18577 115602

BY THE COMPTROLLER GENERAL

Report To The Congress

OF THE UNITED STATES

To Be Self-Sufficient Or Competitive? Eximbank Needs Congressional Guidance

The financial condition of the Export-Import Bank of the United States is deteriorating.

Eximbank has been attempting to match the financing terms of its foreign competitors in a period of unusually high domestic interest rates. As a result, Eximbank's average borrowing costs are exceeding its lending rates by several percentage points. Furthermore, its increased lending operations in recent years have not been accompanied by a corresponding increase in retained income in its loss reserve.

This situation threatens Eximbank's traditional self-sufficiency and requires that the Congress decide whether it wants Eximbank to give greater attention to remaining self-sufficient or to meeting foreign competition. The latter course could require appropriated funds to subsidize Eximbank's lending activity.

UNITED STATES GENERAL ACCOUNTING OFFICE

ID-81-48
JUNE 24, 1981

017356

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

B-203449

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

This report discusses the dilemma the Export-Import Bank of the United States faces during this period of high domestic interest rates in countering severe foreign export credit competition while remaining financially self-sufficient.

We made this review at Senator William Proxmire's request. However, with the Senator's concurrence, we are addressing the report to the full Congress in the belief that the subject matter involves significant policy issues requiring congressional direction.

We are sending copies of the report to Senator Proxmire; the Director, Office of Management and Budget; the Secretary of the Treasury; and the President and Chairman, Export-Import Bank.

Milton J. Socolar
Acting Comptroller General
of the United States

COMPTROLLER GENERAL'S
REPORT TO THE CONGRESS

TO BE SELF-SUFFICIENT OR COMPETITIVE? EXIMBANK NEEDS CONGRESSIONAL GUIDANCE

D I G E S T

The Export-Import Bank of the United States (Eximbank) provides financing support for U.S. exports. It does not currently receive appropriated funds, but uses an initial $1 billion Treasury capitalization, retained earnings, and public borrowings to sustain its lending operations. Under the Export-Import Act of 1945, Eximbank should set interest rates on loans after considering the average cost of its funds and the rates offered by other governments. It did not become apparent that these two factors would produce a conflict until the last few years, when domestic interest rates rose dramatically and competition for export financing intensified.

Traditionally, Eximbank has been self-sustaining; since 1934, it has accumulated an income reserve of $2.2 billion and paid the Treasury $1.05 billion in dividends for the use of its capital. Although a negative interest rate spread between lending and borrowing has occurred in most years since 1966, Eximbank was able to remain profitable through 1980 because of interest earned on loans financed by its $2.2 billion reserve and $1 billion capital.

Whether Eximbank can remain self-supporting in the future is now in doubt. Faced with a probable operating loss in fiscal year 1982 and rising losses in later years, the Bank did not pay its customary dividend to the U.S. Treasury in 1980.

STRESS ON COMPETITIVENESS HAS INCREASED BANK'S COSTS

In response to concessionary financing by foreign government competitors, Eximbank has kept its loan commitments at low, fixed rates and increased its participation in financing packages that combine Bank and private financing to yield below-market average interest rates.

The Bank followed this policy despite the very high cost of borrowed funds in the United States. Current borrowings at more than 13 percent are being reloaned at 9 percent or less, and the average cost of the Bank's debt is now more than 2 percent above the rate earned on all outstanding loans. Eximbank loans are being used to cover a larger segment of each financing package in order to produce a lower blended and, thus, more competitive overall export credit rate. Also, to persuade private lenders to continue making export funds available at competitive interest rates, Eximbank has guaranteed private sector loans more frequently. (See ch. 2.)

PEFCO financing arrangement

In September 1980, the Bank formed an arrangement with the Private Export Funding Corporation (PEFCO) to discharge certain of its loan commitments. PEFCO is a Government-sponsored commercial corporation which raises funds to finance exports in the private market using unconditional Eximbank guarantees.

While such guarantees normally do not require a Bank financial outlay unless a borrower defaults, the PEFCO arrangement is unique in that it obligates the Bank to make up the difference between the borrowers' interest payments and PEFCO's interest charges. Assuming a continuation of Eximbank borrowing costs through the Federal Financing Bank of 13 percent, the guarantees could result in increased costs to Eximbank of over $300 million. (See p. 9.)

ADEQUACY OF LOAN
LOSS RESERVE UNCERTAIN

GAO annually examines Eximbank's financial statements. For some years, GAO has qualified its opinion on the adequacy of the Bank's reserves because the increased risks resulting from higher lending levels have not been accompanied by corresponding increases in income. Moreover, earned but uncollected interest income--from rising loan delinquencies, reschedulings, and purchases of guaranteed loans--is becoming increasingly significant in relation to net income. In the past 2 years, for example, the Bank's outstanding commitments rose 35 percent while the amount of income added to reserves each year remained stable. In fiscal year 1980, $93 million of the Bank's $110 million in net income was earned but uncollected interest on delinquent loans. In addition, projected operating losses from continuing to lend below the cost of borrowed funds could impair the Bank's reserves in years to come. (See ch. 3.)

INTERNATIONAL CREDIT NEGOTIATIONS AT IMPASSE

Since 1973, the U.S. Government has participated with other governments in a generally futile effort to eliminate or at least reduce the subsidies for officially supported export credit. Although the U.S. Government signed an "International Arrangement on Guidelines for Officially Supported Export Credits" in 1978, the Carter administration consistently regarded the Arrangement as inadequate and pushed hard for changes. The Arrangement consists of voluntary guidelines on minimum interest rates and repayment terms in relation to borrowing countries' economic development levels. The U.S. Government sees two major problems with the Arrangement; interest rate minimums are both fixed and identical for all currencies.

Negotiations to correct these problems failed in December 1980. The U.S. Government considered the French Government to be the principal obstacle to a new agreement. In response, the Government announced that it would selectively extend loan repayment terms and subsequently extended terms on several loan offers where France was the principal competitor.

With borrowing rates at historically high levels, the failure to successfully negotiate changes to the existing Arrangement is intensifying the Bank's financial dilemma. (See ch. 4.)

CONCLUSION

Recent Eximbank practice has been to aggressively meet foreign subsidies as a way of compelling intransigent governments to reduce the subsidy element of financing. Aside from the issue of whether directly subsidizing export financing is a prudent use of public funds, consistent matching of export credit offers of other governments--especially their so-called foreign aid or mixed credit type loans--is a costly undertaking in a period of high borrowing costs. The need for increased borrowings or appropriated funds seems probable if the Bank's current financial condition continues to deteriorate. Whether such a course would prompt resumption of the now stalled negotiations and bring them to an "acceptable" conclusion is unknown, but one fact is incontestable: Eximbank cannot indefinitely borrow at rates which exceed its lending rates by several percent and remain self-sustaining.

AGENCY COMMENTS AND OUR EVALUATION

Eximbank contends that, under the Export-Import Bank Act of 1945, it has an explicit statutory mandate to provide competitive financing for U.S. exports and that there is no statutory provision requiring it to be self-sustaining. Furthermore, it believes that an appropriation is not and will not be necessary for the continuance of operations. Eximbank argues that lenders would normally be willing to make loans to finance its operation regardless of any operating losses it might incur. (See app. II.)

GAO agrees that Eximbank is not statutorily required to be self-sustaining; however, this has been its practice since it was created in 1934, supported by congressional understanding that Eximbank is and should remain a self-sustaining institution. Moreover, Congress may not want Eximbank to operate indefinitely at a deficit.

Treasury shares GAO's concern over Eximbank's deteriorating financial condition and the adequacy of its loss reserve, but believes the conflict between the self-sufficiency and competitiveness goals is not as stark or as long lasting as GAO's report implies. Treasury attributes the current financial problem in large measure to adhering to a policy of aggressively matching the low-interest loans of foreign official export credit agencies. It considers the problem to be temporary and one that will subside as interest rates decline under the President's economic program. In the meantime, Treasury said Eximbank should not abandon good business practice in pursuit of meeting foreign competition which results in large subsidization losses. (See app. III.)

GAO concurs in Treasury's assessment of the causes of Eximbank's financial plight but not necessarily in the view that it is a short-term problem. (See p. 34.)

MATTERS FOR CONSIDERATION BY THE CONGRESS

Continuing to meet the concessional financing practices of its export competitors in a period of sustained high interest rates makes Eximbank's basic objectives simultaneously unattainable. By clarifying legislation, Congress should either direct Eximbank to emphasize

--its statutory mandate to be competitive over its longstanding and congressionally accepted policy of remaining self-sustaining or

--this congressional understanding to remain self-sustaining over its statutory requirement to be competitive. (See p. 34.)

GAO believes the Bank's current financial dilemma has intensified to the point where Congress needs to clarify its intent. If the mandate to meet the competition is given predominance over self-sufficiency, some form of subsidy for the Bank's lending activity with public funds could be necessary. If Congress does not intend that meeting the competition be given predominance in the current situation, then it should affirm that fact by indicating what it believes is acceptable lending policy. In any event, it is now clear that increased congressional involvement is needed in determining Eximbank's export financing policies.

APPENDIX

ABBREVIATIONS

EC	European Community
GAO	General Accounting Office
OECD	Organization for Economic Cooperation and Development
PEFCO	Private Export Funding Corporation

Contents

CHAPTER 1

INTRODUCTION

Eximbank was created in 1934 to provide financing support to aid U.S. export sales. Its financing programs today include direct loans, financial guarantees to private lenders, and commercial and political risk insurance. Eximbank does not receive appropriated funds. It received $1 billion in capital from the Treasury and uses mainly Federal Financing Bank borrowings to sustain its lending operations.

The Export-Import Bank Act of 1945, as amended, declares as U.S. policy that Eximbank shall set its loan interest rates after considering both the average cost of its funds and the rates offered by other governments; it is to supplement and encourage, but not compete with, private capital.

Traditionally, Eximbank has been self-sustaining. For the period 1934-66, it was able to charge more interest on loans than it paid on its borrowings. Part of its earnings were paid to Treasury in the form of dividends and the remainder, retained as a reserve for contingencies and defaults, was invested in export loans. Cumulatively, the Bank has paid dividends of $1.05 billion while amassing a reserve of $2.2 billion. Although it has generally had a negative spread between the average interest rate on its loan portfolio and the average rate on outstanding debt since 1966, it has continued to show a profit through 1980 because of its interest earnings on the $2.2 billion reserve and $1 billion capital.

The Bank's self-sufficiency is now being jeopardized by continued concessionary lending in the face of historically high interest rates. Current borrowings at 13 percent are being reloaned at 9 percent or less, and the average cost of the Bank's debt is now more than 2 percent above the rate earned on all outstanding loans. Earnings on the Bank's reserve and capital are no longer sufficient to offset the widening negative interest rate spread on outstanding debt and loan investments.

SENATOR PROXMIRE'S REQUEST

In a letter dated October 1, 1980, (see app. IV) Senator William Proxmire, former chairman of the Senate Committee on Banking, Housing, and Urban Affairs, asked us "to investigate the financial implications of Eximbank's use of very low interest direct credits to achieve low blended interest rates for export financing." Senator Proxmire noted that:

> "Eximbank was intended to be a self-sustaining institution. But I doubt whether it will be able to remain self-sustaining if it begins the practice of adding

very low interest PEFCO 1/-related direct credits to a loan portfolio already heavily laden with low interest, broad coverage loans."

PEFCO is a Government-sponsored commercial corporation formed in 1970 to raise funds from the private market using unconditional Eximbank guarantees as a means of attracting funds and offering them for export transactions at competitive rates of interest. PEFCO is designed to be a supplemental lender in the sense that Eximbank's backing will enable PEFCO to commit loans at fixed rates of interest for long maturities and disbursement periods when other private sector lenders are unwilling to take the risk.

In his letter, Senator Proxmire said: "I am deeply concerned about the Export-Import Bank's new practice of using a mixture of PEFCO loans and very low interest direct credits that has been authorized for fiscal year 1980 to finance exports."

PREVIOUS GAO REPORTS ON EXIMBANK

The Bank's statutory mandate to promote exports on a competitive basis has been emphasized over its self-sustaining policy. Although it was possible for the Bank in the past to substantially meet both these objectives, it is no longer able to do so. Our opinion on this issue today is the same as that expressed in our October 17, 1975, report, 2/ when high interest rates also prevailed, which stated that:

> "We recognize that Eximbank's purpose is to promote exports and we believe it should do everything possible to do so on a self-sustaining basis. If that cannot be achieved, Eximbank should more clearly identify the extent to which public subsidization of its operations is required."

Our most recent report on Eximbank, issued on April 30, 1980, 3/ reflected the concern expressed in 1975, stating:

> "Eximbank operates on a self-sustaining basis, and within this framework it also tries to comply with its mandate to offer competitive interest rates * * * i.e., to remain self-sustaining it must charge interest rates which are not fully competitive."

* * * * *

1/Private Export Funding Corporation.

2/Weakened Financial Condition of the Export-Import Bank of the United States (ID-76-17).

3/Financial and Other Constraints Prevent Eximbank from Consistently Offering Competitive Financing for U.S. Exports (ID-80-16).

"Continued high borrowing costs, which depend on the market rates for Government securities, will adversely affect Eximbank's income and weaken its financial position if its lending rates remain stable or it tries to consistently match lower foreign rates. * * * Since the Bank's accumulated income is also its reserve against loan defaults and claims, it cannot use accumulated income to subsidize its lending rates and to absorb such losses without jeopardizing the adequacy of its reserves."

