Understanding the Importance of Export Credit Financing to U.S. Competitiveness

BY STEPHEN J. EZELL | JUNE 2011

Global competition in export credit financing has become increasingly formidable, with foreign competitors enjoying substantial support from their countries' export credit agencies.

The United States is falling behind in global economic competition, with the result being lost jobs and a rising trade deficit. One reason for this fall is that international trade has become much more competitive. Establishments in the United States are competing against more formidable competitors, many of them receiving significant support from their governments as they seek to gain global competitive advantage and the jobs that go with it.

One key factor in this competitive race is export financing. Indeed, global competition in export credit financing has become increasingly formidable, with foreign competitors enjoying substantial support from their countries' export credit agencies (ECAs). Indeed, many of the United States' strongest international trade competitors invest significantly more in export credit assistance as both a share of GDP and exports than the United States does. With the current authorization of the U.S. Export-Import (Ex-Im) Bank set to expire at the end of the fiscal year on September 30, 2011 and as the U.S. Congress looks to reauthorize the Bank for a new four-year term, it will be important that it does so promptly with a reauthorization that significantly raises the statutory lending authority of the Bank so it can boost its export credit financing activities for U.S. exporters.

ROLE OF THE U.S. EXPORT-IMPORT BANK

As the official export credit agency of the United States, the Ex-Im Bank provides financing and insurance for export transactions that would not otherwise take place because commercial lenders are either unable or unwilling to accept the political or commercial risks inherent in certain deals. Ex-Im is authorized to provide up to $100 billion in outstanding export credits and currently has about $80 billion in credits outstanding. The Ex-Im Bank's lending is backed by the full faith and credit of the U.S. government and is only provided if the Bank is convinced there is a reasonable assurance of repayment. The Ex-Im Bank enables transactions that might not otherwise occur and keeps the U.S. competitive in world markets by offering three types of financial programs: direct loans; guarantees, which can either be loan guarantees or working capital guarantees; and insurance.[1]

The Bank's direct loans provide financing directly to foreign buyers of U.S. goods and services, covering up to 85 percent of the U.S. contract value or 100 percent of the U.S. content, whichever is less. Loan guarantees cover repayment risks on a foreign buyer's debt obligations incurred to purchase U.S. exports. Here the Bank guarantees to the lender that if the foreign borrower defaults on the debt it used to purchase a U.S. export, the Ex-Im Bank will repay the outstanding principal and interest. The Bank's working capital guarantees provide repayment guarantees to lenders who have made working capital loans to U.S. exporters so they have the needed capital to fulfill export orders. Finally, the export credit insurance instrument helps U.S. exporters sell their goods overseas by protecting them against the risk of foreign buyer or other foreign debtor default for commercial or political reasons, thus allowing U.S. exporters to extend credit to their international customers.[2] Through these instruments, the Ex-Im Bank makes new export sales possible by filling market gaps where the private sector is unable or unwilling to take on risks—often for example with regard to exports to places like Russia, Latin America, or Africa.[3]

Over time the Ex-Im Bank's mission has evolved to not just promote U.S. exports but also to address U.S. competitiveness in the global marketplace, specifically by using export financing as a tool to level the competitive playing field by taking financing terms off the table as a determinant when foreign buyers are choosing whether to purchase a U.S. or competing country product. This enables U.S. exporters to compete in international markets based on their price and quality, and not lose a potential sale because a competing country's government is offering excessively generous financing terms to close a sale.[4] For example, Pakistan Rail (the nation's railroad authority) recently announced a $500 million solicitation bid for a vendor to supply 150 locomotives to the country. Pakistani officials told GE they preferred its locomotives and were willing to pay a premium for their high-quality and dependability.[5] But there was a complication: the bid from the Chinese locomotive manufacturer included a financing package with longer terms and drastically reduced fees that did not conform to international standards and practices and which put the sale and thousands of American jobs at risk. The U.S. Ex-Im Bank intervened with a financing package that took the advantage of China's financing assistance off the table, enabling Pakistan to make its decision based on the true performance-to-price characteristics of the competing Chinese and American products.

