shown by foreign financial institutions in many parts of the world, Eximbank believes that this program will assist in increasing U.S. exports.

Cooperative Financing Facility

In April 1970 Eximbank established the non-U.S. Bank Joint Financing Program, now called the Cooperative Financing Facility, to enable selected foreign financial institutions and overseas affiliates and branches of U.S. banking institutions to assist foreign buyers in financing up to 90 percent of the cost of purchasing U.S. goods and services for export. This program is similar to Eximbank's relending program in that a line of credit is extended to financial institutions to enable them to finance the purchase and exportation of U.S. goods and services by foreign buyers. However, the Cooperative Financing Facility differs from the Relending Program in that Eximbank finances only 50 percent of the transaction and the cooperating financial institution finances the remaining 50 percent; whereas, under the Relending Program, Eximbank makes a loan for the full amount of the transaction financed.

Under the Cooperative Financing Facility, Eximbank enters into an agreement to make specific amounts of funds available to the cooperating financial institutions for specific periods of time for joint financing of purchases of U.S. goods and services. The cooperating financial institution or Eximbank may suggest that a particular purchase transaction be considered under their agreement but both must approve the subloan. These agreements require Eximbank to provide its share under one of the three following alternatives.

Alternative A--Eximbank and the cooperating financial institution each extend a loan for 50 percent of the financed portion of each transaction directly to the buyer. Each assumes both political and commercial risks on its portion; however, the cooperating financial institution may obtain a financial guarantee from Eximbank covering its risks.

Alternative B--Eximbank extends a loan, equivalent to 50 percent of the financed portion of each transaction, to the cooperating financial institution, which extends a loan for 100 percent of the financed portion to the buyer and assumes both political and commercial risks[1] on the entire loan. The interest rate charged by the cooperating financial institution on the portion covered by Eximbank's loan may not exceed Eximbank's interest rate by more than 2-1/2 percent.

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[1]See p. 38 of this report for a description of these risks.

Alternative C-- This option is the same as alternative B except that Eximbank will extend a financial guarantee to cover the borrowing from another financial institution to make up the remaining 50 percent of a loan not advanced by Eximbank.

During the period June to November 1970, Eximbank established under this facility lines of credit totaling $134 million to six cooperating institutions. Two major recipients were the Bank of America and the First National City Bank of New York which received $50 million and $60 million, respectively. These U.S. institutions qualify for the program as they have overseas affiliates or branches in several countries which can make use of the lines of credit.

CHAPTER 4

GUARANTEE AND INSURANCE OPERATIONS

Section 2(c) of the Export-Import Bank Act of 1945, as amended, authorizes Eximbank to guarantee, insure, coinsure, and reinsure U.S. exporters and foreign exporters doing business in the United States against commercial-credit and political risks of loss due to nonpayment arising in connection with U.S. exports. Commercial-credit risks include the insolvency of a buyer and the protracted default of payment by a buyer. Political risks include the actions taken by a foreign government--such as currency convertibility restrictions, export and import restrictions, war, revolution, civil commotion, and expropriation--which prevent consummation of payment for a sale.

Eximbank does not insure nor guarantee the full amount or contract price of items exported; its liability as to principal is determined after deduction of the required cash down payments and the percentage of the financed portion not underwritten and is based on the instructions established for the various risk markets. For purposes of assessing premium fees and establishing guidelines for its guarantee and insurance programs, Eximbank classifies foreign markets into four groups or risk markets--A through D. Countries are graded according to their degree of economic and political stability, the A market being composed of the lowest risk countries and the D market the highest.

Although U.S. exporters are protected against the same types of commercial and political risks under the Eximbank insurance and guarantee programs, the approach under each of the two systems is different. In the case of insurance, it is the exporter who seeks the insurance from the Foreign Credit Insurance Association (FCIA) and follows through with the necessary paper work. If he desires financing, he assigns the proceeds of the insurance policy to his bank. In the case of a guarantee, the commercial bank seeks the guarantee, from Eximbank for a credit it is willing to extend to an exporter. The commercial bank before submitting an application to Eximbank must make a judgment as to the soundness of the transaction and must do the necessary paper work.

The principal distinction between the general nature of Eximbank's guarantee and insurance programs involves the beneficiaries participating in the programs. That is, commercial banks are generally the beneficiaries in the guarantee program, whereas exporters are the principal beneficiaries in the insurance program.

GUARANTEE OPERATIONS

Eximbank issues guarantees, generally to commercial banks, to cover the repayments of their medium-term (6 months to 5 years) financing of U.S. export sales. Under the commercial bank exporter guarantee program, Eximbank guarantees the payment of export debt obligations acquired by U.S. banking institutions, without recourse, from U.S. exporters. Eximbank's financial guarantee program guarantees the repayment of direct loans made by financial institutions to foreign purchasers of U.S. goods and services. In certain instances Eximbank also extends its guarantees directly to exporters of U.S. goods and services.

During fiscal year 1970 Eximbank authorized 902 new guarantees and increases in existing guarantees totaling about $612.5 million. As shown in the following summary, there was a substantial increase in the dollar value of the guarantees authorized during fiscal year 1970.

Fiscal year	Total amount of guarantees authorized	Amount by type of guarantees: Financial	Commercial Bank exporter	Exporter
	(millions)			
1966	$300.1	$ 94.2	$203.8	$ 2.2
1967	193.0	23.4	168.1	1.5
1968	290.0	59.2	229.9	.9
1969	396.9	112.3	277.5	7.1
1970	612.5	335.5	265.1	11.9

The substantial increase in the dollar amount of guarantees authorized during fiscal year 1970 resulted from increased emphasis by Eximbank of its policy of seeking private financial participation in transactions requiring direct lending. Under this method of financing U.S. exports, which is called participation financing, Eximbank makes a direct loan at its current rate of interest of 6 percent per annum for a portion of the financing required and guarantees the repayment of credit extended by private lenders at the commercial rate of interest for the remaining portion of the financing under the financial guarantee program. Forty-five of the 52 financial guarantees authorized by Eximbank during fiscal year 1970 were issued in combination with Eximbank direct loans. Prior to fiscal year 1970, only a limited number of financial guarantees were authorized in this manner.

