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Eximbank's Role in International Banking and Finance: Loans, Reschedulings, and Development

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I. Functions of the United States Export-Import Bank (Eximbank)

Eximbank plays three chief roles: (1) to provide guarantees and export credit insurance so that exporters and their bankers will provide credit to foreign buyers; (2) to neutralize financing as a factor by offering loans[1] direct to foreign buyers and loans to U.S. banks with interest rates and repayment terms which are competitive with other countries' export credit agencies; and (3) to participate in negotiations with other countries which are designed to reduce the level of subsidy in export credits.

II. Guarantees and Insurance

One might ask how Eximbank can be so bold as to offer guarantees that foreign buyers will repay when banks and exporters are often unwilling to do so, and are experiencing repayment difficulties due to past activities. There are several factors working in Eximbank's favor. First, Eximbank can take a rather long view, because it raises its funds through the U.S. Treasury on terms of up to ten years—it does not have anxious depositors who can shift money at short notice.

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1. As part of Eximbank's 1987 budget, the Administration is proposing that instead of providing direct loans to borrowers or U.S. banks, Eximbank would source loans from commercial lenders in behalf of the borrowers and subsidize the interest rates charged on these loans when necessary. This proposal, referred to as I-Match II, is designed to provide the same effective support as is currently offered by Eximbank's direct loans.

Second, Eximbank has been at its business for a long time. Eximbank celebrated its 50th Anniversary two years ago, and although none of the present staff was there at the beginning, there are a number whose service exceeds twenty-five years. Eximbank's partnership with the U.S. Foreign Credit Insurance Association (FCIA) dates back to 1961. Moreover, buyers and their governments know that Eximbank is likely to be in business for many years into the future. Its programs and techniques for financing exports may change, but Eximbank expects to be an important player in the game. Foreign buyers know that Eximbank is prepared to reschedule debts for buyers and countries who have a genuine problem which they are working to solve, but they also know that Eximbank will not forget those who do not pay promptly when they could do so, and—equally bad—those who do not keep their creditors informed as to their financial condition.

III. Status of Capital and Reserves

During the 1950s, 1960s and 1970s, Eximbank paid annual dividends to the U.S. Treasury on the $1 billion of capital stock which Treasury, Eximbank's sole stockholder, owns. But, Eximbank also accumulated $2.5 billion of reserves. Eximbank has had to dip into these reserves in the past four years, in part because of heavy claims by holders of its guarantees and insurance and in part because some of its loans now, and many of them in the late 1970s and early 1980s, had to be made at interest rates below its cost.[2] When its 1985 fiscal year ended last September 30, those reserves had been reduced to $1.072 billion, so that its capital and reserves were $2.072 billion. At that date Eximbank had outstanding commitments for insurance and guarantees of $14.5 billion, disbursed loans of $16.9 billion, and undisbursed loans of $3.4 billion, so that total committed loans and guarantees were $34.8 billion. Capital and reserves were 6 percent of that figure. Many major commercial banks are trying hard to bring their capital and reserves up to that ratio. The figure is not troublesome, but the downward trend of recent years needs to be reversed.

IV. Changes to Accommodate Today's Conditions

Many of Eximbank's counterparts in Europe were not so heavily endowed with reserves as Eximbank when the flood of claims from guaranteed exporters first hit them in 1982. Many countries have a policy of setting premiums for export credit guarantees and insurance on a year-to-year basis. As their claim experience sharply deteriorated in 1982 and

2. *See infra* text accompanying note 3 (regarding the OECD Arrangement).

thereafter, countries such as France, Japan, Germany, and the United Kingdom increased their overall premium structure by 40 percent or more, and premiums for some types of policies nearly doubled.