Thus, the Ex-Im Bank's export credit financing fosters a stronger U.S. economy by supporting exports of U.S. goods and services that can drive domestic job creation and help balance the trade deficit. In fiscal year (FY) 2010, the Ex-Im Bank provided $24.5 billion worth of export credit financing which supported $34.4 billion worth of U.S. exports.[6] Through that financing in FY 2010, the Ex-Im Bank supported 227,000 jobs at 3,300 U.S. companies, helping those companies export to 175 countries around the world. In fact, 7,400 U.S. jobs are created by every $1 billion worth of exports supported by the U.S. Ex-Im Bank.[7]

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Export credit financing is especially important to small-medium sized enterprises (SMEs), and thus a particular focus of the Ex-Im Bank is to support U.S. SME exporters, which were responsible for 32.8 percent of goods exports in 2009.[8] Ex-Im has a statutory goal of providing at least 20 percent of its financing to small businesses. Small businesses benefit in two distinct ways from export credit financing. First, 85 percent of the transactions financed by the Ex-Im Bank directly support small-medium sized businesses. Secondly, small businesses benefit indirectly from large company export credit support as subcontractors to large company exporters. For example, when a large U.S. company successfully exports a jet aircraft, locomotive, or wind turbine, it's effectively exporting tens of thousands of assembled parts contributed by thousands of U.S. SMEs. During the 2009 financial crisis, Ex-Im played one of the key roles for which it was designed, providing export credit financing, especially for SMEs, as the private sector withdrew from export finance. In FY 2010, Ex-Im's total small business transactions reached $5.1 billion, a 58 percent increase over the amount in 2008. The Ex-Im Bank expects to increase its SME lending to $9 billion annually by 2015.[9]

The Export-Import Bank is one of the most successful programs within the federal government. The Ex-Im Bank is financially self-sustaining, having returned $3.4 billion to the U.S. Treasury above and beyond the cost of its operations over the past five years. The Bank therefore no longer requires annual funding from the U.S. Treasury, meaning that increasing its statutory lending authority from the current $100 billion exposure cap would not add to the national debt. And while the Bank is backed by the full faith and credit of the federal government, only 1.5 percent of the Bank's loans default (well below most commercial banks' default rates), meaning that the Bank's financing efforts are not a financial or credit risk for the United States.[10] Yet despite the Bank's successes, not enough American exporters are receiving the benefits of its assistance. Thus, the Bank needs to provide still more export credit financing assistance to U.S. exporters, especially as international competition in export credit financing intensifies.

WHY HAVE AN EX-IM BANK?

So why have an entity like Ex-Im? Or another way of asking this is to ask why should government support exports generally, and through export financing specifically? The answer to the first question is easy. If business establishments in the United States on net lose competiveness in global markets, the American economy suffers. Because jobs producing exports create twice as many jobs as jobs producing for local markets, job creation is hindered, especially in periods like the present when the economy is producing underneath its capacity. Indeed, economist Lori Kletzner has found that, within an industry, a 10 percent increase in sales due to exports leads to a 7 percent increase in employment, while a 10 percent increase in domestic demand leads to just a 3.5 percent increase in employment.[11] In general, exporting firms tend to have about twice as many employees and sales as non-exporting firms, and they tend to be about 10 percent more capital- and skill-intensive.[12] Moreover, because export-related jobs pay as much as 18 percent more than jobs producing for the domestic market, boosting exports raises wages and U.S. living standards.[13] And finally, if the United States loses competitiveness, the value of the dollar must fall, meaning that Americans will pay more for imports, thus lowering their effective standard of living.

Why export financing? There are two reasons: externalities and risk. As described above, the benefits from robust exporting accrue not just to the exporter but to the overall U.S. economy. For example, if the United States had exported as much as it imported in 2009, it would have created 1.3 million more jobs in the U.S. economy, benefitting non-exporting companies and their workers.[14] But even if all the benefits of exporters accrued only to exporters and didn't spill over to society, exporters would still export less than societally optimal because of risk factors. For example, the Ex-Im Bank often intercedes when a small-medium sized enterprise exporter is unable to secure upfront capital from private markets for needed materials or inputs to manufacture a product because technical or political risks make the transaction uncertain or when a foreign buyer needs financing to purchase the goods or services of a U.S. exporter. Thus, Ex-Im does not compete with private sector lenders but rather acts as a "lender of last resort," responding to a market failure by providing export financing products that fill gaps in private trade financing.[15]