Authorizations under the financial guarantee program also increased due to expansion of the program beginning in August 1969 to cover loans made by foreign financial institutions for the purchase and exportation of U.S. goods and services. During fiscal year 1970 nine guarantees were issued to foreign financial institutions covering loans totaling over $70 million. With such a guarantee, a foreign financial institution may loan funds for exports with the assurance, that Eximbank will absorb related losses, wholly or in part, if such a loan is not repaid in accordance with the respective loan agreement.

Foreign financial institutions currently eligible to participate in Eximbank's guarantee program include, but are not limited to, overseas offices of U.S. trading companies, foreign branches of U.S. commercial banks and investment banks, foreign trading companies, public or private foreign commercial investment and development banks.

As a general rule, a financial guarantee will not be extended to a foreign financial institution whenever private U.S. sources of funds are willing and able to finance the transaction on reasonable terms.

In addition to extending its guarantee program to foreign financial institutions, Eximbank, during fiscal year 1970, also expanded its guarantee program to include

1. political-risk guarantee coverage on U.S. equipment used by U.S. contractors in their performance on contracts abroad,

2. financial guarantee coverage to non-U.S. financial institutions which provide local-cost[1] financing necessary to support sales abroad of U.S. goods and services, and

3. financial guarantees of loans extended by either U.S. or non-U.S. commercial banks for engineering planning and feasibility studies performed by U.S. firms.

For fiscal year 1970 Eximbank records show a net gain from guarantee operations of $1,351,000 compared with a net gain of $1,544,000 for fiscal year 1969, a decrease of $193,000.

	1970	1969
Guarantee fees	$2,306,000	$2,181,000
Claims recovered	157,000	416,000
	2,463,000	2,597,000
Less:		
Administrative expenses	992,000	847,000
Nonadministrative expenses	3,000	1,000
Claims paid (cash basis)	117,000	205,000
Total	1,112,000	1,053,000
Net gain	$1,351,000	$1,544,000

Accumulated net income from the inception of the program to June 30, 1970, totaled $10,252,598. In view of the fact that claims are accounted for on a cash basis, this amount does not give consideration to any provision for

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[1]Local costs are those expenses incurred by the buyer of U.S. goods and services for the purchase, in his own country, of goods and services associated with the transaction. They may include expenses for engineering services; public utility connections; locally available construction materials, labor, equipment installation; employee housing; and similar items of host-country origin.

estimated future losses resulting from program activity through fiscal year 1970.

INSURANCE OPERATIONS

Eximbank, under an agreement with FCIA, currently composed of about 50 private casualty, property, and marine insurance companies, provides comprehensive export insurance and political-risk-only insurance to U.S. exporters. Comprehensive insurance policies cover both commercial-credit and political risks. Policies are further classified between short-term transactions (up to 180 days) and medium-term transactions (181 days to 7 years).

Contract with FCIA

The agreement between FCIA and Eximbank is designed to allocate income and expenses of the program in such manner as to provide FCIA with a limited profit for its services. At any time mutually agreed upon, FCIA and Eximbank can reallocate between themselves such income and expenses to meet this objective. Several such changes have been made since the original agreement was signed in 1961 that were specifically designed to assist FCIA in operating on a profitable basis. At the present time, FCIA receives 80 percent of comprehensive premium income, net of commissions, and assumes 55 percent of the related expenses while Eximbank receives 20 percent of the income and assumes 45 percent of the expenses. There is a profit limitation provision in the agreement, however, which stipulates that, if the underwriting result at the association level is a cumulative net profit after taxes, Eximbank and FCIA shall share this profit equally. Eximbank also receives net premium income from political-risk-only policies not underwritten by FCIA.

The joint Eximbank-FCIA insurance program generates investment income in addition to premium income. This income is earned primarily from investing cash reserves for future insurance losses in certificates of deposit and short-term commercial notes. The Eximbank-FCIA agreement provides that investment income be allocated on the basis of the proportion of the funds that each has outstanding as reserves for future losses.

The agreement between Eximbank and FCIA provides that, for short-term insurance transactions, member companies of FCIA assume the commercial-risk losses of the first $150,000 for any one buyer and that losses in excess of that amount be borne by Eximbank. For medium-term or combined short-term and medium-term policies, FCIA is permitted to select the amount of commercial-credit risk it wishes to assume and Eximbank assumes the balance. Any resulting losses on such policies are borne by Eximbank and FCIA in proportion to the risks each has assumed. Eximbank assumes all the political risk of loss insured against in both the comprehensive and political-risk-only policies.

NEW TYPES OF POLICIES

During fiscal year 1970 Eximbank made a market survey and an analysis of the types of export insurance being offered. On the basis of the results of this survey, Eximbank introduced several new types of export insurance which it believed were responsive to the needs of U.S. exporters and export financing institutions.

1. Small business policy--A policy, covering a 2-year period, provides comprehensive coverage of political and commercial risks for all or any desired portion of short- and medium-term sales of newcomers in the export business or those who have modest sales. This coverage is intended for companies whose annual export sales do not exceed $200,000. The cost of these policies is minimal.

2. Catastrophe policy--This policy covers political and commercial risks in various percentages of effectiveness for all of an exporter's transactions made on credit terms up to 5 years. It is designed to protect against the danger of catastrophic experiences that otherwise would inhibit interest and participation in exports. The exporter can obtain political-only coverage on all of its exports and may determine whether he wishes to have commercial-risk coverage on sales to a preselected group of buyers, in excess of an agreed deductible amount.

3. Short-term and medium-term comprehensive policies--This policy provides comprehensive coverage for both commercial and political risks on all or a reasonable spread of an exporter's short- and medium-term credits for periods up to 5 years. The deductible feature referred to above will also be included in this policy.

4. Short-term and medium-term political policies--For exporters who want political-risk coverage only, this policy provides the broadest possible coverage without the inclusion of commercial coverage.

5. Initial-inventory coverage--This coverage allows exporters to extend, to new dealers and distributors abroad, repayment terms of up to one full year for the initial stocking of parts, accessories, and other shelf items.

6. Agricultural policy--In recognition of the fact that exporter margins are usually 2 percent or less in the case of most bulk agricultural commodity shipments, this policy was established to reduce the minimum supplier participation from 5 percent to 2 percent in supplier credit coverage relating to agricultural commodities.