In view of this situation, our 1980 report concluded:

"* * * the Congress should reexamine the framework and financial constraints within which Eximbank operates and consider * * * whether Eximbank should be given additional direct loan authority to enable it to increasingly offer

"--up to 100 percent of the required long-term financing in cases where a mixture of commercial and Eximbank loans results in a blended interest rate higher than rates offered by other governments, and

"--medium-term direct loans and loans for exports under $5 million in cases where commercial interest rates and Eximbank's discount rate are not competitive with financing offered by other governments."

* * * * *

"An alternative or supplement to increased direct loan authority would be lowered Eximbank lending rates, thereby enabling increased commercial bank participation. * * *

"Another alternative would be to provide annual appropriations to subsidize the difference between Eximbank's normal lending rates and the rates offered by other governments competing for a sale."

We also annually examine Eximbank's financial statements; since 1975, our reports on the statements have included a qualification on the adequacy of the Bank's reserve. The fiscal year 1980 statements and our opinion thereon are in appendix I.

OBJECTIVES, SCOPE, AND METHODOLOGY

To respond to Senator Proxmire's concerns (see p. 1), we examined Eximbank's financial statements, policies, and financing programs at its Washington, D.C., offices. Bank records we reviewed included annual reports, financial summaries, interest rate analyses, loan trend reports, portfolio evaluations, and studies on foreign export credit competition, capital adequacy, and preliminary commitment dispositions. We also interviewed senior Eximbank officials and surveyed relevant literature regarding the Bank's lending policies and practices.

Concurrently with this review, we completed our annual audit of Eximbank's financial statements and concluded that its financial disclosures are fair and complete; however, because of various contingencies, we were unable to express an opinion on the adequacy of the reserve. On the basis of this concurrent audit work, it was not necessary for the purposes of this report to determine whether Eximbank's financial statements fairly present its assets, liabilities, and other related financial information.

We also interviewed and obtained data from officials of the Department of the Treasury, Office of Management and Budget, Office of the U.S. Trade Representative, and PEFCO. We did not attempt to quantify the public benefit and cost of Eximbank export subsidies as Senator Proxmire originally asked in his letter; however, we do discuss these issues and analyze Treasury studies of export additionality attributable to Eximbank financing in this report. We also reviewed a draft report that the Congressional Budget Office is preparing on the benefits and costs of Eximbank's loan subsidy program.

Eximbank's multiyear projections of changes in its financial position are shown in chapter 3. These projections are based on assumed interest rate changes and other variables, using a standard format designed by the Bank and approved by the Office of Management and Budget. The Bank's projections we used were made in January 1981 and included the following assumptions.

1. Congressional loan authorization of $5.5 billion in fiscal year 1981, $5.0 billion in fiscal year 1982, and a 10-percent increase each year thereafter.

2. Discount loan authorization of $400 million in fiscal year 1981 and no authorization in subsequent years.

3. Guarantee and insurance authorization of $8.6 billion in fiscal year 1981, $9.4 billion in fiscal year 1982 and a 10-percent increase each year thereafter.

4. No dividend paid to the Treasury Department in any year between fiscal years 1981-90.

5. Various constant lending rates between 9 and 11 percent.

6. Various constant borrowing rates from the Federal Financing Bank between 10 and 14 percent.

CHAPTER 2

EXIMBANK CREDIT POLICIES IMPAIR SELF-SUFFICIENCY

Eximbank, in arranging export financing packages, has stressed competitiveness more than self-sufficiency; despite the increasing cost of funds, it has maintained lending rates below those necessary to recover costs and assure its ability to remain self-supporting. The Bank estimates that it needs to charge between one-quarter and one-half percent above its average cost of borrowed funds to cover its administrative costs and provide an adequate reserve for defaults. However, as the cost of funds has moved sharply higher, the negative spread between average current lending and borrowing rates has widened to more than 2 percent, with no prospects of immediate improvement in sight. Although this foreshadows operating losses in the years ahead, Eximbank's investment earnings on its interest-free capital and income reserve more than offset losses on current loans through 1980; the reserve, however, is not increasing commensurate with the Bank's outstanding commitments.

Eximbank loans traditionally have been issued in participation with credits provided by private lenders, including exporters, so as to achieve an overall lower blended rate. As domestic interest rates rose, Eximbank increased loan commitments in anticipation of higher loan authorization levels and raised the portion of its direct credit segment included in financing packages in order to keep them competitive. Also, to persuade private lenders to continue making export funds available at competitive interest rates, Eximbank more frequently has been obliged to guarantee private sector loans. The combined effect of these responses and the manner in which they were implemented have significantly added to the Bank's budgetary costs.

LOAN RATES BASED MORE ON COMPETITIVE FACTORS THAN ON COST OF FUNDS

The Export-Import Bank Act of 1945, as amended, states that, as a matter of policy, the Bank shall set interest rates on its loans after considering (1) the average cost of its funds and (2) the rates, terms, and conditions offered by other governments. It did not become apparent that these two factors would produce a conflict until the last few years, when interest rates rose dramatically and competition in export financing intensified. For about 3 years, these objectives--providing competitive financing and maintaining financial self-sufficiency--have been exerting opposing influences on the level of loan interest rates. During these 3 years, Eximbank's policy has been to match foreign governments' credit offers. The Bank's average lending rate consistently remained at about 8.3 percent for fiscal years 1978 through 1980 while its current cost of funds rose from 7.2 percent in September 1977 to 11.4 percent in September 1980, and to 13.5 percent in March 1981.

Eximbank raised its interest rates in April 1980, but it has not closed the gap between current lending and borrowing rates. The former lending scale of 7.75 to 8.75 percent, depending on loan repayment terms, which had been in use since October 1977 was abolished in favor of two rates--8.75 percent for nonaircraft loans and 9.25 percent for aircraft loans--resulting in an effective average increase of three-quarters of one percent, or 75 basis points, in the rate charged. However, because of the Bank's traditional practice of honoring preliminary commitments which were extended at lower rates and the large volume of such outstanding commitments, a Bank official estimated that it would take nearly a year for the rate increases to be reflected in loan authorizations. The estimate is borne out by the fact that the average rate was only 8.6 percent for loan authorizations through the first 4 months of fiscal year 1981. By way of contrast, Eximbank's cost of funds rose to over 13 percent during this period and was not expected to moderate appreciably in the foreseeable future.

Eximbank faces serious financial problems because the cost of new borrowings has risen so much faster and higher than loan rates. At the end of December 1980, its weighted average interest expense had climbed to more than 2 percent above the rate earned on loans for which funds were borrowed (9.45 versus 7.41 percent). This interest rate deficit on $11.4 billion of then-outstanding debt reduced the Bank's net income by about $230 million annually. Nonetheless, it was able to continue to operate profitably up through December 1980 because of interest earnings on its $1 billion capital and $2.2 billion income reserve. At that time, the average cost of all its funds available for lending (including equity) had increased to 7.37 percent or just below the 7.41-percent earnings rate. In January 1981, the cost of all funds surpassed the overall earnings rate, thus signaling that operating losses were imminent.

Eximbank's lending rate, while below its cost of funds, does substantially meet its mandate of providing competitive financing, even when blended with financing provided by private banks. Eximbank's October 1980 report to the Congress on officially supported export credit competition for the year ended June 30, 1980, concluded that the average blended rate on Eximbank-supported loans was not uncompetitive, stating that:

> "* * *it appears that Eximbank's long-term support [over 5 years] is relatively expensive, but not totally cost-uncompetitive--it is within 75 basis points of the lowest-cost program and within 25 to 50 basis points of all other competitors."

END TO INCREASED LOAN COVERAGE BEING SOUGHT

A consequence of higher commercial rates is that Eximbank is using more loan funds to support a larger segment of each financing package in order to produce a lower blended, and thus more competitive, overall export credit rate. Direct loans were used to cover an average of 58 percent of new credit authorizations in fiscal year 1979 and 62 percent in fiscal year 1980; this average was even higher early in fiscal year 1981. Financing of non-aircraft transactions, particularly power projects, received the highest percentage of Eximbank loan support.

Eximbank has sought to reduce loan concentration by reducing the coverage of its own loans and increasing its reliance on private lenders. Effective as of March 1980, Eximbank reduced its maximum coverage from 85 to 65 percent of a sale, but raised it to 75 percent if the exporter agreed to carry 10 percent of the financing on Eximbank's terms.

The full impact of this change was not felt at the end of 1980, because a significant volume of Eximbank credit authorizations made during the year involved conversions of preliminary commitments carrying higher coverage provisions.

INCOME DECLINE AGGRAVATED BY FIXED-RATE LENDING

Eximbank traditionally has been the primary source of financing for export transactions when borrowers require fixed interest rates and long disbursement and repayment periods. As we stated in our April 1980 report:

> "* * * Commercial banks are reluctant to lend at fixed interest rates due to fluctuations in their costs of funds and their dependence on short-term deposits. Private lenders are also reluctant to assume all the political and commercial risks associated with financing exports, such as loan default because of expropriation by a foreign government or insolvency of a foreign buyer.* * *."

To some extent, commercial banks and private lenders are willing to participate in a financing package, but they generally require repayment first and frequently seek Eximbank financial guarantees to cover their risk. Eximbank acceptance of those repayments which fall due in the later stages of a loan, when the useful economic life of the asset is shorter and thus riskier, no doubt helps to promote the participation of otherwise unwilling lenders. However, because many of the assets financed, such as plants and heavy equipment, cannot easily be repossessed in the event of borrower default, access to Eximbank financial guarantees is necessary to tap major sources of private financing. That Eximbank is making increased use of the financial guarantees to obtain participatory private financing is clear from the fact that the amount of financial guarantees increased from $0.5 billion in fiscal year 1979 to $1.9 billion in 1980.

The value of preliminary commitments issued by Eximbank, outlining the terms of direct credit and financial authorizations it is prepared to approve, has been rising sharply in recent years, indicating the potential demand for its long-term financing programs. At November 30, 1980, commitments representing potential Eximbank loan authorizations amounted to over $9 billion, at a weighted average interest rate of about 8.6 percent. Experience has shown that at least half of these commitments may never be converted to credits because the particular project is won by foreign competition, is canceled, or is funded in another manner. Even so, at current funding levels, the commitments represent close to a year's volume of future loan authorizations. Although the rates and terms can be adjusted in the final loan authorization, they rarely are substantively altered. Therefore, under current conditions, it might take a year or so for an increase in Eximbank's lending rates to be reflected in its loan authorizations.

Eximbank's methods of funding loans also affects its future financial picture. The entire amount of a loan is authorized at a fixed interest rate, but disbursements on that loan may be spread out over several years as the exporter ships his products. Eximbank does not borrow in advance but borrows to fund loans as the need arises. Thus, when Eximbank commits itself to a rate on a particular loan, it may not know the financial consequence of funding and disbursing the loan proceeds until several years later.

The large amount of Eximbank's preexisting commitments in the face of current high interest rates is cause for concern. If existing preliminary commitments are converted to loan authorizations (resulting in roughly $4.5 billion in new loans) and are added to the more than $7.6 billion in currently authorized but undisbursed loans, Eximbank will need to finance in excess of $12 billion to meet existing commitments at interest rates averaging 8.5 percent. Such financing will continue to diminish net income in the future if a negative interest rate differential persists over the next several years.

In fiscal year 1976, Eximbank briefly adopted a policy of pricing its new loan authorizations from 50 to 75 interest basis points over the cost of funds for similar maturities; it abandoned this policy in fiscal year 1978 when interest rates rose above levels where Eximbank could compete with offers by foreign government export credit agencies. However, even if the pricing policy had been continued to the present time, the Bank estimates that its net income still would have declined substantially and become negative in future years because of the increase in interest rates and the time lag between commitment or authorization of a loan and disbursements.

Conclusion

Eximbank's fixed-rate commitments make it vulnerable to the recent volatile interest rates in the capital market. Because the Bank does not borrow until the need arises, it may need to establish safeguards against being permanently "locked in" to interest rates substantially below those of the prevailing market. To do this, it could reduce the level of its preliminary commitments and adopt a more flexible or moving fixed-rate structure, depending on competitive and financial factors, within the framework of congressional guidance concerning how Eximbank goals are to be met.

FINANCIAL GUARANTEES USED TO SUBSIDIZE PRIVATE FINANCING

In September 1980, in a unique agreement with PEFCO, Eximbank agreed to support $1,099 million in loans for which it will incur increased costs that could possibly reach hundreds of millions of dollars. The arrangement grows out of Eximbank's use of supplemental fiscal year 1980 direct loan ($251 million) and financial guarantee ($274.75 million) authority granted in August 1980 to discharge $1,350 million in preliminary loan commitments. The guarantee authority, charged at 25 percent, enabled Eximbank to support PEFCO-financed loans of $1,099 million for which no direct credit authority remained. The Eximbank guarantees, combined with Eximbank's share of $251 million, financed 16 loan transactions with a total value of $1,350 million. The loans carried fixed interest rates to the borrower ranging from 8 to 10.7 percent and repayment terms of from 8.5 to 19.5 years, averaging on a weighted basis about 9 percent interest and 14.6 years maturity (12 years for the portion financed by PEFCO). What makes this arrangement extraordinary is that Eximbank will not only guarantee repayment of PEFCO's share of the loans by borrowers, as is customary under normal guarantee provisions, but has also agreed to reimburse PEFCO for the difference between the latter's charge for funds (to be determined when PEFCO acquires them for loan disbursement) and the rates at which they were committed; i.e., at 9 percent on the average. All loan disbursements and repayments will be made through Eximbank.