Eximbank has not been compelled to take such drastic action. However, it was noted that a disproportionately large portion of Eximbank claims arose from policies for short- and medium-term insurance issued by FCIA and reinsured by Eximbank. This led to several consequences. Eximbank has worked with FCIA management to revise its fee structure, particularly the level of premiums for short-term insurance, so that such premiums more closely reflect the perceived degree of risk. Meanwhile, each of the private insurance companies—approximately sixty in number—decided after their 1982 experiences to drop out of the pool of risk-takers. Prior to that time, Eximbank assumed all political risk and re-insured commercial risk above pre-arranged levels. Individual insurance companies have joined and later left FCIA in the past, and Eximbank is confident that a large number of them will want to rejoin in the future. Meanwhile, Eximbank is retaining the basic structure, but improving underwriting practices while making the premium structure more realistic.

Realistic pricing is important to FCIA not only to enable it to cover its claim and administrative costs in difficult markets, but also because of private insurers which are now willing to provide similar policies, particularly for sales to top-notch markets.

V. Matching Competitors' Interest Rates

In medium- and long-term export credits, i.e., credits involving repayment terms of five to ten years after the goods have been shipped or the project completed, Eximbank has been successful to a large degree in matching foreign governments' support of exports. I will return later to one problem area—combinations of development assistance grants or loans on concessional terms with normal export credits to produce a very sweet offer. The most common variety is known as a mixed credit.

Eximbank's ability to match most foreign offers has been greatly assisted by an agreement with twenty-one other Organization for Economic Cooperation and Development (OECD) countries called the "Arrangement on Guidelines for Officially Supported Export Credits" (the Arrangement). The Arrangement began as a Consensus among seven countries that wished to establish standards for officially supported export credits[3] and was expanded to a Gentlemen's Agreement (without any provisions for sanctions in the document) in the mid-1970s. Each docu-

3. For additional information regarding this subject, see Duff, *The Outlook for Official Export Credits*, 13 L. & Pol. in Int'l Bus. 891 (1981).

ment established maximum terms of repayment, minimum cash payments, and minimum rates of interest. Prior to 1983, interest rate provisions were not satisfactory because there was no way to adjust the minimum rates of interest to reflect changes in financial markets—no way except tedious negotiation.

At their meetings of October 1983, the governments that participate in the Arrangement (the Participants) agreed to a formula to adjust interest rates every six months, if the weighted average of five governments' bond yields has changed by at least .50 percent since the previous change. The weighting is the same as used by the International Monetary Fund in calculating interest accruals on Special Drawing Rights, and represents a rough approximation of the five major currencies' share of world trade. Interest rates for each day in the months of December and June are averaged to determine interest rates for each of the five currencies. The currencies and their respective weights (as changed January 1, 1986) in the combined average are:

U.S. Dollar	42%
German Mark	19%
Japanese Yen	15%
Pound Sterling	12%
French Franc	12%
	100%

The resulting minimum rate is actually not one rate, but a matrix of rates for three categories of countries and two categories of repayment terms. Most countries of Western and Eastern Europe (including the Soviet Union) are grouped in Category I (relatively rich), as are Australia, New Zealand, Canada, Japan, the United States, and several Middle East oil producers. Countries eligible for International Development Agency (IDA) assistance by action of the Board of Governors of the World Bank (and countries not members of the World Bank or otherwise ineligible for IDA assistance which would be eligible on the basis of per capita Gross National Product) are placed into Category III (relatively poor). All other countries fall into Category II (intermediate).

This system does not solve all problems, but it does tend to keep minimum rates of interest close to market rates. This is particularly true for the dollar, since it has such a large weight in the average. Generally, the rate for Category II countries will approximate Eximbank's cost of funds, although distortions can be introduced during the six-month period between changes, and on rare occasions where dollar interest rates are moving in one direction and a majority of the other four countries' rates are moving in the opposite direction. Category II countries are important:

it is a large category and includes the so-called "Newly Industrialized Countries" and many other countries which are large users of capital goods and, hence, important recipients of export credits. In Category I countries, private banks and exporters themselves finance most exports from the United States.

This brief summary has not mentioned exceptions to the basic principles of the Arrangement, and the problems remain to be resolved. Certain sectors are not covered by the Arrangement. Special understandings have been worked out for three of these: ships, nuclear power plants and fuel charges for those plants, and large commercial aircraft. A new agreement covering intermediate and small aircraft, including helicopters, was implemented in March 1986. An agreement for agricultural commodities remains to be negotiated. Military sales are also excluded.