These new types of policies are designed to benefit the exporter by reducing the cost of the protection. The philosophy behind this new approach is to provide protection to the exporter for credit risks in exporting, which are of such magnitude that it should not normally be expected to assume in the course of business. To the extent that financially capable exporters are willing to accept "deductibles" which exceed their expected credit losses, the cost of the insurance can be reduced and the decisionmaking process accelerated.

Results of insurance operations

During fiscal year 1970, FCIA authorized the insurance of new and renewed policies totaling $1,145.7 million. A brief comparative summary of policies issued during fiscal years 1970 and 1969 follows.

	Fiscal year 1970		Fiscal year 1969	
	Number of policies	Amount (millions)	Number of policies	Amount (millions)
Issued and renewed:				
Short-term comprehensive	1,062	$ 733.9	1,059	$604.1
Short-term political	84	66.4	86	62.1
Medium-term comprehensive	1,500	340.3	1,050	147.9
Medium-term political	36	5.1	65	10.2
Total	2,682	$1,145.7	2,260	$824.3

Eximbank records showed that it incurred a loss of $166,000 in the insurance program for the fiscal year ended June 30, 1970. A brief comparative summary of the results of the insurance operations for fiscal years 1970 and 1969 follows.

	1970	1969
Premium income	$717,000	$515,000
Less:		
Administrative expenses	821,000	746,000
Claims and other losses (cash basis)	62,000	38,000
Total	883,000	784,000
Net loss	$166,000	$269,000

Eximbank records also showed that it had sustained cumulative losses since inception of the insurance program totaling $2.5 million.

The net income of FCIA, according to its financial statements, amounted to $62,000 and $318,000 for the years ended June 30, 1969 and 1970, respectively, which provided FCIA with a cumulative gain, since the inception of the program, of $377,000. The following schedule shows the distribution of net gains and losses to FCIA and Eximbank from inception of the program to June 30, 1970.

	Reported gain or loss(–)		
	Total net	FCIA	Eximbank
Cumulative net gain or loss(–) from inception through June 30, 1965	$ –353,000	–$645,000	$ 292,000
Fiscal year 1966	–556,000	–34,000	–522,000
" " 1967	–346,000	380,000	–726,000
" " 1968	–832,000	296,000	–1,128,000
" " 1969	–208,000	62,000	–270,000
" " 1970	–152,000	318,000	–166,000
Cumulative net income or loss(–) through June 30, 1970	–$2,143,000	$377,000	–$2,520,000

In our report to the Congress on the operations of Eximbank for fiscal year 1969 (B-114823; May 19, 1970), we recommended that Eximbank (1) develop a more reasonable basis for allocating the income and expenses of the program between FCIA and Eximbank and (2) establish a level of income for the program, which is commensurate with its cost of operations. In commenting on our report for fiscal year 1969, the President of Eximbank advised us that he agreed in principal with our recommendation.

During fiscal year 1970 Eximbank made efforts to comply with the intent of the recommendation; however, it has not been able as yet to fully implement the recommendation because, to some extent, the purpose of Eximbank's participation with FCIA in the program is to promote U.S. exports and this purpose has priority over the return of a profit to Eximbank. Therefore, we are not repeating our recommendation at this time.

CHAPTER 5

ADDITIONAL FACILITIES DESIGNED TO INCREASE EXPORTS

EXPORT EXPANSION FACILITY

Eximbank's export expansion facility was authorized by the act of July 7, 1968 (82 Stat. 296), which provided a more liberal policy statement by the Congress regarding Eximbank's criteria for loans, guarantees, and insurance than that included in Eximbank's basic enabling legislation. The basic legislation provides that Eximbank make loans which, in the judgment of the Board of Directors, offer "reasonable assurance of repayment." The legislation enacted early in fiscal year 1969 provided that Eximbank devote a part of its resources to the support of export transactions which offer "sufficient likelihood of repayment" to justify Eximbank's support in the interest of foreign trade and long-term commercial interest.

Eximbank must specifically designate the loans, guarantees, and insurance made under this program. In determining the $500 million limitation on the outstanding amount under the program, loans are charged at 100 percent and insurance and guarantees at 25 percent of Eximbank's liability. The legislation provided also that, in the event of any losses under the program, the first $100 million of losses be borne by Eximbank, the second $100 million be borne by the Treasury, and all additional losses be borne by Eximbank.

An Export Expansion Advisory Committee is chaired by the Secretary of Commerce and includes the Secretaries of State and Treasury and the President of the Eximbank. The Committee provides guidance to Eximbank with respect to the operation of the export expansion facility. To expedite actions on relatively small transactions, the Committee has agreed that Eximbank can approve, without prior committee approval, credits, guarantees, and insurance transactions in which the amount of principal liability does not exceed $500,000. However, Eximbank must subsequently report on such transactions to the Committee. Eximbank's liability under the export expansion facility as of June 30, 1970, is summarized below:

Types of financing	Amount outstanding (thousands)
Loans	$117,586.8
Medium-term guarantees	103,538.0
Medium-term insurance	56,609.0
Short-term insurance	43,805.9
Total	$321,539.7

In our report on Eximbank's activities for fiscal year 1969 (B-114823 dated May 19, 1970), we stated that Eximbank had developed guidelines to govern the use of the export expansion facility. These guidelines were approved by Eximbank's Board of Directors and the Export Expansion Advisory Committee in December 1969. The Department of Commerce concurred in these guidelines.

These guidelines essentially provide that Eximbank support those export sales which offer a sufficient likelihood of repayment if the transaction will advance the nation's long-term commercial interest. Such interest may be judged on the basis of one or more of the following conditions.

1. The sale is to a country which has questionable current capacity to service foreign debts but which, in the judgment of Eximbank, offers the potential for improving its debt capacity and therefore current development of markets for U.S. goods and services is justified.

2. The sale is to a buyer for which the current financial standing does not offer reasonable assurance of repayment but which, in the judgment of Eximbank, offers the potential for an improved financial standing leading to continuing sales.

3. The transaction will result in significant follow-on sales (i.e., 100 percent within 5 years) of equipment, spare parts, servicing, raw materials, semimanufactures, or the like, and there is sufficient likelihood of repayment also for the follow-on sales.