Moreover, one of the Ex-Im Bank's most important functions is to level the playing field for U.S. exporters by matching credit support that other nations provide to their exporters, thus preventing foreign exporters from enjoying undue advantage. This ensures that U.S. exporters are able to compete against foreign competitors based on the quality and price of their products and services, and not lose sales because a foreign government has helped a foreign competitor by providing superior financing terms to a potential buyer. Thus, the Ex-Im Bank helps companies compete against foreign competitors who receive assistance from their export credit agencies. For those who argue that the best answer would be for every nation to reduce export financing, the stark reality is that for the foreseeable future America's economic competitors are in the game to win and if we unilaterally disarm the only result will be fewer U.S. exports and the jobs dependent on them.

Finally, export financing can play an indispensible role in helping address the United States' growing trade imbalance, which has reached astounding levels. From 2000 to 2010, the United States accumulated a $5.5 trillion trade deficit in goods and services with the rest of the world.[16] The largest contributor to this $5.5 trillion deficit was a $4.5 trillion trade deficit in manufactured products.[17] As Figure 1 illustrates, the trade deficit has been exacerbated because of the United States' very low export intensity (exports as a percentage of GDP). While it's not surprising that the United States' export intensity would be below European countries that have substantial cross-border European trade, what's striking is that China has an export intensity four times greater than the U.S. economy's. On an absolute basis, despite being the world's largest economy, the United States is only the third largest exporter (behind China and Germany).

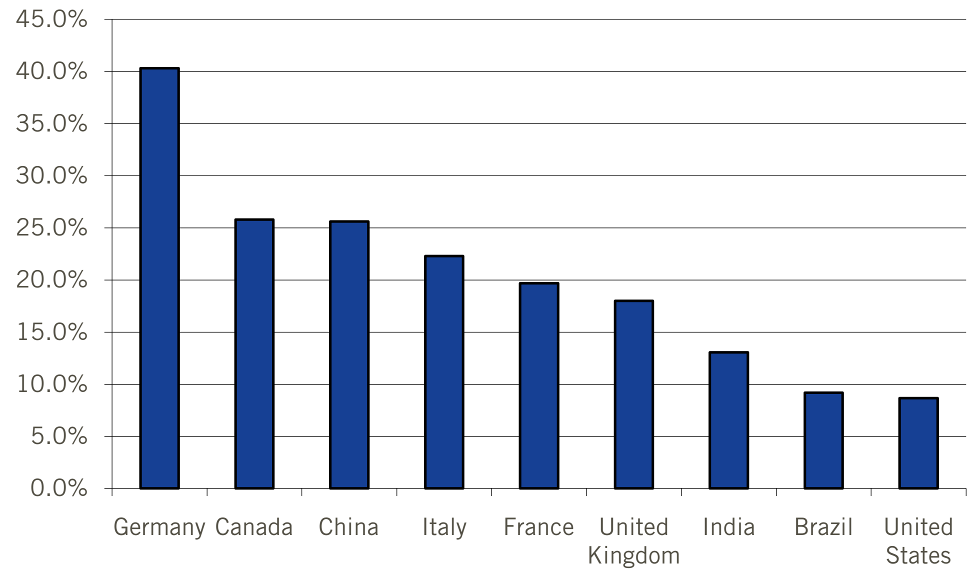

Figure 1: Exports as a Percentage of GDP by Selected Country, 2010[18]

The Ex-Im Bank levels the playing field for U.S. exporters by matching credit support other nations provide, ensuring U.S. exporters are able to compete based upon the price and performance features of their products.

Not only does the burgeoning U.S. trade deficit reflect an increasing lack of competitiveness from the U.S. economy, more worryingly it represents a hidden tax on the next generation of Americans. For the massive bill we run up every year by buying more imports than selling exports will have to be paid eventually when foreign nations demand payment in real goods and services, not in Treasury Bills. While several million workers in U.S. traded sectors have lost employment during the Great Recession, the effects of the continuing U.S. trade deficit will be felt most keenly in the future in the form of relatively lower U.S. productivity and a trade debt that future generations will have to pay off by producing more than they consume and exporting the difference.[19] The United States will need to leverage every tool at its disposal to boost U.S. exports, and export credit financing will have to play a key and increasing role.