The arrangement with PEFCO has several questionable features. By agreeing to meet any shortfall between the borrowers' and PEFCO's interest charges, Eximbank in effect used its guarantee authority the same as its direct credit authority, with attendant budget implications. That is, the financial effect to the Bank is fundamentally the same as if it had made the loan directly instead of merely guaranteeing repayment of the loan by the borrower.

The fiscal year 1980 supplemental guarantee authority of $274.75 million was used to commit the Bank to subsidize loans amounting to $1,099 million, an amount four times greater than it would have been using equivalent direct credit authority. The increased cost to be incurred through use of this guarantee mechanism cannot be determined until the loans are disbursed but may well amount to hundreds of millions of dollars. This cost can be viewed as consisting of two parts: (1) what it would have cost Eximbank to make the loans itself, since what Eximbank did was tantamount to making loans directly, and (2) the added cost of financing the loans through the PEFCO facility. The first part is measured as the difference between what it would have cost Eximbank to fund the loans through its normal financing facility (Federal Financing Bank) at the time they are disbursed and the 9-percent rate at which they were guaranteed by Eximbank. Based on recent Federal Financing Bank borrowings at 13 percent, this cost would be calculated as follows.

Value of loans	$1,099 million
Interest differential (4%)	x .04
Annual increased cost	$43.96 million
Average number of years PEFCO loans outstanding	x 6.0 (1/2 of 12 years' average maturity)
Estimated increased cost	$263.8 million

The arrangement places an additional cost on Eximbank because PEFCO's average interest charges exceed the rates Eximbank obtains through the Federal Financing Bank. This cost also won't be known until the loan funds are disbursed, but it can be roughly estimated. According to Eximbank and PEFCO officials, the increased rate to Eximbank of financing the $1,099 million in loans through PEFCO rather than through the Federal Financing Bank will be approximately three-quarters of one percent. Thus, we estimate Eximbank's additional cost of funding the loans through PEFCO to be as follows.

Value of loans	$ 1,099 million
Rate differential (.75%)	x .0075
Annual increased cost	$8.2425 million
Average number of years PEFCO loans outstanding	x 6.0 years
Estimated increased cost	$ 49.4 million

The September 1980 agreement shows the increased activity between Eximbank and PEFCO since PEFCO began operations in May 1971. PEFCO's loan commitments tripled in 1979 and in 1980; furthermore, they accounted for over 80 percent of all the financial guarantees issued by Eximbank to private lenders in fiscal year 1980. PEFCO is willing to commit for loans at fixed interest rates and long maturities since Eximbank unconditionally guarantees all of PEFCO's loans. Also, because of Eximbank's support, PEFCO is able to borrow and relend funds at interest rates below those of private lenders. It is especially this last feature, lower cost financing, that enables PEFCO to be such an important source of private export financing.

Conclusion

Usually, Eximbank financial guarantees protect PEFCO and other private lenders by assuring repayment of loans in the event of default by the foreign buyer or bank to whom the credit was extended. Although guarantees normally do not require an Eximbank outlay unless the borrower defaults, the September 1980 arrangement was unique in the sense that it placed substantial financial burdens on the Bank regardless of whether borrowers default. In our opinion, such burdens represent a questionable use of financial guarantee authority and should be avoided in future financing arrangements.

AGENCY COMMENTS AND OUR EVALUATION

Eximbank's formal comments did not mention its September 1980 arrangement with PEFCO. (See app. II.) We did, however, discuss this arrangement and our views on it with Eximbank officials, who told us that it was a one-time arrangement needed to honor preliminary commitments for which Eximbank lacked adequate direct loan authority. The officials also provided additional information which we used to refine our original estimates of the additional cost of the arrangement.

With respect to our estimates of additional cost, the Treasury pointed out in its comments of May 13, 1981 (see app. III) that we overstated these future costs by not calculating them in terms of their present value. We agree that computing the present discounted value of the future subsidy payments is conceptually a correct method of valuing any payment stream made over a period of years and that the resulting value would be the appropriate amount to use for estimating, on an accrual basis, the approximate loss to Eximbank's reserve. Our estimate of the increased budgetary cost makes a related point and is included for illustrative purposes. As we point out on page 9, the increased cost incurred through use of this guarantee mechanism cannot be determined until the loans are disbursed. Until the actual payment stream is known, the present value of the subsidy cannot be accurately determined.

With regard to the broader issue of competitiveness versus self-sufficiency, Eximbank stated that, although it believed the self-sustaining objective is highly desirable and important, it has emphasized its statutory mandate of competitiveness when conflicts have arisen between the two objectives.

Treasury agreed that the conflict between the objectives of self-sufficiency and competitiveness was a real problem, but that, in its view, the conflict was not as stark or as long lasting as our report implies. (See ch. 5 for a fuller discussion of this issue.)

CHAPTER 3

IS EXIMBANK'S LOSS RESERVE ADEQUATE?

Eximbank's increased lending operations in recent years have not been accompanied by corresponding increases in income to its reserve for contingencies and defaults; therefore its capacity to absorb losses has been reduced. Also, its risk of incurring possible future losses on delinquent loans and obligations arising from purchases and guarantees of loans made by private creditors has increased to a much larger extent. The reserve at the end of fiscal year 1980 was adequate to cover possible loan losses resulting from borrowers who were presently in financial difficulty, but whether it will also cover possible losses on loans and guarantees that have not yet matured is uncertain. The amount reserved for contingencies and defaults has been the cause of our qualified opinion on Eximbank's financial statements since fiscal year 1975.

Projected operating losses from lending below the cost of funds also could impair the Bank's reserve in years to come. To prevent this, the Bank's lending rate would have to roughly match its rate for borrowings used to fund new loans on a continuing basis. If rates remain high, and assuming that the Bank's borrowing costs will exceed its lending rates for some time, the more pertinent questions concern the magnitude and timing of operating losses. Eximbank's projections of the size of such losses and when they are expected to occur vary widely, according to what interest rates will be and what policies it pursues.

MEASUREMENT OF RESERVE ADEQUACY DIFFICULT

It is inherently difficult to measure the adequacy of Eximbank's income reserve, because there is no accepted standard and no comparable U.S. lending institution. However, a measure used by Eximbank compares the income reserve to outstanding commitments. The following schedule shows how the retained income reserve has deteriorated relative to outstanding commitments between 1970-80.

Ratio Comparison of Reserve to Outstanding Commitments
(Loans, Guarantees, and Insurance)

Fiscal year	Retained income reserve	Outstanding commitments	Comparison expressed as ratio
	(millions)		
1970	$1,246	$ 6,779	1:5.4
1971	1,315	7,128	1:5.4
1972	1,413	7,990	1:5.7
1973	1,503	9,275	1:6.2
1974	1,563	11,241	1:7.2
1975	1,624	13,118	1:8.1
1976	1,719	14,640	1:8.5
1977 (note a)	1,850	15,616	1:8.4
1978	1,954	15,443	1:7.9
1979	2,078	16,777	1:8.1
1980	2,187	19,861	1:9.1

a/Includes transition quarter when end of fiscal year was changed from June 30 to Sept. 30.

Despite this deterioration, Eximbank maintains that its ratio remains well below that of comparably sized commercial banks. A May 1979 Eximbank study of capital adequacy showed that the largest U.S. private banks typically had ratios ranging between 1:15 to 1:18. The study concluded that Eximbank's reserve was fully adequate by private sector standards. However, one reason why Eximbank has fared so well is its extremely low loan losses, which the study showed as amounting to only about 10 percent of the lowest losses experienced by any of the top 10 banks. Eximbank's loans are generally considered to be riskier than those made by private banks, thus its low loan losses may be explained, in part, by differences in accounting practices.

Outstanding commitments fairly stated

Eximbank's total outstanding commitments on September 30, 1980, consisted of $19.9 billion in disbursed loans, guarantees, and insurance in force; $13.8 billion was for loans outstanding with the remaining $6.1 billion representing repayment assurance to private lenders and exporters requiring no Eximbank outlays except in the case of default or loss. Since guarantees and insurance, like loans, constitute a potential charge against the reserve, it is appropriate to include them in a comparison of the reserve to outstanding commitments.

Retained income reserve fully valued

Eximbank records income and expense as earned or incurred, except for loan writeoffs and claims payments on guarantees and insurance policies. Loans are written off and charged against income only after Eximbank officials determine that the outstanding balance is uncollectible. Such determinations have been rare. No loans were written off in fiscal years 1979 and 1980, and only $8 million in loans has been charged off against income since 1934. For example, no determinations of uncollectibility have been made for delinquent loans of $26.4 million made in 1946 to the then recognized government of China and $36.3 million made to Cuba before 1961 when a prior government existed. In addition, Eximbank had accrued for record purposes, but ceased to place on its books, interest of $36.4 million for loans it deemed to be of doubtful collectibility but had not written off.

Commercial banks, which seek to maximize profits, would write off similar loans for tax reasons. We see no particular advantage for Eximbank to charge off loans of doubtful collectibility against the reserve, but the effect of not doing so tends to keep its reserve-to-commitment ratio lower than that of commercial banks.

As the schedule below shows, Eximbank's reserve would cover possible losses arising from current loan delinquencies as well as defaults to private creditors that have so far been identified. The reserve, adjusted for uncollected interest, amounts to $1.7 billion compared with $1.1 billion of delinquent ($736 million), purchased ($191 million), and prospective-purchase loans relating to existing agreements ($213 million).

Composition of Reserve and Outstanding Commitments

	(millions)
Retained income reserve	
As of Sept. 30, 1980	$ 2,187
Less uncollected interest and fees	-468
Adjusted loss reserve, net of uncollected interest and fees	$ 1,719
Outstanding commitments	
Outstanding loans:	
Current, nonrescheduled	$12,203
Current, rescheduled	635
Delinquent loans	736
Purchased guarantees and insurance	191
	13,765
Guarantees and insurance in force:	
Contingent liability, subject to claims	5,883
Outstanding purchase agreements	213
	6,096
Total (note a)	$19,861

a/Excludes undisbursed loans and associated contingencies for guarantees and insurance of $13.3 billion (see p. 16).

Eximbank's accounting treatment has affected specific parts of the above schedule in the following ways.

Uncollected interest and fees

Earned but uncollected interest and fees receivable on loans and guarantees amounting to $468 million was included in the income reserve at September 30, 1980. Of this amount, $264 million was attributable to current nonrescheduled loans; $39 million to current rescheduled loans; and $165 million to delinquent loans, two-thirds of which has previously been rescheduled.

Delinquent loans

A delinquent loan is one for which any installment of principal or interest is past due 90 days or more. As of September 30, 1980, the outstanding principal amount of delinquent loans included in loans receivable was $735.9 million. Of this amount, $305.7 million represented an acceleration of repayment of loans made to or guaranteed by the Government of Iran. A list of the amounts owed by country, including interest, is provided in Eximbank's fiscal year 1980 financial statements. (See note 4, app. I.)

Rescheduled loans

Eximbank sometimes reschedules the repayment date of some or all principal installments of a loan. It does so in cases where a borrower or country has encountered temporary financial difficulty and when it determines that providing such relief will aid collectibility and enable continued debt servicing. Since the Bank's inception, loans totaling about $1.4 billion (or 4.1 percent of loans disbursed) have been rescheduled. The aggregate value of such outstanding rescheduled loans at September 30, 1980, amounted to $634.7 million, of which about one-fourth was classified as delinquent. Outstanding reschedulings include $144 million in interest previously credited to the income reserve, $105 million of which was delinquent.

Purchased guarantees and insurance

Guarantee and insurance claims paid have only partially been charged against income, thus postponing possible future loss charges against the reserve. Since 1934, such chargeoffs have amounted to $76 million. With our concurrence, Eximbank modified its practice in 1977 of deducting payments on guarantee and insurance claims from net income when unusually large payments were required on defaulted commercial loans to Zaire. It now treats the cost of such purchased loans as a loan receivable asset in those cases justified by the amount and prospects of repayment. As of September 30, 1980, net loans purchased pursuant to Eximbank guarantee and insurance agreements amounted to $191.3 million. Still outstanding was $213 million in prospective additional purchases. (See note 6, app. I.)

NET INCOME NOT KEEPING PACE WITH INCREASED RISK

Current net income added to the reserve is not keeping pace with the increased risk of losses from Eximbank's expanding loan portfolio. In fiscal year 1980, for example, the reserve increased by only $109 million compared with increased outstanding commitments of $3,084 million, yielding an annual ratio of 1:28. This is more than three times the overall ratio of 1:9.1 (see p. 13). Moreover, only a small portion of Eximbank's outstanding loans fell due during the year. Loan repayments during fiscal year 1980 amounted to only 10 percent of the $13.8 billion in loans outstanding at September 30, 1980. Total outstanding commitments were 35 percent above the level of 2 years ago.

Indications are that the Bank's outstanding commitments will continue to increase rapidly. Not included in the $19.9 billion of outstanding commitments at September 30, 1980, were $7.6 billion in approved but undisbursed loans and $5.7 billion in contingent liabilities for associated guarantees and insurance. Thus, the Bank's overall commitments and contingencies at the close of fiscal year 1980 totaled $33.2 billion.

The approved loans of $7.6 billion, which amount to more than 55 percent of those already outstanding, were expected to be disbursed over the next 3 to 5 years. In addition, Eximbank's new commitment authority for fiscal year 1981 was set at $5.9 billion (subsequently reduced by President Reagan to $5.148 billion) for loans and $7.6 billion for guarantees and insurance.