4. The transaction will preempt the sale by the foreign competitor which either is "buying in" the market for follow-on sales of spares and the like or is attempting to establish an assured market for its country's raw materials or semimanufactures.

5. The transaction is demonstrably necessary for the U.S. supplier, or the industry, to maintain "presence" in the marketplace.

In applying the guidelines, Eximbank stated that the important consideration in each case is the "leverage" which can be obtained through the transaction and that mere consummation of a sale is not necessarily responsive to the nation's long-term commercial interest; rather, each transaction must be judged on the additional benefits to be derived from its consummation. The factors that disqualify an application under normal Eximbank criteria should be identified, and the basis for judgment that the transaction offers sufficient likelihood of repayment should be established.

Our examination, on a test basis, of the loans, insurance, and guarantees approved by Eximbank under the export expansion facility indicated that, in evaluating the applicants, primary emphasis was placed on determining whether a sufficient likelihood of repayment existed rather than the potential of long-term trade and commercial interest to be gained from the acceptance of higher risk transactions.

For example, a review of 63 of the 128 export expansion medium-term insurance policies in effect at June 30, 1970, showed that only 10 evaluations of applicants made by Eximbank contained a discussion of the potential leverage that could be obtained from the transactions and that seven of those were approved prior to adoption of the new guidelines in December 1969 and three were approved subsequent to adoption of the guidelines.

We did note, however, that five medium-term insurance transactions approved under the facility appeared to have qualified under the condition that the export was needed to preempt the sale by a foreign competitor which either was "buying in" a market or was attempting to establish an assured market for his country's raw materials or semimanufactures. We believe that these types of transactions are more in keeping with the interest and spirit of guidelines established for the export expansion facility.

The majority of insurance policies approved, if categorized by the criteria established by the new guidelines in December 1969, appear to have been made with the understanding that the sales were to buyers whose current financial standings did not offer reasonable assurance of repayment and that Eximbank was assuming that, with an improvement in the buyers' financial standings, continued sales could develop. Eximbank had made no attempt, however, to definitize or project the real long-term benefits to be achieved from accepting higher risk applicants.

With respect to medium-term guarantees, our review showed that a greater percentage of the guarantees included some discussion of the leverage to be gained from the consummation of one particular transaction than was apparent in the medium-term insurance policies approved under the facility. After adoption of the new guidelines, however, we noted a decline in the number of individual transactions which contained some discussion on the potential long-term benefits to be derived from the consummation of the individual transaction.

We noted, for example, that six of 13 medium-term guarantees approved prior to adoption of the new guidelines contained some evidence that the long-term interest of the United States was given some consideration but that only one of the seven medium-term guarantees approved after adoption of the guidelines contained evidence that long-term trade objectives were given primary consideration.

We were informed by Eximbank officials responsible for approving the individual guarantee transactions under the facility that quantative data was not available to measure or project the long-term trade benefits which were hoped to be gained from the consummation of the particular transaction. They stated that, although Eximbank had not identified the long-term trade benefits to be gained, it was felt that the exports generated through the export expansion facility would have been lost had Eximbank's guarantee been denied. Moreover, it was a generally accepted premise that the consummation of these transactions would increase U.S. presence in foreign markets and that, as foreign consumers became more aware of U.S. products, the potential for increased exports would develop.

Conclusion

Although Eximbank has taken the additional risks involved in approving loans, insurance, and guarantees under the facility, we believe that management should increase the effort to provide some measurement of the potential trade growth developing from consummation of the individual transactions. If this additional information was provided, management would be able to develop a more effective program to measure the potential long-term benefits of individual transactions against the higher risk being assumed under the facility.

We recognize that many of the transactions, especially those with small- and medium-scale importers, do not provide a practical opportunity to measure, with any degree of certainty, the potential long-term benefits to be derived from the individual transaction. We believe that, if long-term trade goals of the United States were identified on a geographic and/or industry basis and transactions then approved if they met such goals, the export expansion facility would be more effective.

We wish to emphasize, however, that the facility's flexibility should not be impaired, but we are suggesting only one means by which Eximbank can establish long-range goals and objectives for the facility and can provide a reasonable basis for justifying the acceptance of higher risk transactions.

CHAPTER 6

OPINION OF FINANCIAL STATEMENTS

The accompanying financial statements (schedules 1, 2, and 3) are those contained in Eximbank's annual report to the Congress.

Our examination of the statement of assets and liabilities of Eximbank as of June 30, 1970, the related statement of income and expense and analysis of retained income reserve, and the statement of source and application of funds for the year then ended was made in accordance with generally accepted auditing standards and accordingly included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

The interest and other financial expense reported by Eximbank include interest charges on a significant part of the borrowings from the U.S. Treasury at rates lower than the rate prevailing at the time the funds were borrowed. Had the Treasury charged Eximbank interest rates approximating the full cost of the funds, Eximbank's interest and other financial expense would have been increased by about $16.8 and $6.9 million in fiscal years 1970 and 1969, respectively, and the net income from operations for the years then ended would have been correspondingly reduced. (See pp. 21 to 30.)

We were advised by Eximbank officials that these special borrowing arrangements were made with the Treasury to compensate, in part, for Eximbank's having financed its operations through the sale of participation certificates and certificates of beneficial interest and for Eximbank's having made certain relatively low interest rate loans, all in furtherance of national policy.

The net income reported by Eximbank is stated before any provision for losses that may be sustained on loans receivable and related accrued interest or on guarantees and insurance. All accumulated net income, after dividends, has been reserved as a provision for future contingencies, defaults, or claims. (See note 2 to financial statements.)

The contingent liabilities reported by the Eximbank as loan maturities sold subject to contingent repurchase commitments include participations in specific loans, in support of which Eximbank issued instruments called certificates of beneficial interest. The buyers of these instruments are not free to dispose of them except as permitted by Eximbank, which also assumes fully the risk of default. Accordingly, we believe that such instruments should be considered as borrowing or financing transactions which, if so handled on Eximbank's financial statements, would increase Eximbank's total assets and liabilities by about $400 million as of June 30, 1970.