Foreign Competition in Export Credit Financing

Over the last decade in particular many nations have ramped up their efforts to win in global export markets. As a result, foreign export credit financing has increased markedly, and now many of the United States' strongest competitors provide significantly more export financing as a share of their GDP to their exporters than the United States does to its. As Ex-Im Bank Chairman Fred Hochberg noted in recent Senate testimony, the United States is "clearly outgunned when it comes to foreign [export credit] competition."[20]

U.S. Export Financing Compared to Developing Countries

As Figure 2 shows, the United States badly trailed many developing nations, including Brazil, China, and India in new medium- and long-term official export credit volumes as a share of GDP in 2010. In fact, in 2010, Brazil's and China's export-import banks provided ten times more financing to their exporters as a share of GDP than the U.S. Ex-Im Bank provided to its.[21] (This represents a slight improvement from 2008, when China provided its exporters seventeen times more export credit support as a share of GDP than the United

States did.)[22] Still, Germany, France, and India all provided at least seven times more export assistance as a share of GDP than the United States did in 2010. While Japan provided less, it supports its exporters by inappropriately intervening in currency markets to keep the value of the yen lower than what it would otherwise be if markets alone set its price.

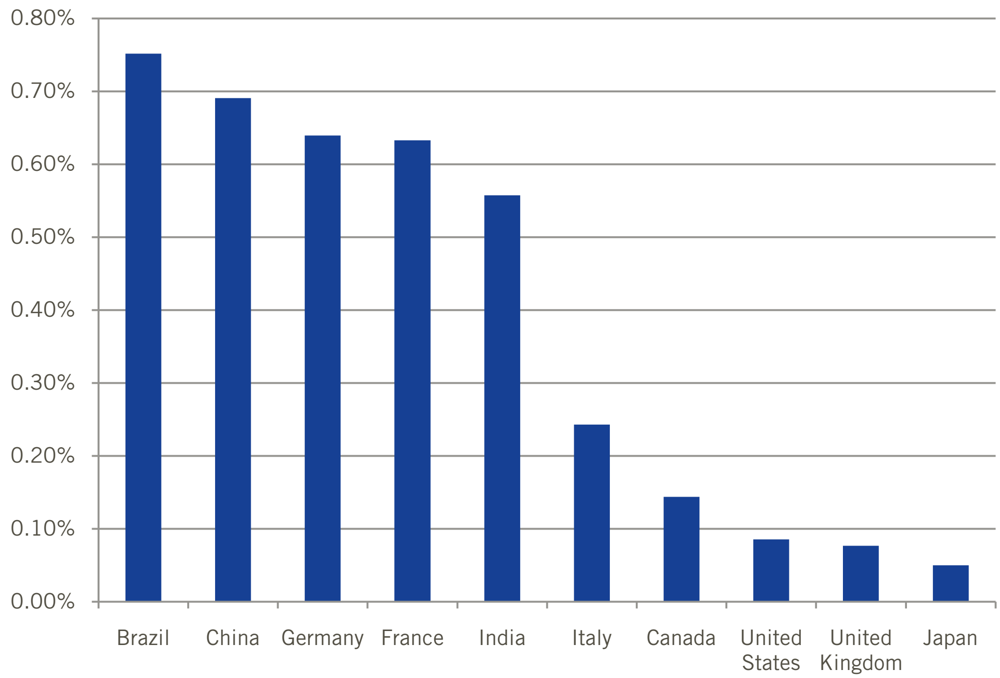

Figure 2: New Medium and Long-term Official Export Credit Volumes, 2010 (as a share of GDP)[23]

When comparing these countries' level of export credit financing as a share of exports (instead of as a share of GDP), these countries still provide much higher levels of export finance than the United States does. For example, from 2005 to 2008, Brazil supported over 4 percent of its merchandise exports with credit financing, while India and China both supported more than 3 percent of their merchandise exports with financing assistance.[24] On average, the United States supported just 1 percent of its merchandise exporters with export credit assistance between 2005 and 2008.