Net income, on the other hand, had stabilized and started to decline. Future losses were projected, possibly commencing in fiscal year 1981. The $110 million addition to the reserve in fiscal year 1980 was roughly comparable with amounts added in recent years, but only because the Bank omitted its customary dividend payment to the U.S. Treasury. The Bank's earnings and dividend payments over the past 5 years are shown below.

	Fiscal year				
	1976	1977	1978	1979	1980
	(millions)				
Net income	$115	$137	$139	$159	$110
Dividend payments	-20	-35	-35	-35	-0-
Additions to reserve	$ 95	$102	$104	$124	$110

CAPACITY TO ABSORB LOSSES FROM CURRENT INCOME REDUCED

An analysis of net income added to the reserve since fiscal year 1977, when Eximbank began recording purchases of guarantees and insurance claims as loan assets rather than as expenses against income, shows a reduced capacity to finance such loan purchases out of current collected income. Eximbank's inability to meet its loan purchase commitments using current income proceeds means that it must apply its reserve funds or obtain additional borrowings to cover the shortage. Obviously, it cannot continue to do so for long if it is to remain self-sustaining.

As explained on page 13, Eximbank credits interest on loans to income when it is earned, as opposed to when it is collected. In recent years, delinquent loan interest has become increasingly significant in relation to net income. Coincidental with this increase has been the rise in Eximbank's loan purchases, as shown below.

	Fiscal year			
	1977	1978	1979	1980
	(millions)			
Net income added to reserve	$102	$104	$124	$110
Increase of delinquent loan interest in reserve	$ 4	$ 11	$ 25	$ 93
Loan purchases (net of repayments)	$ 18	$ 32	$ 56	$ 85

As the table indicates, current net income in fiscal year 1980 (after adjusting for uncollected delinquent loan interest) was not sufficient to finance the purchase of guarantees and insurance claims by private lenders and exporters. The trend does not bode well for Eximbank's future ability to absorb losses as more of its commitments mature.

OPERATING LOSSES PROJECTED FOR THE 1980s

Eximbank periodically calculates the potential impact of continued negative interest rate spreads on net income and the reserve. According to December 1980 staff memorandums prepared for the Board of Directors and the Reagan transition team, the current $2.2 billion reserve was considered sufficient to last for 10 years or more under most assumptions. These projections were based principally on a borrowing rate of three-quarters of one percent higher than the lending rate on new loans. Eximbank maintained such an average negative interest rate spread on its loan portfolio until December 1978. The projections also showed that Eximbank would exhaust its reserve in the 1987-88 timeframe if a 2.5 percent or larger spread between rates on then-budgeted levels of new loan authorizations and current funding costs was maintained indefinitely. This negative spread on new loan authorizations, which was sustained up to December 1980, currently exceeds 4 percent.

Eximbank projections made in January 1981 dim the earlier outlook. These projections--which take into account the cost of later borrowings, reduced authorization levels, financial effect of the PEFCO arrangement, and omission of dividends--show a probable loss for fiscal year 1982 and possibly earlier exhaustion of the reserve.

The following tables show the effect of various lending and borrowing interest rate assumptions on Eximbank's net income and income reserve. From alternative Bank projections, we selected several which we believed to be both representative and realistic. For example, we did not include in the tables projections based on a 5-percent spread between borrowing and lending rates. Tables 1 and 2 are based on the use of constant interest rates. Table 3 assumes a constant lending rate of 9 percent and declining borrowing rates from 13 percent in 1981 to 8 percent in 1984 and 1985. The tables employ a number of other current assumptions described in detail in chapter 1.

Table 1

Projected Annual Net Income Under Alternative Interest Rate Assumptions

Constant lending/ borrowing rate (percent)	Interest rate spread	Fiscal year ending 1981	1982	1985	1986	1989
		(millions)				
11/10	+1	$ 61	$ 55	$257	$362	$ 738
10/10	-0	58	39	117	161	313
9/10	-1	56	22	-24	-40	-111
10/12	-2	28	-69	-279	-354	-642
9/12	-3	25	-86	-424	-562	-1,089
11/14	-3	-1	-162	-553	-695	-1,235
10/14	-4	-4	-179	-702	-911	-1,703

Source: Eximbank

Table 2

Projected Value of Accumulated Income Reserve

Constant lending/ borrowing rate (percent)	Interest rate spread	Fiscal year ending 1981	1982	1985	1986	1989
		(millions)				
11/10	+1	$2,248	$2,303	$2,822	$3,184	$5,007
10/10	0	2,246	2,284	2,527	2,687	3,472
9/10	-1	2,243	2,265	2,231	2,191	1,938
10/12	-2	2,215	2,146	1,508	1,154	-462
9/12	-3	2,213	2,127	1,205	643	-2,060
11/14	-3	2,186	2,025	743	48	-3,078
10/14	-4	2,184	2,005	433	-478	-4,738

Source: Eximbank

Table 3

Projected Net Income and Reserve

Constant lending/ variable borrowing rate	Fiscal year ending 1981	1982	1983	1984	1985
9% vs.	13%	11%	9%	8%	8%
	(millions)				
Net income	$ 7	$ -94	$ -117	$ -75	$ -14
Income reserve	2,194	2,101	1,984	1,909	1,895

Source: Eximbank

The above tables indicate that:

1. Fiscal year 1981 will show a reduced profit, or small loss, compared to fiscal year 1980 earnings of $110 million, regardless of the course interest rates take over the short term. (See table 1.)

2. Losses will commence in fiscal year 1982 and continue throughout the decade unless lending rates are roughly brought into line with current borrowing costs. The interest rate spread at December 31, 1980, was a negative 4 percent. (See table 1.)

3. The income reserve is adequate to cover losses resulting from lending at rates below borrowing costs through fiscal year 1986 if the average negative spread does not exceed about 3 percent. (See table 2.)

4. Lending rates of approximately 2 percent or more below current borrowings will deplete the income reserve by the end of the decade. (See table 2.)

5. The higher the interest rates go, even assuming a constant spread between lending and borrowing rates, the greater are the prospects for increased deficits and earlier depletion of the income reserve. (See table 1 and 2 where spread is -3 percent.)

6. A steady decline and leveling off of interest rates on borrowed funds to 8 percent by 1984-85 will not prevent losses beyond 1981 but will do much to prevent the income reserve from being depleted. (See table 3.)

CONCLUSION

The reserve is sufficient to cover possible loan losses on outstanding commitments due where borrowers are in financial difficulty. However, we have qualified our opinion on the adequacy of the reserve because:

--The reserve increased but the risk of incurring possible future losses increased to a larger extent.

--Reserve adequacy cannot be realistically assessed because of the uncertain nature of future foreign economic and political conditions.

--Eximbank's current borrowing rates are higher than its lending rates and the gap between its average cost of borrowed funds and interest earned on loans is widening.

--The difference between Eximbank's borrowing and lending rates may be further aggravated as a result of an agreement between it and PEFCO concerning the funding of certain loans.

AGENCY COMMENTS

Eximbank did not comment on the adequacy of its loss reserve. It pointed out that it had been aware of the impact of high interest rates on profitability and for some time had projected the possibility of operating losses in fiscal year 1982 and beyond. Eximbank specifically cited its former Chairman's testimony on this matter more than a year ago before the Senate Banking's Subcommittee on International Finance.

Treasury said that our concerns over the adequacy of the loss reserve were justified. It noted that, although Eximbank could be treated like other agencies which do not establish reserves for possible losses, Eximbank had not been so structured nor would Treasury recommend such a structural change.

CHAPTER 4

EFFORTS TO REVISE INTERNATIONAL

CREDIT GUIDELINES FAIL

International negotiations to eliminate, or at least reduce, subsidies for officially supported export credits failed in December 1980. The Carter administration believed that French intransigence caused the negotiations to fail. The U.S. Government responded with a retaliatory strategy designed to make Eximbank-supported exports more competitive with exports supported by other governments. A former Treasury Department official announced in late 1980 that:

> "We will now move to improve Eximbank's competitive position by extending its loan repayment terms. Eximbank will selectively offer terms of 15-20 years or more if necessary to assure that U.S. exporters are not disadvantaged by the highly subsidized official export credits of our major trading partners."

Eximbank's retaliatory response to date, however, has been limited. In November 1980, shortly before the final breakdown in negotiations, Eximbank extended terms on three preliminary commitments--two involved sales to the Ivory Coast for which repayment terms were extended from a normal 10 years to 20 years and one involved a sale to Argentina for which the term was extended from 8.5 to 12 years. The French Government was the principal competitor in these cases. U.S. exporters won these sales, but some Eximbank officials with whom we talked were skeptical that this strategy would produce the intended effect; Treasury officials, however, were more optimistic. The Treasury Department represents the U.S. Government at the credit negotiations, supported by Eximbank and other executive branch departments and agencies.

ROAD TO THE CURRENT IMPASSE: A CHRONOLOGY

1973

After the OPEC oil embargo in October and subsequent OPEC-induced price increases, U.S., German, French, and European Community (EC) representatives met informally in Washington, D.C., to discuss limiting the components of official export credit support. Later, at the 1973 annual meeting of the International Monetary Fund/World Bank Group in Nairobi, it was decided that official export credit support should be reassessed as part of a reevaluation of the international monetary system.

1974

In February, the EC governments proposed that the United States, Japan and EC countries enter into a "gentlemen's agreement" aimed at harmonizing export credit terms. The U.S.

Government's position was that interest rates should be closer to market levels and that repayment terms should relate to a project's economics.

The U.S. Government also sought limits on the use of local-cost financing and mixed or aid-type credits. The Europeans sought absolute limits on repayment terms regardless of a project's economics.

1975

In May, officials from the EC member countries, the United States, and Japan agreed that terms and conditions might vary by the level of a borrowing country's economic development. There was no agreement on other issues, such as (1) minimum interest rates, (2) schedule of benchmark maturity limits based on economic development levels, (3) a list of exemptions by product type, and (4) use of mixed credits.

The basic differences among the countries concerning interest rates and repayment terms persisted. The United States sought an interest rate minimum of 8 percent with repayment terms determined by a project's economics. France and other EC countries continued to press for absolute maturity limits and opposed an 8-percent interest floor.

The Germans proposed to break the impasse with a compromise consisting in part of an absolute maturity limit of 10 years for less developed countries and a minimum 8-percent interest rate for developed countries; the U.S. Government in turn suggested four variations on this compromise. All these proposals attempted to specify the interrelationships among economic development levels, loan maturities, and interest rate minimums.

The impasse continued through the summer. France believed the proposed maturity limits were too open-ended, while Japan felt the minimum interest rates were too high for intermediate and poor countries. All of the participating EC governments except France were willing to accept at least one of the U.S.-proposed compromises.

In November, the heads of state of the principal negotiating countries met at Rambouillet, France, and, among other things, agreed to continue efforts to reduce official export credit competition.

At about the same time, the European Court of Justice ruled that the European Commission and not EC member governments had exclusive competence to conclude export credit agreements.

1976

The Rambouillet summit and European court ruling appeared to have intensified the search for an export credit agreement. The European Commission was subsequently outmanuevered by "unilateral national pronouncements" embodying the compromise proposals resolved earlier in the year. Since it was not an "agreement," it was outside the Commission's jurisdiction. The U.S. Government made its unilateral declaration in June. The interest rate minimum matrix of this "gentlemen's agreement" was as follows.

Borrower's economic development level	Repayment terms: 2 to 5 years (percent)	Repayment terms: over 5 years (percent)
Relatively rich	7.75	8.00
Intermediate	7.25	7.75
Relatively poor	7.25	7.50

Maximum repayment terms were 10 years for the "relatively poor" and 8.5 years for all others. Eximbank's interest rates ranged from 8.25 to 9.50 percent at that time.

1978

The international consensus was formalized as an "International Arrangement on Guidelines for Officially Supported Export Credit" in February and became effective in April.

Key features of the Arrangement are summarized below.

1. Cash payment must equal at least 15 percent of the export value.

2. Repayment terms cannot exceed 10 years for exports to relatively poor countries or 8.5 years for exports to other countries.

3. Minimum interest rates are established on the basis of the wealth of the buyer country and the term of the loan and range from 7.25 to 8 percent.

4. Costs incurred in the buyer country (local costs) can be financed only up to the amount of the cash payment.

5. Export credits can be mixed with foreign assistance funds (mixed credits). If the aid funds comprise less than 25 percent of the total credit, other participants must be notified. Credits having more than 25 percent aid funds are considered foreign aid and thus not subject to the Arrangement's terms.

The U.S. Government took the position that the Arrangement, although it increases the information about each country credit offer, does not address the substantive improvements sought by the United States, including (1) broadening coverage to include agriculture, aircraft, nuclear power plants, and ships, (2) increasing interest rate minimums, and (3) reducing the subsidy aspect of official export financing.

1979

During late 1978 and early 1979, attempts to change the Arrangement again proved fruitless, largely, the U.S. Government believes, because of continued French intransigence. On March 16, President Carter announced that negotiations had failed, concluding that "further negotiations would not be productive at this time." The President also noted that "lack of progress requires us to reexamine our own eforts to assure that we remain competitive in the export credit field." Accordingly, Eximbank continued to selectively match mixed credit offers, with mixed success. Budgetary limits, however, soon restricted this practice.

1980

In the fall of 1979, the U.S. Government perceived a new willingness to negotiate changes in the Arrangement. The participating countries agreed to study alternative ways to change the interest rate matrix.