In our opinion, the accompanying financial statements, subject to our comments in the preceding paragraph, present fairly the financial position of the Export-Import Bank of the United States at June 30, 1970, and the results of its operations and the source and application of its funds for the year then ended, in conformity with generally accepted accounting principles applied on a basis consistent with that of the preceding year and with applicable Federal laws.

FINANCIAL STATEMENTS

COMPARATIVE STATEMENT OF ASSETS AND LIABILITIES

ASSETS

	June 30, 1970		June 30, 1969	
Cash:				
In banks, in transit, and on hand	$ 13,480,868		$ 8,276,329	
With U.S. Treasury	12,931,687		242,349	
		$ 26,412,555		$ 8,518,678
Loans receivable:				
Outstanding loans and undisbursed authorizations	8,690,392,261		7,883,825,630	
Less undisbursed balance of authorized loans	2,976,582,969		2,462,337,827	
Outstanding loans receivable *(Notes 2 and 3)*		5,713,809,292		5,421,487,803
Accrued interest and fees receivable on loans and guarantees		71,186,966		57,017,826
Other assets:				
Due from Foreign Credit Insurance Association	274,740		170,295	
Miscellaneous	1,676,586		143,994	
		1,951,326		314,289
Furniture and equipment, less accummulated depreciation (1970, $405,022; 1969, $382,296)		297,314		275,268
Deferred charges — unamortized balance of financial expense		2,483,347		8,018,995
Total assets		**$5,816,140,800**		**$5,495,632,859**

The Notes to the Financial Statements on pages 61 and 62 are an integral part of this statement. See Note 1 for composition of the U.S. Government's investment in Eximbank.

FISCAL YEARS 1970-1969

LIABILITIES, CAPITAL, AND RESERVE

	June 30, 1970		June 30, 1969	
Liabilities:				
Portfolio Participation Certificates payable *(Note 3)*	$1,492,798,705		$1,813,952,940	
Debentures payable	400,000,000		400,000,000	
Short-term discount notes payable	—		258,145,000	
Notes payable to U.S. Treasury *(Note 1)*	1,586,440,848		720,188,081	
Dividend payable *(Note 1)*	50,000,000		50,000,000	
Guaranteed letters of credit payable	7,092,338		27,722,408	
Accrued interest payable	26,294,462		28,760,279	
Other	2,791,431		6,657,819	
Total liabilities		$3,565,417,784		$3,305,426,527
Deferred Income		5,176,936		5,390,652
Capital and Reserve:				
Capital stock held by U.S. Treasury *(Note 1)*	1,000,000,000		1,000,000,000	
Retained income reserve for contingencies and defaults *(Note 2)*	1,245,546,080		1,184,815,680	
Total capital and reserve		2,245,546,080		2,184,815,680
Total liabilities, capital, and reserve		**$5,816,140,800**		**$5,495,632,859**

COMPARATIVE STATEMENT OF INCOME AND EXPENSE AND ANALYSIS OF RETAINED INCOME RESERVE

	Fiscal year ended	
Income:	**June 30, 1970**	**June 30, 1969**
Interest and fees on loans	$ 317,121,559	$ 278,250,929
Insurance premiums and guarantee fees	3,024,814	2,696,114
Other income, principally interest on U.S. securities	8,408	177,097
Total income	**$ 320,154,781**	**$ 281,124,140**
Expenses and losses:		
Interest and other financial expense	$ 203,441,369	$ 172,551,327
Loans charged off and claims paid — net of recoveries	15,978	(172,173)
Administrative and other expenses	5,967,034	4,716,478
Total expenses and losses	**$ 209,424,381**	**$ 177,095,632**
Net income	**$ 110,730,400**	**$ 104,028,508**
Less: Dividend declared on capital stock *(Note 1)*	50,000,000	50,000,000
Addition to Retained Income Reserve *(Note 2)*	**$ 60,730,400**	**$ 54,028,508**
Analysis of Retained Income Reserve:		
Balance at beginning of fiscal year	$1,184,815,680	$1,130,787,172
Addition to reserve *(Note 2)*	60,730,400	54,028,508
Balance at End of Fiscal Year	**$1,245,546,080**	**$1,184,815,680**

The Notes to the Financial Statements on pages 61 and 62 are an integral part of this statement.

COMPARATIVE STATEMENT OF SOURCE AND APPLICATION OF FUNDS

	Fiscal year ended			
	June 30, 1970		**June 30, 1969**	
FUNDS PROVIDED:				
Net income from operations	$110,730,400		$104,028,508	
Add depreciation expense for the year	45,904		42,216	
Funds provided by operations		$ 110,776,304		$ 104,070,724
Sales of short-term discount notes		—		1,053,055,000
Repayments and other credits to loans receivable		870,586,219		924,354,194
Sale of debentures		—		400,000,000
Sales of individual loan maturities		406,240,453		378,149,573
Borrowings from U.S. Treasury — Net		866,252,766		358,608,820
Other — Net		(55,408,346)		48,599,424
Total Funds Provided		**$2,198,447,396**		**$3,266,837,735**
FUNDS APPLIED:				
Payment of dividend to U.S. Treasury		$ 50,000,000		$ 50,000,000
Disbursements and other additions to loans, including capitalized interest (1970, $5,912,363; 1969, $7,828,068)		1,569,148,161		1,665,347,871
Repayments on Portfolio Participation Certificates		321,154,235		369,114,864
Redemptions of short-term discount notes		258,145,000		1,182,375,000
Total Funds Applied		**$2,198,447,396**		**$3,266,837,735**

The Notes to the Financial Statements on pages 61 and 62 are an integral part of this statement.

NOTES TO THE FINANCIAL STATEMENTS JUNE 30, 1970

Note 1

Eximbank's authority to borrow from the U.S. Treasury is limited to $6 billion outstanding at any one time, and the authority to lend, guarantee, and insure is limited to $13.5 billion. Up to $3.5 billion of outstanding guarantees and insurance may be charged against this lending authority at 25 percent of the contractual liability assumed. At June 30, 1970, the uncommitted authority to lend, guarantee, and insure totaled $3,791.3 million.