And these countries have been ramping up their support at a much faster rate than the United States. The percentage growth in export credit volumes from 2005 to 2008 in emerging countries like India and China and from 2005-2009 in developed countries such as France have dramatically outstripped export credit growth in the United States (see Figure 3).

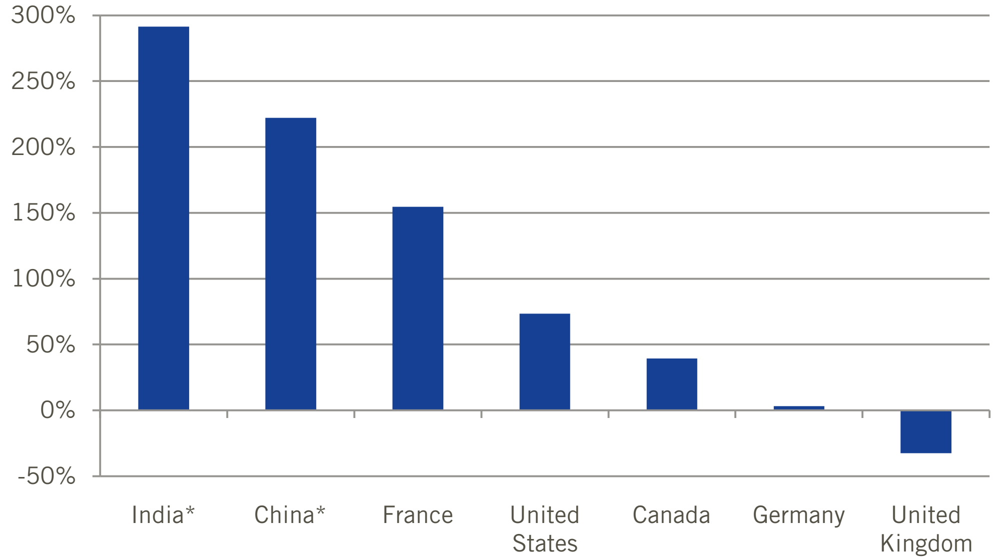

Figure 3: Percent Increase in Export Credit Volumes, 2005-2008/9*[25]

From 2006-2010, China issued over $203 billion in new medium- and long-term export credit financing, an amount four times invested by the United States in absolute dollars, and ten times more as a share of GDP.

But it's not just about growth and relative share, for China is now providing more export credit financing assistance to its exporters on an absolute basis than the United States is, even though its GDP is approximately 40 percent of the U.S level. In 2010, China issued $45 billion in new medium- and long-term official export credit volumes to the United States' $13 billion (figure 4).

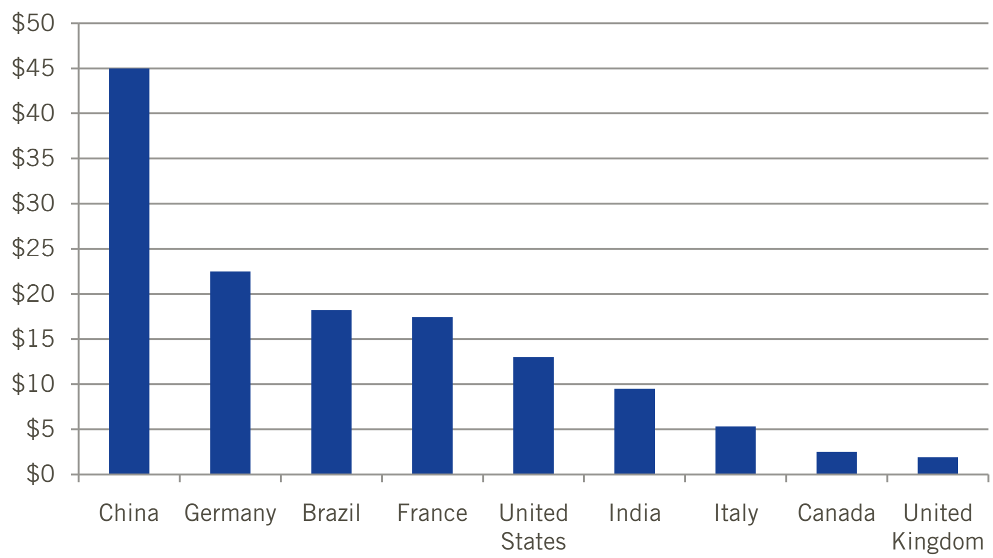

Figure 4: New Medium- and Long-term Official Export Credit Volumes, 2010 ($ billions) [26]