In April, the so-called Wallen Report was submitted, outlining two possible changes in the matrix which would help to rectify what the U.S. Government continues to see as a major problem of the Arrangement. First, the Arrangement's interest rate minimums are fixed, and fluctuations in market interest rates, particularly upward, can produce sharp divergences between Arrangement and market conditions and generate major increases in effective subsidies. Second, the Arrangement's interest rates are identical for all currencies; however, market rates differ sharply from country to country (and, over time, for all countries) and thus create anomalies among countries.

The Wallen Report proposed two alternatives for dealing with these anomalies: (1) a "differentiated rate system," and (2) a "uniform moving matrix," stating that with the differentiated rate system:

> "the basic minimum interest rate for each currency is closely related to its market interest rate. Subsidization is minimized and tends to be equal among currencies. Market forces and exporters' and buyers' expectations would play a much greater role than in the present system."

* * * * *

and that a uniform matrix:

> "would ensure that the basic minimum interest rate is more closely related to developments in general levels of market interest rates than is the case with the present uniform fixed matrix. * * * [It is] suggested that an average of monthly market interest rates based on [Special Drawing Rights] weights be used."

In May, the European Commission, on behalf of its member countries, announced that it could not approve the differentiated rate system discussed in the Wallen Report. The Commission, however, did approve an increase in the interest rate minimums. At the Venice economic summit in June, the heads of state of the principal negotiating countries endorsed efforts to conclude an agreement by December.

Negotiations in the summer and fall failed to yield "acceptable" results; France would not agree to any changes other than a modest increase in interest rates. Since the European Commission cannot negotiate unless its members are in unanimous agreement, France's position meant that the Commission did not have a mandate to negotiate changes to the Arrangement except to support an additional modest increase in interest rates--an offer regarded as unacceptable by the U.S. Government. No agreement was reached before the December deadline, and the current round of negotiations have now been concluded.

DISCUSSION

Senator Proxmire's request included the question: "Should Eximbank change its current policy of requiring repayment within 7 to 10 years and abrogate the International Arrangement on Export Credits?"

As the foregoing chronology shows, and the Arrangement not withstanding, these negotiations represent 7 years of near futile effort by the U.S. Government to conclude an "acceptable" agreement. Nevertheless, we don't believe the Arrangement should be abrogated for the reason that there is little to abrogate save the information-sharing requirement, and it is in the U.S. Government's interest to know what other governments are offering in order to possibly match them.

Whether our negotiating partners will accept some variation of the Wallen Report alternatives is not yet known.

CHAPTER 5

WHAT IS EXIMBANK'S FUTURE?

Aggressive export financing in a period of relatively high borrowing costs has accentuated the conflict between Eximbank's goals of meeting the competition and remaining self-sustaining.

In one sense, the answer to the question posed by this chapter's title is straightforward. If the projections of the Bank's current financial condition discussed in chapter 3 become reality, the Bank could not continue as a self-sustaining institution and its future would be determined by the willingness of Congress to appropriate funds for lending and other programs. Faced with the looming prospect of direct subsidization, questions which seem especially relevant are: Does Eximbank financing increase exports? If so, to what extent? In short, is the Bank necessary? and importantly, How can necessity be determined?

MEASURING THE EFFECT OF EXIMBANK FINANCING

Senator Proxmire's request included a number of questions concerning Eximbank's purposes and future. He concluded his letter by asking:

> "Do Eximbank's export-financing programs, including direct credits and financial guarantees, benefit U.S. export sales and economic growth? Would U.S. exports and economic growth be lower without Eximbank's export subsidies? At what point does it become uneconomic (in terms of costs exceeding benefits) for the Bank to finance exports? I am especially interested in having the GAO quantify the public benefit, if any, to be gained by an increase in U.S. exports and compare the benefit with the cost of the Eximbank export subsidies."

Considering the scope of the Senator's request, we agreed to discuss the issues inherent in this set of questions, but not to attempt to independently answer them. Executive branch attempts to measure the effect that Eximbank financing has had on U.S. exports have been unsatisfactory. The Treasury Department's latest effort in this regard is discussed below.

Treasury's study of additionality

Treasury twice has attempted to measure a so-called "additionality" factor in Eximbank programs. Treasury defines additionality as the "probability that Eximbank programs have in fact fostered U.S. exports by overcoming capital market imperfections and by meeting the competition of foreign official export credit agencies."

The latest study attempted to calculate only fiscal year 1978 export sales booked as a result of Eximbank's participation; it concluded that:

> "* * *for Fiscal Year 1978, exports supported by direct credits are calculated to have a very high probability of additionality, somewhat greater than 70 percent; those supported by bank guarantees and medium-term insurance are calculated to have significantly lower probablility of additionality, about 30 percent."

Although this conclusion suggests impressive success in measuring an elusive subject, the seeming precision is misleading. To be sure, the report sounds a cautionary note: "[G]iven the simple framework of [the] analysis and uncertainty surrounding its assessment (1) of private capital market norms and (2) of the foreign official credit competition, it is difficult to place confidence bounds on the results."

A former Treasury official in 1978 congressional testimony posed several questions which present the additionality concept somewhat differently than does the Treasury study; he asked:

> "Does Eximbank financing actually increase United States exports? Is the Bank assisting exports which would not otherwise be sold? This question of additionality is a difficult one to answer. Yet it is fundamental for any U.S. Government export credit program."

The same official also noted that "To identify additionality, it is necessary to exclude the effect of such factors as price, quality, and marketing, where Eximbank does <u>not</u> play a role. This is a sound statement of the methodological hurdle to be overcome, but the Treasury study did not attempt to make these "necessary" exclusions.

We would not dwell at length on this study were it not for the fact that its conclusions are sometimes used to justify Eximbank's export stimulation role. Briefly put, the problem with the study is that it defines additionality in a way that virtually guarantees the conclusion noted above.

It is circular to argue, as does the Treasury study, that "to the extent that Eximbank credit characteristics fall outside of perceived norms in private markets, a higher probability of additionality is assumed." Eximbank has been part of the international lending system for over four decades. What the study calls "private capital market norms" are likely defined with Eximbank lending terms in mind, a situation which suggests the following question: Does Eximbank make long-term loans because of existing private capital norms (e.g., lending terms less than 5 years) or are those norms what they are because Eximbank dominates the long-term market?

It is not clear how additionality can partly be defined as "overcoming capital market imperfections," since there is so little to overcome. The market generally, and individual loans specifically, are shared between private and public lenders. There is no indication that Eximbank is crowding out private investment in the long-term market. By law, Eximbank loans must not compete with private capital. Assuming Eximbank faithfully adheres to the law, additionality, if solely defined as overcoming private capital norms, should equal 100 percent.

The second part of Treasury's additionality concept consists of "meeting the competition of foreign official export credit agencies." The strength of foreign competition was rated by Eximbank--the very organization that is, in a sense, being "rated" by the study as a whole. Although Eximbank's rating may have been the best possible, there is an inherent conflict of interest; Eximbank surely is not a disinterested measurer of its own behavior.

Eximbank's loans are "additional" according to the way Treasury defined the concept. The Bank's behavior is evaluated by the very concepts that define Eximbank's place in the international lending system. Whatever else the Treasury study may be, it is not helpful in answering the questions posed previously: "Does Eximbank financing actually increase U.S. exports? Is the Bank assisting exports which would not otherwise be sold? To empirically answer these questions, we would have to be able to determine the extent to which financing independently influences a sale; product quality, price, compatibility, deliverability, and serviceability all potentially influence a purchasing decision in a competitive market. If all other factors are equal, differences in financing become relatively more important and the rationale for government intervention perhaps more obvious.

Such an argument, however, is troublesome, because it is the governments that have deliberately tried to make financing an important factor--governments share the market with commercial banks, lend at concessional rates in relation to the private market, and compete against each other within the loose terms of the international Arrangement. In other words, governments have created the very condition they use to justify continued intervention. Trying to measure the independent or causal strength of the six factors mentioned previously is difficult, because government activity is a seventh factor which influences the strength of the others.

Arguments for the Bank

In summary, Eximbank-type financing is generally defended for two reasons: (1) it allegedly fills a gap in the credit market for long-term (over 5 years) financing of capital goods exports and (2) since other OECD 1/ governments provide a similar service, so should the U.S. Government. Of these two justifications, the first tends to be encompassed by the second. Although Bank financing may fill a loan-maturity gap, it is impossible to disentangle cause and effect. To paraphrase the question posed previously: Do commercial banks avoid long-term maturity loans because Eximbank dominates this market or does Eximbank dominate this market because commercial banks are reluctant to do so?

Subsidies extended by other governments tend to make the finance-gap argument irrelevant. Even if U.S. commercial banks were to fill the gap, they would presumably do so for profit-making reasons; lending rates would exceed their borrowing costs. In the current interest rate climate, commercial banks would not be competitive with subsidized interest rates offered by other OECD governments. Other factors, like price, quality, and servicing, would presumably have to be very advantageous to offset the disadvantage of commercial bank financing in order to make capital goods competitive in international markets. For this reason, arguments in favor of Eximbank-type financing tend to turn on the alleged necessity of matching the export finance offers of competitor governments. In short, the argument runs, the U.S. Government must subsidize export financing to the extent that other governments do. The following two cases are examples of Eximbank's attempts to neutralize highly concessional financing terms offered by competitor governments. The Bank matched concessionary offers in these and several other instances in 1978 and 1979 in order to influence the direction of international negotiations on the Arrangement.

Cyprus earth satellite station - December 1978

Eximbank's preliminary commitment included a 15-percent cash payment, 85-percent direct credit at 8.125 percent, and 9-year term.

The Bank's staff reported that "competition for equipment of this type is stiff," with other countries supporting 85-percent coverage and comparable interest rates.

Several American firms bid on the earth station and one U.S. firm was reported by the Bank's staff to be the "Cypriot's first choice from the start, being both the most suitable technically and having the lowest price."

Shortly after the Bank made a preliminary commitment, it learned that the French had established a mixed credit facility with the Cypriot Government and had offered an interest rate between 5.6 and 6.3 percent; the favored U.S. firm asked Eximbank to reconsider its interest rate in light of the French action. The Bank learned that the Cypriots had indicated that, after

---

1/Organization for Economic Cooperation and Development.

reviewing initial price and quality considerations, the first choice would be strongly affected by the suppliers' proposed financing agreements.

The problem for the Bank presumably was to decide whether the Cypriot Government was bluffing. In other words, was the U.S. product's price and quality sufficiently attractive to offset the French subsidy? The Bank decided not to risk losing the export sale and instead offered 6-percent interest on a 9-year, 10-month loan, which resulted in a sale. In matching the French offer, the Bank noted that

--the U.S. firm would probably win the business if financing was competitive;

--the dollar amount was relatively small, thus not greatly affecting the Bank's resources;

--there was a good possibility of additional business;

--the U.S. firm had made every effort to win the business through intensive marketing; and

--the Bank's exposure in Cyprus was negligible.

Cyprus steam turbine generators - December 1978

Eximbank's preliminary commitment included a 15-percent cash payment, 85-percent direct credit at 8 percent, and 12-year, 9-month term.

Before the bid submission deadline expired, the United Kingdom's Export Credits Guarantee Department asked its American, Japanese, and French counterparts if they intended to offer concessionary financing terms. The three governments replied that they would adhere to the Arrangement's guidelines. The British Government then notified other governments participating in the Arrangement that it too would offer terms consistent wih the Arrangement.

About 2 weeks later, the British Government changed its mind and announced that, due to "strong industrial pressures," it was offering to finance 50 percent of the power station out of its capital aid program. The British offer included 50 percent of the financing at 4-percent interest for 25 years with a 3-year grace period and 50 percent at 7.75 percent for 10 years with no grace period.

Eximbank's staff, in its comments to the Bank's Board of Directors, noted that:

"Given the extremely low rates necessary to match the British offer, staff is reluctant to attempt to be competitive. However, in view of the fact that all members had agreed to cooperate and the British nevertheless granted a concessionary credit, the Board may wish to be more forceful in its final decision."

Although Eximbank matched the British offer, the sale was lost to Germany on the basis of lower price, better quality, and allegedly better financing, although German financing was reportedly not as favorable as the American or British offers.

Discussion of mixed credit offers

Is the public well served by this sort of aggressive financing? Because of Eximbank's new offer in the earth satellite station case, the favored U.S. firm made a sale that it otherwise might not have made. Eximbank helped to facilitate the sale at some cost to itself. During the August to December 1978 transaction period of the Cyprus loans, Eximbank borrowings from the Federal Financing Bank carried an 8.5 to 9.0 percent interest rate and the gap between its average borrowing costs and lending rates increased from 0.64 to 0.75 percent.

Aside from consideration of public and private costs and benefits, the transactions perhaps had symbolic value to the extent that the principle of reciprocity in trade was upheld. In both cases, the Bank's ultimate offers "neutralized" the French and British offers to the extent that nongovernmentally determined factors, like price and quality, apparently determined the sales.

As a former Treasury official said in 1980 congressional testimony:

> "[E]xport credit subsidies work only if no other country is willing to match them. Over the last few years, it has become clear that export credit agencies are willing to match each other's programs."

Most recently, for example, the Canadian Government announced in early 1981 that, as a result of the breakdown of international export credit negotiations in December 1980, it would establish a $900-million fund to be used for mixed-credit financing over a 3-year period.

Arguments against Eximbank

The Bank's critics fall into two categories: (1) those who accept the premise that officially supported export credit is necessary but question Eximbank's lending practices as being too generous or not generous enough and (2) those who do not accept the underlying premise and believe that the Bank should be abolished. The following discussion concerns the second type of criticism.