The investment of the U.S. Government in Eximbank is comprised of the following:

	June 30, 1970	*June 30, 1969*
Notes payable to U.S. Treasury	$1,586,440,848	$ 720,188,081
Capital stock held by U.S. Treasury	1,000,000,000	1,000,000,000
Dividend payable	50,000,000	50,000,000
Retained income reserve *(Note 2)*	1,245,546,080	1,184,815,680
Total investment	**$3,881,986,928**	**$2,955,003,761**

A dividend of $50 million was declared on June 25, 1970, and paid on July 13, 1970.

Note 2

Loans with delinquent installments of 30 days or over at June 30, 1970, are summarized in millions of dollars as follows:

Country	*Number of loans*	*Oldest past due installment*	*Total outstanding principal*	*Delinquent installments*		
				Principal	*Interest*	*Total*
Cuba	5	1958	$ 36.3	$22.8	$20.3	$43.1
Nigeria	1	1967	1.6	1.2	.3	1.5
Republic of Indonesia	4	1970	36.6	5.2	1.1	6.3
United Arab Republic	2	1966	23.4	19.0	5.3	24.3
Other	8	1966	13.4	.7	.3	1.0
Total	20		$111.3	$48.9	$27.3	$76.2

In addition, by agreement, the Republic of China is not at this time being called upon to make payments on that portion of four loans made to the Republic of China prior to 1947, when the seat of the government was on the mainland, which relates to assets no longer under the government's control. The total outstanding principal of this portion of these loans was $26.4 million at June 30, 1970; on that date $36.8 million ($20.0 million principal plus $16.8 million interest) was matured and outstanding, the oldest past due installment having matured in 1949. The Republic of China is continuing to make timely payments of principal and interest on the balance of the four loans which represents assets still under its control. This portion of the loans, which is not included in the foregoing figures, has an outstanding principal balance of $129 thousand at June 30, 1970.

The entire retained net income is reserved for contingencies and defaults. This amount of $1,245,546,080 substantially exceeds the total outstanding balances of both principal and interest on the foregoing delinquent loans. Because of the unpredictable nature of future economic and political conditions throughout the world, the risk of loss on Eximbank's loans, guarantees, and insurance is not susceptible to accurate measurement. The management of Eximbank believes therefore that its accumulated net earnings should be retained as a reserve for contingencies and defaults.

The contingent liabilities of Eximbank are summarized below in millions of dollars as of June 30, 1970:

Note 3

From May 1, 1962, to June 30, 1968, 19 issues of guaranteed Certificates of Participation in portions of Eximbank's loan portfolio were sold. On June 30, 1970, this designated portion of loans totaled \$2.0 billion. Certificates of Participation outstanding at June 30, 1970, totaled \$1.5 billion.

Loan maturities sold subject to contingent repurchase commitments	$ 415.0
Guarantees	912.3
FCIA insurance	1,250.9
Consignment insurance	.1
Total contingent liabilities	$2,578.3

APPENDIXES

EXPORT-IMPORT BANK OF THE UNITED STATES
WASHINGTON, D.C. 20571
CABLE ADDRESS "EXIMBANK"

PRESIDENT AND CHAIRMAN

February 9, 1971

The Honorable
Elmer B. Staats
Comptroller General of the United States
General Accounting Office
Washington, D.C. 20548

Dear Mr. Staats:

We want to thank you once again for the opportunity to comment on Mr. Stovall's letter of December 14, 1970, and its enclosed draft copy of the GAO report on your audit of Eximbank for fiscal 1970. Certain minor matters which we have noted in your report have been discussed and resolved with members of your staff.

This letter, however, is to reiterate my own thoughts which I expressed to you personally in our recent meeting on those more significant matters raised in your report.

Interest Rate on Certain Eximbank Borrowings from Treasury

To repeat, I strongly disagree with the recommendation that Eximbank's low-interest rate loans from Treasury should be renegotiated to carry, instead, Treasury's "current average borrowing costs".

We cannot agree with your insistence that the "cost" of Eximbank's low-yield, national interest loans be borne by the Bank or shown in its books of account. We believe this cost is more properly borne by Treasury or some other agency of the Executive Branch. The criteria for reporting such costs should not be dictated by the immediate source of funds but, rather, should be related to the purposes served by the granting of the respective loans.

[See GAO note, p. 67.]

Your report implies Eximbank continues to obtain funds for such purposes at low rates, which is not actually the case, although we believe it should be. For example, in April 1970, Eximbank increased its military loan commitment to Australia, at the request of the Department of Defense, by approximately $39 million at 4-3/4% without obtaining any corresponding low-cost funds from Treasury.

I do agree, however, that our present agreement with Treasury in this regard needs to be redefined. Therefore, we are presently in the midst of just such negotiations with Treasury.

As a result of your draft report and its recommendation in this regard, we have thoroughly researched these so-called "concessionary" borrowings and the reasons therefor. In summary, we have found that the Bank's low-cost borrowings were originally intended to offset its low-yield loans made in the over-all national interest and that this contra relationship between source and application of particular Bank funds has inadvertently been lost over the years.

Accordingly, we have proposed to Treasury a new agreement in this regard whereby our low-interest borrowings from Treasury would be tied-in directly to the rate, term, and amount of the outstanding balances of those loans which we have made at concessionary terms in the national interest. Thus, such borrowings from Treasury would be paid-down as Eximbank in turn received payments on its contra loans outstanding (this has not generally been the case heretofore).

We believe such an agreement would be a fair one and would establish a direct and logical relationship between the Bank's low-interest Treasury borrowings and its concessionary national-interest loans; we are hopeful that such an agreement will be reached in the very near future.

"Discount" Loans from Treasury

It is true that, from April 1968 to June 30, 1969, Treasury lent funds to Eximbank at a low rate. These same low rates were passed on by Eximbank to those commercial banks which had increased their export financing over a base period. The point your report fails to make, however, is that Eximbank is no longer borrowing from Treasury at low rates for the Discount Facility and that such preferential interest rate loans to banks were terminated on July 1, 1969, as a result of this Administration's thorough revision of the discount program at that time.

Sale of PC's and CBI's

The discussion on pages 5-9 re Eximbank's issuance of Participation Certificates and the sale of Certificates of Beneficial Interest creates the impression that, when Eximbank issued PC's in FY 1962 - 1968 and treated them as receipts for budget purposes, it was in some way wrong for us to do so and contrary to Government policy. I believe the general consensus during that period, however, was clearly that sales of Participation Certificates should be treated as receipts for the purposes of the Federal Budget. After the President's Commission on Budget Concepts concluded that Participation Certificate issues should be treated as borrowings, Eximbank ceased issuing Participation Certificates and began to show, as we do now, all outstanding PC's as borrowings in our budget schedules.