In fact, it's clear that the Chinese government has made export credit financing a focal point of its nation's export promotion strategy, launching the most aggressive export credit financing campaign in history. From 2006-2010, China issued over $203 billion in new medium- and long-term export credit financing, an amount four times invested by the United States in absolute dollars, and ten times more as a share of GDP, as Figure 5 illustrates. In part because of its efforts to aggressively support its exporting companies, China has become the world's largest exporter.

China's use of export credit financing does not follow OECD norms, particularly with regard to its "tied aid" practices.

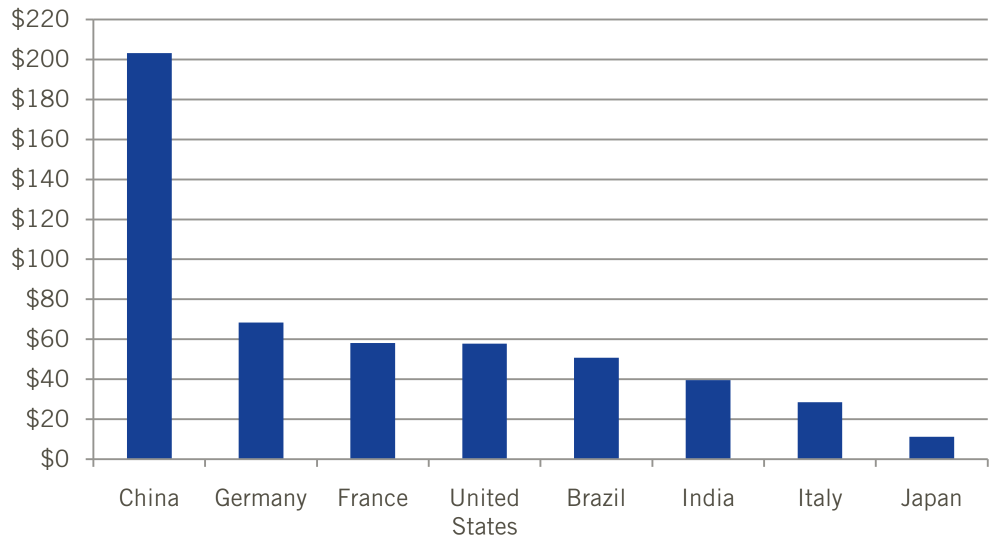

Figure 5: Cumulative New Medium- and Long-term Official Export Credit Volumes, 2006-2010 ($ billions) [27]

To understand the sheer amount of resources China has poured into export credit financing, consider that China has supported one company alone, telecommunications equipment manufacturer Huawei, with a $30 billion credit line from the Chinese Development Bank, meaning that China has supported a single company with about half as much newly issued export support as the United States has invested in all its companies combined over the past five years. [28] Such support enabled Huawei to boost its sales in one country alone, India, from $50 million to $2.5 billion in just one year.

Unfortunately, China's use of export credit financing does not follow OECD norms, particularly with regard to its "tied aid" practices, which refer to development assistance that is conditioned upon the purchase of goods and services from the donor country.[29] China is a major practitioner of tied aid transactions, which has given it an unfair advantage in many export deals. [30] As Gary Hufbauer elaborates with regard to that $30 billion credit line the China Eximbank extended to Huawei:

> The China Development Bank offered a $30 billion credit line to Huawei Technologies Co., which was bidding to sell network equipment to Brazil's largest land-line company, Tele Norte Leste Participacoes SA (TNLP3). The interest rate was two percentage points lower than the London interbank rate, and the China Development Bank offered a two-year grace period on payments. Tele Norte's Chief Financial Officer indicated that the presence of this below-market credit was a major reason for choosing Huawei over American and European competitors. The Chief Financial Officer of America Movil, the largest mobile phone carrier

in Latin America, also made similar comments about a 2009 deal with Huawei.[31]

Keep in mind that the main purpose of the Chinese Export-Import Bank is to fund Chinese companies so they can export, including to the United States. And they have been doing so with gusto, especially targeted at key U.S. markets and companies. The China Eximbank reports, "With China Eximbank credit support, China First Heavy Industries has seen enhanced market competitiveness and facilitated its exports of complete sets of large equipment…to regions worldwide," including to America, taking market share away from Peoria, Illinois-based Caterpillar.[32] As noted above, China Eximbank signed a financing agreement to support Huawei Technologies, a direct competitor to companies such as U.S.-based Cisco Systems and Juniper Networks, because of the bank's confidence in "Huawei's intellectual property rights and ability to expand into international markets." This is rich given that Huawei allegedly stole Cisco's technology to develop a lineup of routers and switches sold in direct competition to Cisco. It provided the Aviation Industry Corporation of China with $15 billion to help China's aviation industry "achieve leaps and bounds development and seek further integration into the international aviation industry."

It's one thing if China wishes to compete by providing many of its exporters with export credit financing, but it's another for it to do so outside the norms of international trade established by organizations such as the OECD, whose rules have contributed to a level international playing field for export finance. While China is not a member of the OECD framework, it needs to understand that if it wishes to have access to foreign countries' markets by enjoying membership in international organizations such as the World Trade Organization, then it has agreed to join a global trading system, not an exporting system.[33] Accordingly, the United States must strongly push China to curtail abusive mercantilist export credit finance practices and comply with international norms set up to ensure level playing fields for export finance.

U.S. Export Financing Relative to OECD Competitors

However, it's not just fast-growing developing countries such as China and India that are providing relatively more export credit assistance than the United States. As Hufbauer noted as far back as 2001, "For years, the ratio of Ex-Im finance to U.S. exports has been well below comparable ratios in other OECD countries."[34] And still today, the United States remains on the low end of the OECD scale. For example, as a share of total merchandise exports, France and Italy supported twice as many exports through medium- and long-term export credit financing between 2005 and 2008 as the United States did, with those countries supporting 2 percent of their exports and the United States only supporting 1 percent.[35] Moreover, these countries were far more active in boosting export credit financing as a response to the recent financial crisis. For example, France increased its medium- and long-term export financing to reach 6 percent of its merchandise export volume during the Great Recession.[36] And as Figure 5 illustrates, two EU states alone—Germany and France—issued more export credits from 2006 to 2010 than the United States did. This suggests that the entire EU-area, though it has roughly the same GDP as the United States, is issuing considerably more export credit than the United States. To be sure, the United States has moved to considerably increase export financing over the past two years, as from 2008 to 2010 the dollar value of the Ex-Im Bank's authorizations increased by 70 percent.[37] Yet even with that increase, China still offers 3.5 times the amount of export credit financing the United States does in absolute dollars, and Germany and France still provide more.

To adequately respond to foreign export credit competition, Congress should raise the Ex-Im Bank's authorization limit to at least $200 billion.

Therefore, the United States needs to continue to increase its export financing activity, and to do so will require a significant increase of the current $100 billion statutory lending limit of the Ex-Im Bank. The Presidents' FY 2012 budget calls for increasing Ex-Im lending from $20 billion to $32 billion annually, which would require a total lending limit of at least $160 billion over five years. But even $32 billion would be a far cry from the $45 billion China invested in export credit financing in 2010. For its part, the Ex-Im Bank has requested that Congress increase its credit cap in increments of $10 billion annually over the next four years to reach a $140 billion cap by 2015.[38] But ITIF believes that to adequately respond to foreign export credit competition Congress should raise the Ex-Im Bank's authorization limit to at least $200 billion. In addition to increasing the Bank's authorization cap, Congress should approve the Ex-Im Bank's requested increase for its administrative budget to $124.6 million in FY 2012, which would allow the bank to update its aging information technology architecture and increase its staffing for outreach to small businesses.[39]

Issues Relating to Ex-Im Bank Reauthorization

While the paramount goal for Congress should be a timely reauthorization of the Ex-Im Bank that includes a significant increase in the Bank's authorization and a concomitant increase in its lending activities, two issues relating to the reauthorization dialogue—local content requirements and the eligibility of high-tech services firms to receive full export credit financing—merit comment.