Central to this sort of criticism is the assertion that there is no special reason to single out exporters as beneficiaries of subsidized financing. Other kinds of business activity are presumably just as deserving. The Bank's critics wonder why the U.S. Government should run what they believe is, in essence, a welfare agency for exporters. They see no compelling reason to give foreign consumers a taxpayer financed windfall in the form of cheaper U.S. goods. As one critic put it:

> "The U.S. is lending money to foreigners at a rate of interest below the yield on capital at home, so that American real income is being reduced through low-yielding loans abroad. In short, the Exim Bank serves as an unintended foreign aid program."

With regard to the demand that the Bank match the credit terms of competitor governments, this critic notes that:

> "The best option would be for the U.S. to cease subsidizing foreign consumers through credits, and welcome any permanent subsidies that foreign governments are foolish enough to provide, thereby increasing the amount of imported goods that the U.S could obtain for any given volume of exports sacrificed."

Critics of the Bank also generally argue that the adoption of floating exchange rates among developed countries diminishes the ability of export support programs to contribute to a satisfactory balance of payments. The Congressional Budget Office has summarized this argument as follows. 1/

> "An export subsidy will tend to cause the U.S. dollar to appreciate as demand for U.S. exports goes up. If the dollar actually appreciated, purchasing U.S. goods would become more expensive (whether the items are subsidized or not); foreign products would become relatively cheaper. Foreigners will therefore tend to buy less of U.S. products; the United States may also tend to import more, which would offset to some extent any increase in exports the support programs stimulate."

The Congressional Budget Office expects to finalize a report on the benefits and costs of Eximbank's loan subsidy program in mid-1981.

1/"U.S. Government Involvement in Commercial Exports: Program Goals and Budgetary Costs," Nov. 1977, p. 19.

CONCLUSION

Our 1975 report concluded that Eximbank should do everything possible to promote exports, but should do so on a self-sustaining basis. Further, we believe that, in the face of high borrowing costs, the Bank will not be able to avoid further erosion of its financial condition unless it charges interest rates which are not competitive.

Recent Eximbank practice has been to aggressively meet foreign export credit subsidies as a way of compelling intransigent governments to accept, for example, the Wallen Report concept. Aside from the issue of whether direct subsidization of export financing is a prudent use of public funds, consistently matching the export credit offers of other governments--especially their so-called foreign aid or mixed credit-type loans--is a costly undertaking in a period of high borrowing costs. The need for increased borrowings or appropriated funds in such a situation seems probable if the Bank's current financial condition continues to deteriorate for the next several years. Whether such a course would prompt resumption of the now stalled negotiations and bring them to an acceptable conclusion is of course unknown; but one fact is incontestable, Eximbank cannot indefinitely borrow at rates which exceed its lending rates by several percent and remain self-sustaining.

AGENCY COMMENTS AND OUR EVALUATION

Eximbank contends that the Export-Import Bank Act of 1945, as amended, includes an explicit statutory mandate for it to provide competitive financing for U.S. exports but that there is no statutory mandate that it be self-sustaining. Furthermore, Eximbank's position is that an appropriation is not and will not be necessary for the continuance of operations, regardless of the size or duration of operating deficits. It cites an Attorney General opinion which holds that the Bank's debt obligations carry the full faith and credit of the U.S. Government. Accordingly, it argues, lenders would normally be willing to make loans to finance Eximbank's operations regardless of any operating losses it might incur.

We agree that Eximbank is not statutorily required to be self-sustaining; however, this has been its practice since it was created in 1934, supported by a congressional understanding that it is and should remain a self-sustaining institution. Moreover, although the Attorney General has held that Eximbank's debt obligations are backed by the full faith and credit of the United States, Congress may not want Eximbank to operate indefinitely at a deficit.

Treasury shares our concern over Eximbank's deteriorating financial condition but believes the conflict between the self-sufficiency and competitiveness goals is not as stark or as long lasting as our report implies. Treasury attributes Eximbank's current financial problem in large measure to adhering to a policy of aggressively matching low-interest loans of foreign official export credit agencies. It considers the problem to be a temporary one that will subside as interest rates decline under the President's economic program, assisted to the extent that (1) the Bank matches foreign credit offers with longer term loans, but at market or near market rates of interest, and (2) the United States is able to negotiate improved export credit understandings with its foreign competitors.

We concur in Treasury's assessment of the causes of Eximbank's financial plight but not necessarily in the view that it is a short-term problem. In this regard, we note that negotiations to eliminate or reduce export credit subsidies so far have been unsuccessful; domestic interest rates continue to remain at very high levels; and changes in the Bank's lending policy would have only a gradual effect on improving its profitability because the time lag between existing loan authorizations and their disbursement typically runs from 3 to 5 years.

In addition, Treasury makes the point that the arguments in the report in support of the Eximbank program are not as strong or precise as they might be. It maintains that the gap in the capital markets that Eximbank fills for foreign buyers is not just for long-term financing, but rather for long-term, fixed-interest financing. Further, Treasury says there are reasons to want a vital Eximbank as a means to enforce export credit understandings with other countries. We agree with these observations, which are presented in more detail in Treasury's letter (see app. III).

Finally, in a conclusion we also fully share, Treasury stresses that Eximbank should not abandon good business practice in pursuit of meeting foreign competition which results in large subsidization losses. According to Treasury:

> "* * * Eximbank is and should continue to be operated on a businesslike basis."

MATTERS FOR CONSIDERATION BY THE CONGRESS

In our April 1980 report on Eximbank competitiveness, we suggested several alternatives regarding possible congressional involvement in determining future Eximbank lending. Those alternatives are partly repeated in chapter 1 of this report. Circumstances may soon make it impossible for the Bank to simultaneously attain both objectives of meeting the competition and remaining self-sustaining. Congress should, by clarifying legislation, direct Eximbank to either emphasize (1) its statutory mandate to be competitive over its longstanding and congressionally accepted policy to be self-sustaining, or (2) this congressional understanding that it remain self-sustaining over its statutory requirement to be competitive.

We believe Eximbank's current financial dilemma has intensified to the point where Congress needs to clarify its intent. If the mandate to meet the competition is emphasized over self-sufficiency, some form of subsidy for the Bank's lending activity with public funds could be necessary. If Congress does not intend that meeting the competition be given predominance in the current situation, then it should affirm that fact by indicating what it believes is acceptable lending policy. In any event, it is now clear that increased congressional involvement is needed in determining Eximbank's export financing policies.

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

B-114823

APR 8 1981

To the Board of Directors
Export-Import Bank of the
United States

We have examined the statements of financial condition of the Export-Import Bank of the United States as of September 30, 1980 and 1979, and the statements of income and analysis of reserve for contingencies and defaults, and of changes in financial position for the years then ended. Our examinations were made pursuant to the Government Corporation Control Act (31 U.S.C. 841-870) and in accordance with generally accepted Government auditing standards, and accordingly included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

The Bank states its income before providing a reserve for losses that may be sustained on loans, guarantees, and insurance. However, it retains accumulated net income after dividends as a reserve for such losses. Although the reserve increased in fiscal year 1980, the risk of incurring possible future losses increased to a larger extent. This increased risk is due primarily to loan purchases, outstanding purchase agreements, and principal and interest delinquencies. (See Statement of Financial Condition and notes 4, 6, and 8.)

The adequacy of the reserve cannot be realistically assessed because of the uncertain nature of future foreign economic and political conditions. For example, the effects of developments in Iran on the Bank's exposure in that country is not determinable at this time. At September 30, 1980, the Bank's exposure in Iran was $312.1 million, including loans of $305.7 million considered to be in a delinquent status. (See note 4.)

Any losses the Bank may incur on purchases of defaulted commercial loans covered by Bank guarantees or insurance and rescheduled under countrywide debt consolidations also are chargeable against the reserve. In fiscal year 1980 the Bank purchased loans totaling $90.4 million. Cumulative loan purchases since fiscal year 1977 have been $205.1 million, while cumulative repayments have been $13.8 million. Under existing agreements, the Bank may be called upon to purchase additional loans totaling as much as $213 million. (See note 6.)

(ID-81-44)
(487040)

B-114823

In addition, the reserve is subject to impairment because the Bank's current funding rates are higher than its lending rates. As a result the Bank's average cost of borrowed funds as of September 30, 1980, exceeded its interest income from outstanding loans by about 1.7 percent. This represents a 0.6 percent increase over the 1.1 percent interest rate differential as of September 30, 1979. If this trend continues, the Bank could be in a loss position by fiscal year 1982. Based on data we obtained subsequent to the balance sheet date the differential had increased and the reserve could be exhausted within 7 to 8 years.

The difference between the Bank's borrowing and lending rates may be further aggravated as a result of a fiscal year 1980 agreement between the Bank and the Private Export Funding Corporation (PEFCO). This agreement provides that the Bank and PEFCO will share in providing $1.35 billion of export financing at fixed rates of interest quoted by the Bank to foreign borrowers. Under the agreement, the Bank has guaranteed to make up any difference between the borrowers' interest payments and PEFCO's interest charges. (See note 8.) Because of the various contingencies, we are unable to express an opinion on the adequacy of the reserve.

In our opinion, except for the amount reserved for contingencies and defaults, the accompanying financial statements present fairly the financial position of the Export-Import Bank at September 30, 1980 and 1979, and the results of its operations and changes in its financial position for the years then ended in conformity with generally accepted accounting principles applied on a basis consistent with that of the preceding year.

Milton J. Socolar

Acting Comptroller General
of the United States

COMPARATIVE STATEMENT OF FINANCIAL CONDITION

ASSETS	September 30, 1980		September 30, 1979	
Cash in U.S Treasury and Commercial Bank..............		$ 200,000		$ 100,000
Loans Receivable (Notes 4, 5, 6 and 9):				
Current Loans - includes rescheduled loans of $634.7 million at 9-30-80 and $592.9 million at 9-30-79............	$13,029,200,000		$11,238,800,000	
Delinquent Loans...............	735,900,000		620,200,000	
		13,765,100,000		11,859,000,000
Accrued Interest and Fees Receivable (Note 4):				
Current Interest and Fees......	263,900,000		223,100,000	
Delinquent Interest............	59,900,000		52,400,000	
		323,800,000		275,500,000
Other Assets:				
Deferred Debenture and Participation Certificate Expenses......................	100,000		200,000	
Foreign Credit Insurance Association Receivable........	1,300,000		1,300,000	
Other Receivables and Miscellaneous Assets..........	300,000		600,000	
		1,700,000		2,100,000
Total Assets...................		$14,090,800,000		$12,136,700,000

	September 30, 1980		September 30, 1979	
LIABILITIES, RESERVE, AND CAPITAL				
Borrowings (Notes 2 and 3):				
Notes Payable to U.S. Treasury.....	$ 79,000,000		$ 50,000,000	
Notes Payable to Federal Financing Bank....................	10,066,900,000		7,952,900,000	
Notes Payable to Private Export Funding Corporation...............	-0-		50,000,000	
Notes Payable to U.S. Institutions.	251,200,000		396,600,000	
Certificates of Beneficial Interest Payable..................	160,100,000		236,900,000	
Participation Certificates Payable...........................	250,000,000		250,000,000	
		$10,807,200,000		$ 8,936,400,000
Other Liabilities:				
Accrued Interest Payable...........	81,900,000		72,600,000	
Dividend Payable to U.S. Treasury..	-0-		35,000,000	
Other Credits......................	4,100,000		6,000,000	
		86,000,000		113,600,000
Deferred Fee Income................		10,200,000		9,000,000
Reserve for Contingencies and Defaults (Notes 3,4,5 and 7): accumulated from income - includes delinquent interest and delinquent capitalized interest of $165.0 million at 9-30-80 and $72.0 million at 9-30-79		2,187,400,000		2,077,700,000
Capital Stock Held by U.S. Treasury (Note 3)...........................		1,000,000,000		1,000,000,000
Total Liabilities, Reserve, and Capital........................		$14,090,800,000		$12,136,700,000

Notes to Financial Statements on pages through are an integral part of this statement.

COMPARATIVE STATEMENT OF INCOME AND ANALYSIS OF RESERVE FOR CONTINGENCIES AND DEFAULTS

	Fiscal Year Ended September 30, 1980	Fiscal Year Ended September 30, 1979
Revenues:		
Interest on Loans	$ 927,700,000	$ 793,500,000
Insurance Premiums and Guarantee Fees	30,000,000	29,500,000
Commitment Fees and Other Income	31,600,000	24,500,000
Total Revenues	989,300,000	847,500,000
Expenses:		
Interest on U.S. Government Borrowings	793,200,000	579,700,000
Interest on Debenture and Participation Certificate Borrowings	12,800,000	38,200,000
Interest on Certificates of Beneficial Interest Borrowings	15,700,000	20,000,000
Interest on U.S. Institutional Borrowings	22,700,000	28,900,000
Other Expense, principally Interest and Amortization of Financing Costs	5,200,000	7,700,000
Administrative Expenses	13,900,000	13,300,000
Claims Paid, net of recoveries (Note 7)	16,100,000	1,000,000
Total Expenses	879,600,000	688,800,000
Net Income	109,700,000	158,700,000
Less: Addition to Reserve for Contingencies and Defaults	109,700,000	123,700,000
Dividend to U.S Treasury (Note 3)	$ -0-	$ 35,000,000

Analysis of Reserve for Contingencies and Defaults:		
Balance at Beginning of Fiscal Year	$2,077,700,000	$1,954,000,000
Addition to Reserve	109,700,000	123,700,000
Balance at End of Fiscal Year	$2,187,400,000	$2,077,700,000

Notes to Financial Statements on pages through are an integral part of this statement.