The point here is that Eximbank has complied and continues to comply fully with the Commission's conclusion. Since that time, we have sold assets in the form of Certificates of Beneficial Interest and have stopped issuing Participation Certificates. The report fails to make this clear.

Further, we continue to believe that our accounting for CBI sales is proper and thus "presents fairly" our financial position and the results of our operations. We believe it is incorrect for GAO to say that Eximbank has "not presented fairly" its financial position (pp. 10 and 14).

[See GAO note below.]

In closing, let me once again express our thanks and appreciation for the fine job done by your staff and for their extra efforts in providing your opinion on our financial statements as quickly as we requested. We truly believe your agency's comments are vital to the successful conduct of Eximbank's operations and we shall continue to heed your valued judgment.

Sincerely yours,

for Henry Kearns

GAO note: Comments pertaining to draft report material not contained in final report have been omitted.

TREASURY DEPARTMENT

WASHINGTON, D.C. 20220

ASSISTANT SECRETARY

FEB 2 1971

Dear Mr. Pahl: Subject: Audit of Export-Import Bank, Fiscal Year 1970

Attached are the Treasury Department's comments on the segment of GAO's FY 1970 audit of the Export-Import Bank presented to us for review.

Sincerely yours,

John R. Petty

Mr. Eugene L. Pahl
Assistant Director
General Accounting Office
Room 126, Treasury Annex #1
Washington, D. C.

Attachment as stated

OPTIONAL FORM NO. 10
MAY 1962 EDITION
GSA FPMR (41 CFR) 101-11.6

UNITED STATES GOVERNMENT

Memorandum

TO : Assistant Secretary Petty DATE: January 29, 1971

FROM : Donald A. Webster

SUBJECT: GAO FY 1970 Audit of EXIMBANK

Treasury has been asked to comment upon a portion of GAO's fiscal 1970 EXIMBANK audit. This memorandum summarizes GAO's principal observations and recommendations and presents Treasury comments on the principal points at issue.

GAO's ANALYSIS

Asset Sales

EXIMBANK sales of Certificates of Beneficial Interest (CBI's) are treated by OMB as asset sales. Such sales are considered to be offsets to expenditures and have the same positive impact as tax receipts on the U.S. Government budget deficit or surplus. GAO argues that CBI's are not significantly different from sales of instruments such as Participation Certificates which are treated as financing or borrowing transactions and do not offset expenditures. Therefore, GAO, citing the "Report of the President's Commission on Budget Concepts" as support, recommends that CBI's be considered financing operations. Were this recommendation followed, the negative budget impact of EXIMBANK's operations, assuming an unchanged level of authorizations, would be increased by the amount of CBI's sold per year. The current FY 1971 OMB mark for asset sales is $420 million.

Statutory Debt Limit

According to GAO, "EXIMBANK's ability to raise money in the private capital markets through issuance of its own debt obligations has been used as a safety valve for pressures on the statutory debt ceiling." GAO believes that EXIMBANK's own debt obligations are similar in most respects to Treasury securities and therefore should be included in the definition of the public debt.

Increased Treasury Borrowing

GAO believes that the Bank ... "finances its operations in the private market rather than through the Treasury because of the supposed benefits this type of financing has in computing the overall Federal budget surplus or deficit and relieving pressures on the statutory debt limit." GAO believes that these benefits are illusory and that EXIMBANK's private borrowing results in substantially increased interest costs when compared to direct Treasury borrowing. The Audit Report therefore recommends that OMB, Treasury and EXIMBANK "takes the steps necessary to increase EXIMBANK's borrowing from the Treasury in order to avoid the increased cost of borrowing in the private market."

Concessionary Interest Rates on EXIMBANK Borrowings from Treasury

GAO describes the arrangements in effect for some years which permit EXIMBANK to borrow substantial amounts from Treasury at concessionary rates. As of June 30, 1970, $581 million were outstanding. Factors justifying these loans are concessionary rates on certain EXIMBANK discount, military, lend-lease and reconstruction loans, and the increased cost of borrowing in the private market rather than directly from the Treasury.

GAO argues that EXIMBANK, as an Executive agency, should bear the full financial cost of actions taken in support of government policy. It is therefore recommended that the concessionary borrowing agreement be renegotiated... "so that the interest rates charged approximate the current average borrowing costs paid by Treasury."

TREASURY ANALYSIS AND RECOMMENDATIONS

While it is difficult to fault the GAO's recommendations on grounds of budgetary analysis, there are policy changes implied which might have considerable impact on the debt ceiling, the U.S. Government Budget, and adequate funding of EXIMBANK's operations.

Asset Sales

This long-standing OMB-GAO dispute should become far less significant if the Bank is exempted from the budget. If the budget exemption is not granted, the problem remains. While GAO's argument for treating CBI's as financing operations is quite persuasive, the effect on EXIM's operations could be serious. OMB's current FY 1971 and 1972 marks are greatly below EXIM's requests and somewhat below Treasury's recommended levels. Should asset sales no longer serve to offset expenditures, the slack would have to be taken up by decreased EXIMBANK authorizations, a larger budget deficit, or both. Furthermore, should the GAO recommendation be accepted, the balance of payments impact of asset sales to foreigners would be lost.

Recommendation

GAO's recommendation to cease treating CBI's as asset sales is likely to result in a restriction in EXIMBANK's export support activities below levels which we judge to be reasonable. Therefore, for the time being, we would oppose changing the budgetary treatment of CBI's.

Elimination of Concessionary Borrowing Privilege

Here, GAO's argument is not convincing. In most, if not all, cases EXIMBANK's extension of low-interest loans was clearly in response to over-all Executive Branch policy. It would seem that when acting for the Government in a role which it would not be likely to undertake on its own, some sort of concessionary rate is justified. It is quite reasonable that the concessionary borrowing lines should not exceed the outstanding amount of underlying low-interest paper, but to eliminate them seems punitive.