Local Content Requirements

Perhaps the most contentious issue related to the Ex-Im Bank's reauthorization has been debate about whether the Bank's local content requirements should be altered. The Ex-Im Bank requires that the products and services it finances have 85 percent of their content be produced in the United States in order to be eligible to receive full export credit financing. This threshold is intended to encourage U.S. exporters to strive to source domestic content as much as possible in their production of goods and services for export. Ex-Im Bank Chairman Hochberg maintains that the requirement helps American companies which supply U.S. exporters.[40] Some parties have even called for the local content requirements to be increased as a means of supporting increased U.S. content in exported products and services and therefore more jobs creating those inputs. But others have advocated for lowering the local content requirement, contending that the 85 percent threshold precludes some firms in the United States from availing themselves of export credit financing and thereby boosting exports and creating even more American jobs.

Research by Gary Hufbauer and colleagues at the Peterson Institute for International Economics finds that, from 2005 to 2009, the average foreign content per transaction (of deals supported by the Ex-Im Bank) as a percent of export value was 11.6 percent.[41] In other words, 88.4 percent of content in the more than 2,000 transactions processed by the

Ex-Im Bank since 2005 was domestically produced, suggesting that the 85 percent local content threshold remains adequate. Moreover, if a product does not contain at least 85 percent domestic content, this does not mean that it is not eligible for export credit financing from the U.S. Ex-Im Bank. Rather, Ex-Im proportionately adjusts the amount of export credit it provides relative to the percentage of domestic content in the product, ensuring that U.S. goods and services containing more than 15 percent foreign content remain eligible for export credit financing. While both sides can marshal arguments for either increasing or decreasing the current 85 percent local content requirement, ITIF believes that given the vital importance of export credit financing—and the paramount priority to raise the statutory lending limit to provide additional financing support to U.S. exporters—the most important issue in reauthorization is to expeditiously reauthorize Ex-Im while significantly raising its authorization limit.

Eligibility of High-Tech Services to Receive Export Credit Financing

While manufacturing accounts for 57 percent of U.S. exports, services have become an increasingly important part of the U.S. economy, accounting for 76.7 percent of U.S. GDP and approximately 30 percent of U.S. exports.[42] Although it was dwarfed by a $646 billion trade deficit in 2010, the United States ran a $149 billion trade surplus in services, suggesting that while services alone won't be enough to balance the U.S. trade deficit, their contributions will be significant.[43] Therefore, the United States must bolster its efforts to support U.S. services exporters, and this includes expanding the availability of Ex-Im credit finance support instruments for U.S. services exporters, particularly in high-tech services. For example, now many U.S. services firms must work through the World Bank to secure financing for projects in the developing world. However, it can take up to nine years to get a project approved through the World Bank. Accordingly, the U.S. Ex-Im Bank should support 85 percent of a services export if the main services contract is signed with a domestic company. This practice would be in line with that of other developed country ECAs.

CONCLUSION

Export credit financing is a critical tool for boosting U.S. exports, boosting U.S. job growth, narrowing the trade deficit, and revitalizing the U.S. economy. Reauthorization of the Export-Import Bank is critical to the ability of many U.S. exporters to compete on a more level playing field in a commercial market where current and future competitors continue to enjoy aggressive support from their countries' export credit agencies. Failure to expand our own efforts will have only one result—fewer U.S. exports and fewer U.S. jobs. Therefore, the Export-Import Bank's activities and efforts need to be significantly expanded as competitor countries increasingly turn to export financing to enhance the competitiveness of their exporters.

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ACKNOWLEDGEMENTS

The author wishes to thank the following individuals for providing input to this report: John Zoshak, for comments and Kathryn Angstadt for editorial assistance. Any errors or omissions are the author's alone.

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