COMPARATIVE STATEMENT OF CHANGES IN FINANCIAL POSITION

	Fiscal Year Ended September 30, 1980	Fiscal Year Ended September 30, 1979
Funds Provided		
Net Income	$ 109,700,000	$ 158,700,000
Borrowings from the Federal Financing Bank (Note 2)	3,704,100,000	2,532,600,000
Borrowings from U.S. Treasury	2,160,400,000	1,520,600,000
Repayments of Loans Receivable	1,377,100,000	1,314,000,000
Repayments of Loans Purchased Pursuant to Guarantee and Insurance Agreements	4,700,000	6,500,000
Sales of Certificates of Beneficial Interest	-0-	1,500,000
Investment in U.S. Securities	-0-	7,700,000
Accrued Interest Payable	9,300,000	(23,300,000)
Total Funds Provided	$7,365,300,000	$5,518,300,000
Funds Applied:		
Disbursements and Other Additions to Loans, includes Capitalized Interest 9-30-80, $55.7 million; and 9-30-79, $13.2 million	$3,197,500,000	$1,567,100,000
Loans Purchased Pursuant to EIB Guarantee and Insurance Agreements	90,400,000	62,400,000
Accrued Interest and Fees Receivable	48,200,000	30,200,000
Repayments of Federal Financing Bank Borrowings	1,590,100,000	1,148,000,000
Repayments of U.S. Treasury Borrowings	2,131,400,000	1,470,600,000
Repayments of Private Export Funding Corporation Borrowing	50,000,000	50,000,000
Repayments of U.S. Institutions Borrowings	145,500,000	39,800,000
Redemptions of Certificates of Beneficial Interest	76,800,000	75,800,000
Redemptions of Debentures	-0-	1,043,100,000
Payment of Dividend to U.S. Treasury (FY 1979 and FY 1978)	35,000,000	35,000,000
Other	400,000	(3,700,000)
Total Funds Applied	$7,365,300,000	$5,518,300,000

Notes to Financial Statements on pages through are an integral part of this statement.

Note 1: Enabling Legislation and Basic Accounting Principles

Eximbank is an independent corporate agency of the United States. The primary legislation governing its operations consists of the Export-Import Bank Act of 1945, as amended through November 10, 1978, and the Government Corporation Control Act.

Eximbank's accounting records are maintained on an accrual basis with the exception of write-offs of loans and payment of claims on guarantees and insurance policies. Loans are written off and charged to income when Eximbank determines that the outstanding principal balance is uncollectable. Interest on delinquent loans receivable is accrued until such time as Eximbank determines on a case-by-case basis that a particular delinquent loan should be nonaccruing. Claims, except for purchases of assets (see footnote 6), are charged to income in the year paid. Later recoveries of amounts written off or of amounts which have been paid as claims are treated as income in the year received.

The commitment authority of Eximbank under the Export-Import Bank Act to lend, guarantee, and insure is limited to $40 billion outstanding at any one time. Under the Act loans are charged against the $40 billion limitation at 100 percent of their authorized amount. Guarantees and insurance are charged against the $40 billion limitation at not less than 25 percent of Eximbank's contractual liability, with the proviso that the aggregate amount of guarantees and insurance so charged may not exceed $25 billion outstanding at any one time. Thus, Eximbank's contractual commitments outstanding at any one time could reach $58.75 billion, consisting of $25 billion of guarantees and insurance outstanding, resulting in a $6.25 billion charge against the $40 billion limitation, and $33.75 billion (additional commitments) charged at 100 percent against the limitation.

At September 30, 1980, the committed and uncommitted authority to lend, guarantee, and insure was:

Category		($Millions) Charge
Loans		$21,412.6
Guarantees	$ 6,178.2	
Insurance	5,570.8	
	$11,749.0 @25%	2,937.3
Committed		24,349.9
Uncommitted		15,650.1
Total Statutory Authority		$40,000.0

Note 2: Borrowings from the U.S. Treasury and the Federal Financing Bank

Eximbank does not receive any appropriated funds. It has authority, under its Act, to borrow directly from the U.S. Treasury and to have outstanding at any one time up to $6 billion of such borrowings. Eximbank avails itself of this authority for its short-term needs on a daily basis at a 91-day Treasury bill rate. Excess cash is used to reduce these borrowings on a daily basis. The average rate for such short-term borrowings, for the quarter ending September 30, 1980, was 7.95 percent.

In previous years, Eximbank borrowed to meet its medium-term needs through the issuance of debentures and participation certificates. One certificate for $250 million with an interest rate of 5.10 percent is still outstanding and matures in 1982.

Eximbank is now borrowing from the Federal Financing Bank (FFB) for its medium- and long-term needs. During the year ending September 30, 1980, Eximbank borrowed the following from the FFB:

Date	($ Millions) Amount	Rate	Final Maturity
12/03/79	$ 949.8	10.559%	12/01/89
3/03/80	124.0	12.694	3/01/90
3/03/80	713.6	13.233	3/01/90
6/02/80	840.2	9.988	6/01/90
6/02/80	209.3	10.293	6/01/90
9/02/80	637.0	11.352	9/01/90
9/02/80	230.2	11.509	9/01/90

As Eximbank is usually a net borrower of funds, it is planned that net short-term borrowings from the U.S. Treasury will be repaid quarterly by borrowing from the FFB on a medium- and long-term basis at a U.S. Government agency borrowing rate appropriate to the term of the borrowing.

Note 3: United States Government Investment in Eximbank

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

	($ Millions) September 30, 1980	September 30, 1979
Capital stock held by U.S. Treasury	$ 1,000.0	$ 1,000.0
Reserve for Contingencies and Defaults	2,187.4	2,077.7
Dividend Payable to U.S. Treasury	-0-	35.0
Notes Payable to Federal Financing Bank	10,066.9	7,952.9
Total	$13,254.3	$11,065.6

No dividend was declared from FY 1980 net income.

Note 4: Delinquent Loans

Loans with any installments of principal or interest past due 90-days or more are classified as delinquent on the Statement of Financial Condition. The outstanding principal amount of delinquent loans is summarized on a comparative basis (see table below).

Delinquent interest of $59.9 million has accrued and is carried as a receivable. The difference between this figure and the $96.3 million shown in the table represents mainly interest on loans which are non-accruing for financial statement purposes.

The delinquent loans to China were made in 1946 to the then recognized government of China. The delinquent loans to Cuba pertain to loans made before 1961, when a prior government existed.

In FY 1980 Eximbank rescheduled principal and interest installments of $86.3 million (see footnote 5). At the time of the reschedulings, $13.3 million ($6.2 million principal and $7.1 million interest) was past due 90-days or more.

Since December 21, 1979, Eximbank has accelerated certain loans and guarantees totaling $310.3 million which had been made to or guaranteed by the government of Iran. These loans were accelerated on the basis of defaults on scheduled repayments to Eximbank or loans with cross-default clauses.

($ Thousands)

Country	Total Outstanding Principal	Delinquent Installments September 30, 1980			Delinquent Installments September 30, 1979		
		Principal	Interest	Total	Principal	Interest	Total
Brazil	$ 25,953.2	$ 2,834.3	$ 439.4	$ 3,273.7	$ 446.8	$ 166.7	$ 613.5
Cen. Afr. Rep.	2,825.9	1,121.0	736.4	1,857.4	439.0	556.6	995.6
China	26,386.0	26,386.0	24,997.3*	51,383.3	26,386.0	24,202.1	50,588.1
Cuba	36,266.6	36,266.6	40,932.4	77,199.0	36,266.6	38,937.3	75,203.9
Dom. Rep.	13,128.0	1,306.8	180.6	1,487.4	-0-	.5	.5
Iran	305,718.3	305,718.3	10,636.4	316,354.7	-0-	125.6	125.6
Liberia	1,995.1	1,917.9	36.7	1,954.6	1,350.6	-0-	1,350.6
Mexico	1,082.2	1,082.2	619.7	1,701.9	1,082.2	570.7	1,652.9
Nicaragua	13,844.7	610.8	1,024.9	1,635.7	22.0	3.8	25.8
Turkey	97,944.9	13,810.2	9,318.7	23,128.9	-0-	-0-	-0-
Uganda	1,818.6	1,653.8	382.4	2,036.2	1,181.3	273.0	1,454.3
Zaire	162,772.3	2,715.6	5,537.9	8,253.5	16,792.4	32,797.2	49,589.6
Other	46,136.7	2,227.2	1,460.0	3,687.2	2,462.7	2,457.9	4,920.6
Total	$735,872.5	$397,650.7	$ 96,302.8	$493,953.5	$86,429.6	$100,091.4	$186,521.0

The countries listed above are not necessarily the obligor of the delinquent loans. Some of the loans are to private parties in those countries.

*Eximbank actually ceased to accrue interest on its books in 1960. At that time, interest amounted to $9,325,442.59.

Note 5: Rescheduled Loans
From time to time Eximbank must extend the repayment date of some or all principal installments of a loan to a new schedule because the obligor or country has encountered temporary financial difficulty and the Directors of Eximbank have determined that providing relief in this manner will aid collectability and enable the obligor ultimately to service the debt.

All loan maturities which were previously rescheduled in this manner are current at September 30, 1980, except for 20 loans with an aggregate outstanding principal balance of $158.0 million as to which principal and interest installments amounting to $29.8 million are 90-days or more past due. These 20 loans are included in the delinquent classification on the Statement of Financial Condition. In FY 1980 Eximbank rescheduled principal and interest installments totaling $86.3 million on loans having an outstanding principal balance of $433.8 million.

Some reschedulings include capitalized interest, which has been previously credited to the Reserve for Contingencies and Defaults. At September 30,1980, the Reserve of $2,187.4 million includes $144.5 million of such outstanding capitalized interest of which $105.1 million is 90-days or more past due. The Reserve also includes past due interest on delinquent loans totaling $59.9 million.

Note 6: Loans Purchased Pursuant to Eximbank Guarantee Agreements
Claim payments under Eximbank's medium- and short-term guarantee and insurance programs are treated as purchases of assets and recorded as loans receivable when, in the opinion of the Board, the prospects of repayment and other factors, including materiality and country-wide debt consolidation considerations, justifies such treatment.

The $13,765.1 million of loans receivable at September 30, 1980 includes $191.3 million of purchased loans and the $11,859.0 million at September 30, 1979 includes $105.6 million. As of September 30, 1980, cumulative purchases of loan installments totaled $205.1 million and cumulative repayments totaled $13.8 million. In accordance with the terms of existing guarantee and insurance agreements, Eximbank may be called upon to purchase some or all of the remaining $213.0 million of installments relating to these loans.

Fiscal year 1979 and 1980 loan purchases are summarized in the table below.

Country	($ Thousands) FY 1980 Loan Purchases	FY 1979 Loan Purchases
Mauritania	$ 436.3	$ -0-
Nicaragua	1,149.5	-0-
Peru	-0-	3,870.0
Sudan	2,997.7	-0-
Togo	889.3	527.7
Turkey	19,824.7	21,944.1
Zaire	65,088.3	36,021.1
Total	$ 90,385.8	$62,362.9

Note 7: Losses, Claims and Reserve for Contingencies and Defaults

Losses, claim payments and recoveries for FY 1980 and FY 1979 are:

	($ Thousands) FY 1980	FY 1979
Loans written off	$ -0-	$ -0-
Guarantee claims paid	8,082.1	5,432.2
Guarantee recoveries	(2,889.0)	(5,092.7)
Insurance claims paid	16,158.4	4,758.1
Insurance recoveries	(5,208.1)	(4,108.3)
Claims Paid, net of recoveries	$16,143.4	$ 989.3

The risk to Eximbank from potential losses and claims is not susceptible to accurate measurement because of the unpredictable nature of future worldwide economic and political conditions. Eximbank's entire Reserve is available to cover such losses, claims and contingencies. Eximbank has a Reserve for Contingencies and Defaults of $2,187.4 million which is 15.9 percent of outstanding loans and 6.6 percent of world commitments. This Reserve, coupled with Eximbank's $1.0 billion Capital, amounts to 23.2 percent of outstanding loans and 9.6 percent of world commitments.

Note 8: Commitments and Contingent Liabilities

Eximbank's worldwide commitments, shown below, include contingent liabilities totaling $11,749.0 million at September 30, 1980, and $9,548.0 million at September 30, 1979.

	($ Millions) FY 1980	FY 1979
Outstanding Loans	$13,765.1	$11,859.0
Undisbursed Loans	7,647.5	7,292.2
Guarantees Contingent Liability	6,178.2	4,961.3
FCIA Insurance Contingent Liability	5,570.8	4,586.7
Total	$33,161.6	$28,699.2

In FY 1980, Eximbank and the Private Export Funding Corporation (PEFCO) agreed to share in providing a total of $1,350 million of U.S. export financing for 16 export credits at current fixed rates of interest quoted by Eximbank to foreign borrowers. The rates on the loans range from 8 percent to 10.7 percent. Eximbank's share of the total is $251 million which is included in the total above for undisbursed loans. PEFCO's share is $1,099 million, which is guaranteed by Eximbank and is included in the figure above for contingent liability for guarantees. Under this arrangement, Eximbank will meet any shortfall or retain any excess between the borrowers' interest payments and PEFCO's interest charges. PEFCO's interest rate will be determined as disbursements are made to the borrower. As of September 30, 1980, no disbursements had been made. Recently, PEFCO's interest rate has exceeded the U.S. Government's borrowing cost for an equivalent maturity (Eximbank's primary financing source) by approximately seventy-five one hundredths of one percent.