Recommendation

We understand that the principal concessionary lines, totaling some $495 million, are not directly tied at present to the amount of underlying loans made at concessionary rates. We would, therefore, recommend that the amounts and rates of the concessionary lines be restructured to reflect the underlying loans made by EXIMBANK in support of national policies.

Statutory Debt Ceiling

There seems to be no compelling reason to change the definitions long accepted by Congress. Further, while GAO's recommendation to include all EXIM securities under the definition of the public debt would not, by itself, have a restrictive impact on the Bank's operations, nonetheless, we feel that it is only realistic to anticipate that pressures could eventually be generated to limit EXIMBANK's borrowings from the private market. These pressures could cause an artificial restriction on the Bank's export support activities.

Recommendation

EXIMBANK's own debt obligation should continue to be excluded from the definition of the public debt.

Increased Treasury Borrowing

Normally, EXIMBANK should borrow from the Treasury. There are situations, however, when it makes sense for the Bank to borrow in the private market. An example of the advantages of a flexible approach to the question of EXIMBANK financing is the recent $1 billion borrowing from the Euro-dollar market.

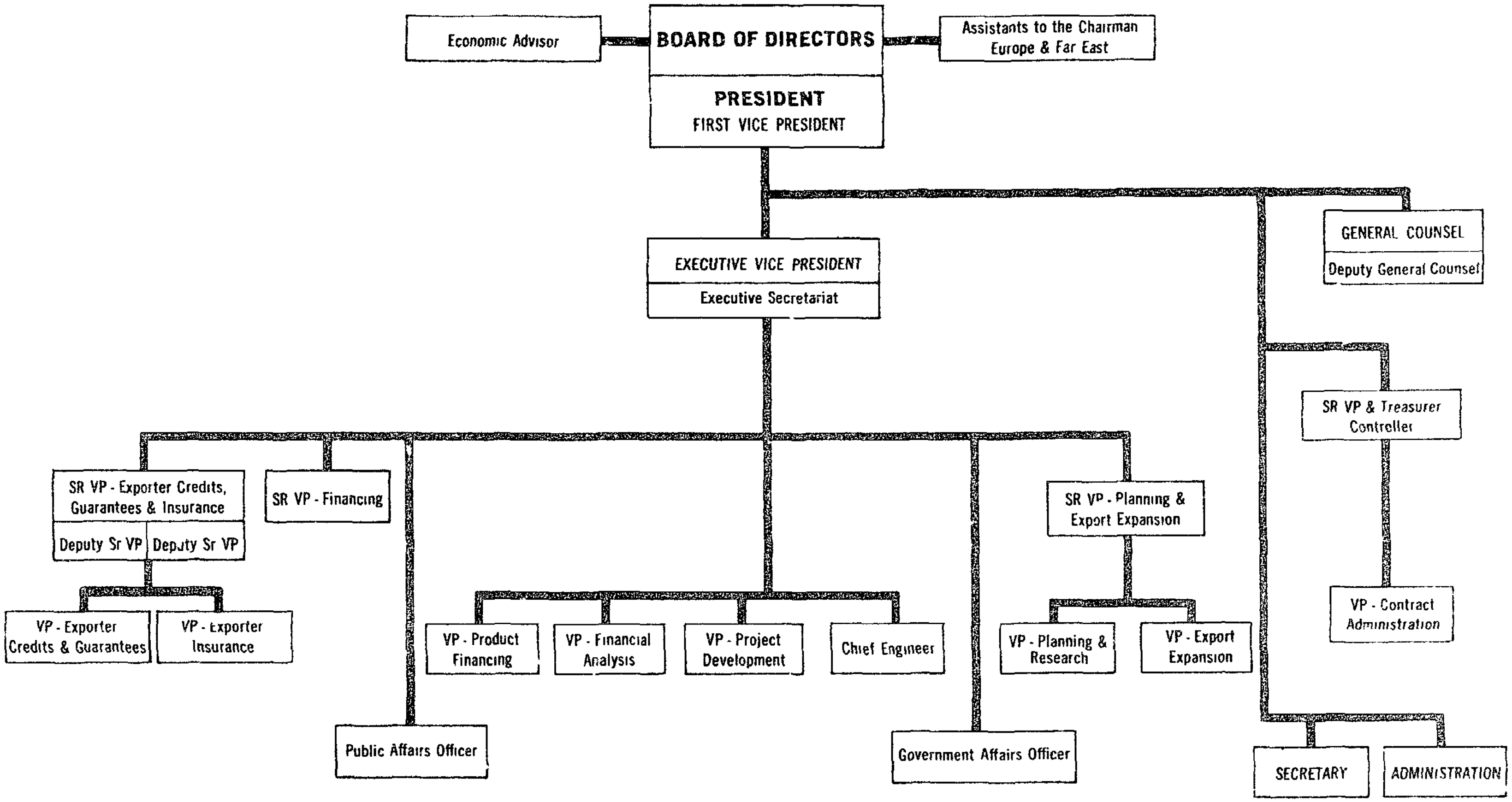
Recommendation

Flexibility should continue to be exercised in determining whether EXIM should borrow from the Treasury or from the private market.

PRINCIPAL OFFICIALS OF THE EXPORT-IMPORT BANK OF THE UNITED STATES AT JUNE 30, 1970

	Position	Date of appointment
BOARD MEMBERS:		
Henry Kearns	Chairman and President	3-20-69
Walter C. Sauer	Vice Chairman and First Vice President	9-28-62
Tom Lilley	Director	10-26-65
R. Alex McCullough	Director	5-21-69
John C. Clark	Director	6- 3-69
R. H. Rowntree	Economic Advisor to Board of Directors	2-10-70
OFFICERS:		
Don Bostwick	Executive Vice President	3-18-70
John E. Corette, III	General Counsel	5- 1-69
J. Patrick Dugan	Senior Vice President and Treasurer Controller	6- 2-69
Warren W. Glick	Senior Vice President Financing	9-21-69
Raymond L. Jones	Senior Vice President Exporter Credits, Guarantees and Insurance	7-22-62
Charles E. Shearer, Jr.	Senior Vice President Planning and Export Expansion	3-18-70
Joseph H. Regan	Secretary	12-14-65

EXPORT-IMPORT BANK OF THE UNITED STATES



U.S. GAO Wash., D.C.