Note 9: Maturity Schedule of Outstanding Loans Receivable

As of September 30, 1980, about 61.2 percent of the outstanding loans receivable balance of $13,765.1 million is projected to be due over the next five years and the remaining 38.8 percent is estimated to be due thereafter, as indicated below:

Fiscal Years of Maturities	Amount ($ Millions)	Percent of Total
1981	$ 1,543.1	11.2
1982	1,627.5	11.8
1983	1,741.4	12.7
1984	1,683.5	12.2
1985	1,836.3	13.3
	8,431.8	61.2
1986-2001	5,333.3	38.8
	$13,765.1	100.0

In addition to the $13,765.1 million of outstanding loans there are undisbursed loans totalling $7,647.5 million most of which are expected to be disbursed over the next 3-5 years.

EXPORT-IMPORT BANK OF THE UNITED STATES
WASHINGTON, D.C. 20571

CABLE ADDRESS "EXIMBANK"
TELEX 89-461

April 20, 1981

Mr. Frank C. Conahan
Director
U.S. General Accounting Office
Washington, D. C. 20571

Dear Mr. Conahan:

Thank you for the opportunity to comment on GAO's proposed report to the Congress on the dilemma facing Exim because of the conflict under current interest rate conditions between the Bank's competitiveness and self-sufficiency objectives.

I am returning a copy of the draft report with our comments noted in detail on the appropriate pages. However, I would like to summarize briefly Exim's position on certain issues raised in the report.

Eximbank has an explicit statutory mandate to provide competitive financing for U.S. exports. The Export-Import Bank Act of 1945, as amended, states that Exim is directed to provide U.S. exporters "extensions of credit at rates and on terms and other conditions which are competitive with the government-supported rates and terms and other conditions available for the financing of exports from the principal countries whose exporters compete with United States exporters".

There is no statutory provision requiring Exim to be self-sustaining. The Bank has been a self-sustaining institution as a matter of policy.

While we believe that the self-sustaining objective is highly desirable and important, when conflicts arise between the two objectives, the Bank has emphasized its statutory mandate of competitiveness. Under current interest rate and competitive conditions, this has resulted in a 3%-5% spread between the Bank's current lending rate and its marginal cost of funds, and more than a 2% spread between its average rate on loans receivable and its average cost of borrowed funds.

We have been aware of the impact of this situation on the Bank's profitability. More than a year ago, Exim's Chairman stated in testimony before the Subcommittee on International Finance of the Senate Committee on Banking, Housing, and Urban Affairs that if interest rates in the economy did not moderate, the Bank would stop showing a profit by 1982. In December, 1980, the Board voted to pay no dividend to the U.S. Treasury from Exim's 1980 net income but to add the entire $110 million to the retained earnings reserve. This decision was based on sharply increased interest expense costs and the projection of an operating loss in 1982. The Bank's initial 1982 budget request, transmitted to Congress in January 1981, showed a loss of $102 million in FY 1982. Because of lower activity levels and lower interest rate assumptions used by OMB under the Reagan revised budget, the current estimate of the Bank's operating deficit for FY 1982 has been lowered to $19 million. Thus, the Bank has been projecting the possibility of operating losses in 1982 and beyond for some time.

The GAO stated in the draft that the Bank may find it necessary to request appropriated funds in the future to supplement its $1 billion Treasury capitalization. While Congress may if it wishes provide such funds, an appropriation is not and will not be necessary for the continuation of Exim's operations, regardless of the size or duration of any operating deficits. Under an opinion of the Attorney General, Exim's debt obligations carry the full faith and credit of the U.S. Government. Consequently, lenders would normally be willing to lend to Exim to finance its operation regardless of any operating losses the Bank might incur.

We particularly call your attention to the concluding paragraph on page 47. We believe that the statement should read that in the face of high borrowing costs the Bank will not be able to avoid further erosion of its financial condition unless it charges interest rates which are not competitive. (See p.33)

Sincerely,

James K. Hess
Acting Treasurer-Controller

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

OFFICE OF
ASSISTANT SECRETARY
FOR INTERNATIONAL AFFAIRS

May 13, 1981

Dear Mr. Conahan:

Thank you for inviting Treasury comment on your draft "Eximbank Financing Hinders Its Aim of Self-Sufficiency." We share your concern over the decline in Eximbank income and its consequences for the maintenance of an adequate loan loss reserve.

Your conclusion has focused on a real problem. It could not have been stated more clearly than your report did on page vii: "If Congress does not intend that meeting the (foreign official credit) competition be given predominance in the current situation, then it should affirm that fact by indicating what it believes is acceptable lending policy." But the conflict between self-sustaining and subsidizing may not be as stark or as long lasting as your report implies. (See p. v)

The current problem was caused in a large measure by a policy of aggressively matching low-interest loans of foreign official export credit agencies. This problem can be mitigated to some degree by the extent to which Eximbank matches long-term, low-interest loans by offering much longer term loans but at market or near-market rates of interest. This would, of course, involve departures from the International Arrangement on Export Credits, which heretofore we were reluctant to do. Thus, the problem is not as stark as one might think.

Secondly, it would be ill-advised to abandon goals of good business practice to solve what we believe to be a short-term problem. The Reagan Administration's economic program is designed to reduce substantially the level of inflation, and interest rates can, as a consequence, be expected to decline. Such a decline, assisted by any improvement that can be negotiated in the Arrangement, will reduce significantly the subsidy required to meet foreign competition. The goals of an institution should apply to its operation over longer periods of time, and so hopefully there are expedients that allow better accountability, but are consistent with temporary departures from criteria based on private market behavior.

The report's concerns over the adequacy of Eximbank's loan loss reserve are justified in our judgment (chapter 3). While Eximbank could be treated as an expenditure agency -- with no attempt to provide reserves for possible losses -- it has not been so structured. Nor would Treasury recommend a structural change. Eximbank is and should continue to be operated on a businesslike basis. We would, in this regard, urge the GAO to provide a more thorough analysis of appropriate measures of reserve adequacy for Eximbank. The adequacy of reserves cannot, of course, be judged from any one year's loan loss level. In the long run, losses should be covered by guarantee fees, either those explicitly charged or those included implicitly in Eximbank's interest rates on direct credits. The reserve should be sufficient, however, to cushion extraordinary temporary losses. The report properly emphasizes that Eximbank will no longer be able to do business when the loan loss is reduced below this critical level rather than reduced to zero as is often assumed.

On matters of measurement, the GAO might find two computational procedures useful. First, an allowance might be made in computing Eximbank's net income for the opportunity cost, equal to the difference in government borrowing rates and Eximbank's lending rates, of lending Eximbank's reserves and capital subscription. This would incorporate the notion that Treasury's capital subscription involved implicit borrowing and taxes must be set to cover interest on that loan. An implicit guarantee fee foregone might be computed as well since a direct credit at government borrowing rates implies a low risk loan.

Second, the estimate (p. 16 in report) of Eximbank's loss arising from the September 1980 Arrangement with PEFCO to underwrite interest rates on $1 billion in credits fails to discount future losses. This results in an overestimate of about two-thirds of the cost. The present discounted value of the subsidy gives the approximate loss to the reserve, on an accruals basis, of undertaking the program. Since your report stresses the implication of Eximbank's reduced income on the adequacy of reserves, it would appear to be a good measure. (See p. 10)

The arguments used in the report in support of the Eximbank program (p. 41 ff) are not the strongest available. Those touching "imperfect markets" are not as precise as they might be. The often cited "gap" in capital markets is not for "long-term (over five years) financing of capital (See p. p. 28)

goods exports." It is rather for long-term, fixed-interest borrowing by foreign buyers. Although not all buyers or capital goods wish fixed rate finance, there are some who find that the certain knowledge of their future interest payments reduces their risk appreciably.

There are a number of good reasons for commercial banks not to be active in this part of the market besides the report's suggestion (p. 42) that Eximbank displaces them. (See p. 29) For example, to the extent that commercial banks fund their lending on shorter terms they run a substantial funding risk by lending at fixed rates. There are in fact a large volume of long-term syndicated Bank loans carrying floating rates of interest. Other institutions, such as insurance companies and pension funds, have on the other hand large long-term liabilities which they will wish to balance in part with long-term, fixed-interest rate assets of low risk. Here it is frequently contended that New York State laws restricting the size of insurance companies' portfolios inhibit foreign lending. I do not wish to suggest that there is a "black hole" instead of a market for long-term, fixed-rate finance to foreign buyers, but only that the problem is considerably more focused than the report suggests.

The "gap" in the financial market to which the report refers may actually be considerably smaller than the export finance activity of OECD governments. The demand for such finance is clearly enlarged by the increased level of subsidies offered, and there are doubtlessly many borrowers that are attracted into the officially supported market who are capable of finding other forms and sources of finance. It may be an overstatement, however, to infer from the fact that private financial institutions may be displaced by overall activity of export finance agencies that there is no gap in the market at all.

There are, moreover, reasons to wish a vital Eximbank to enforce improved export credit understandings, quite aside from the pressure it can bring in support of negotiating these improvements. These understandings rely on information exchanges to encourage matching of credit terms. This removes the incentive not only to breach the limits of these understandings but also to keep the terms as firm as practicable. In fact, this is a more efficient means to enforce an arrangement than cumbersome adjudication procedures.

The foregoing considerations should stress that although meeting the competition of certain countries means incurring large subsidization losses, it is not necessarily the case.

Governments like Germany and Switzerland have successful guarantee programs while Canada prefers to lend for very long terms at higher interest rates.

I hope you find these remarks useful. My staff would be pleased to offer any further assistance that you might wish.

Sincerely,

John D. Lange

John D. Lange
Acting Deputy Assistant Secretary
for Trade and Investment Policy

Mr. Frank C. Conahan, Director
International Division
United States General Accounting Office
Washington, D.C. 20548

United States Senate

COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS

WASHINGTON, D.C. 20510

October 1, 1980

Honorable Elmer B. Staats
Comptroller General
General Accounting Office
441 G Street, N.W.
Washington, D.C. 20548

Dear Mr. Staats:

I am deeply concerned about the Export-Import Bank's new practice of using a mixture of PEFCO loans and very low interest direct credits that has been authorized for FY 1980 to finance exports. I am especially troubled by the excessively low interest that will be charged on the direct credit portion of the loan package to give the overall financing a low blended interest rate.

Eximbank was intended to be a self-sustaining institution. But I doubt whether it will be able to remain self-sustaining if it begins the practice of adding very low interest PEFCO-related direct credits to a loan portfolio already heavily laden with low interest, broad coverage loans.

These new very low interest credits are being offered at a time when Eximbank's average cost of borrowed funds is about 8 percent and its marginal cost is higher—and rising. That means that the Bank will not even come close to covering its average and marginal money costs on these loans. If the new PEFCO/direct credit combination is continued, the Bank will inevitably have to subsidize the difference between the low rate of return on these loans and the high cost of borrowed funds by using its earnings or dipping into its equity capital.

I would like the General Accounting Office to investigate the financial implications of Eximbank's use of very low interest direct credits to achieve low blended interest rates for export financing. Specifically, I am interested in the cost to the Bank--both short and long term—of this new interest subsidy and what affect it could have on the Bank's earnings and capital. Will the cost eventually amount to $200 million, as some people have indicated, if this approach were to be continued? Has Eximbank undertaken any studies on the prognosis for interest rates for the short and long term to examine the implications of this program? Or is the new program an open-ended commitment where the actual cost would be uncontrolled?

In addition, I want the GAO to examine the Bank's interest rate and loan policies and its capital adequacy and how they relate to the Bank's new loan undertaking. The following questions are of particular interest:

Are Eximbank's assets properly valued? If these assets are overstated or overvalued and do not reflect the loans that are in default or have remote probability of repayment, it follows that Eximbank's equity capital is overstated and should be adjusted downward.

Has Eximbank's interest rate policy since FY 1978 been responsive to market conditions as reflected in the Bank's average and marginal cost of borrowed funds? What has been the impact of Eximbank's low interest rates on loan demand as measured by the Bank's outstanding commitments over the past 3 fiscal years?

Has Eximbank extended more commitments for direct credits than it can realistically fund within its current budget parameters?

Should Eximbank use longer repayment terms at higher interest rates rather than low interest rates as the competitive feature of its loans? Should Eximbank change its current policy of requiring repayment within 7 to 10 years and abrogate the International Arrangement on Export Credits?

To what extent have Eximbank policies been coordinated with other U.S. Government agencies in an effort to reach a multilateral agreement with our trade competitors to end government-subsidized official export credit competition (within OECD or elsewhere)?

Do Eximbank's export financing programs, including direct credits and financial guarantees, benefit U.S. export sales and economic growth? Would U.S. exports and economic growth be lower without Eximbank's exports subsidies? At what point does it become uneconomic (in terms of costs exceeding benefits) for the Bank to finance exports? I am especially interested in having the GAO quantify the public benefit, if any, to be gained by an increase in U.S. exports and compare the benefit with the cost of the Eximbank export subsidies.

I would appreciate a report by January 31, 1981.

Thank you for your cooperation.

Sincerely,

William Proxmire
Chairman

WP/bfw

(483334)

AN EQUAL OPPORTUNITY EMPLOYER

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

OFFICIAL BUSINESS
PENALTY FOR PRIVATE USE,$300

POSTAGE AND FEES PAID
U. S. GENERAL ACCOUNTING OFFICE

U.S.MAIL

THIRD CLASS