VI. Commercial Interest Reference Rates (CIRRs)

One sensitive problem relates to currencies where the private market does, in fact, provide medium- and long-term financing at fixed rates of interest lower than at least one of the minimum rates of the matrix. The constraint not to lend below the matrix became particularly troublesome to the Export-Import Bank of Japan, which feared a lack of demand for its loans if its interest rates had to be set significantly higher than rates charged by private and other public Japanese banks for comparable loans. The export credit agencies of other countries, notably Canada and Sweden, had raised funds in Swiss and Japanese capital markets and wanted to offer attractive rates of interest in these currencies. All wanted a market-related rate—high enough to cover their costs of raising funds, overhead, etc., but not necessarily as high as the matrix. To meet this problem, governments whose capital markets offer (or might soon offer) fixed interest rate financing at rates of interest below the matrix were invited to propose a unique minimum interest rate for their currency. These rates are called Commercial Interest Reference Rates (CIRRs).

In terms of the Arrangement, CIRRs set a minimum only for government export credit agencies that are lending or subsidizing export credits denominated in that particular currency. The level of dollar, yen, Swiss franc and German mark CIRRs are, therefore, of great importance to the governments of such countries such as Canada, Sweden, and Italy (as well as Japan) which raise funds in one or more of these currencies to finance their exports. The CIRR rates are also important to three other groups that do not want those rates below actual market rates: export credit agencies such as Eximbank which prefer to guarantee banks able to loan a low-interest currency; exporters of the country which issues the currency, most of which do not have access to subsidized financing; and

suppliers in a low-interest currency seeking business with a domestic customer against a foreign competitor. In practice, a formula to determine the rates (generally a set margin over a government bond yield) has been proposed by the issuing country at an OECD meeting, discussed and usually questioned or criticized by the other delegates, perhaps modified somewhat to reflect some of the other countries' objections, and then put into effect. The matter does not end there, however, because CIRRs are reviewed two or three times a year at OECD meetings of the Participants. The current rates are distributed early in each month to all Participants and are in effect from the fifteenth of the month of notification until the fifteenth of the following month.

VII. Mixed Credits and Other Uses of Tied Aid for Commercial Purposes

The U.S. government would like to see a sharp distinction made between development assistance and export credits. Just as the U.S. Agency for International Development reserves most of its funds to enable the least developed countries to meet basic human needs, we expect commercial projects, that can pay for themselves in five to ten years to be financed on commercial credit terms.

Many other countries are prepared to mix development assistance and export credit, either because they want to stretch their development assistance budget by adding a small amount of export credit funds to a larger concessional credit, or because they want to improve the terms of an export credit by adding a small amount of low-interest loan funds or even a small grant. Sometimes concessional funds are offered from government to government in the form of a general line of credit, or a line which may be used for a group of projects, but on condition that export credit funds and concessional funds are blended together in a predetermined ratio. At other times the mixed credit is offered for one specific project. Some countries, notably Canada, prefer parallel financing where Canada's International Development Agency provides funds for part of a project or purchase order on concessional terms and Canada's Export Development Corporation will finance all or part of the remainder on export credit terms. Often the concessional portion will enable the Canadian supplier to win the entire order, because the buyer is reluctant to split an order of, say, locomotives between two countries.

Some success has been achieved in restricting tied aid, but progress has been slow partly because other countries have varied programs and strategies for development assistance. Also, there is the problem of different jurisdictions within the respective governments and within the OECD. Policy matters regarding development assistance are analyzed

and discussed and guidelines set, by the Development Assistance Committee of the OECD (DAC). Export credits are the responsibility of the Trade Directorate, which functions as secretariat for the Export Credit Group and for the Arrangement.

The DAC has set standards as to the degree of concessionality which tied aid loans (or loans combined with grants) must have to be counted toward a donor country's quota of .70 percent of GNP. Such concessionality is expressed in terms of "grant element," which measures the difference between the present value (using a 10 percent discount factor) of actual debt service on a concessional loan and the amount of the loan. The difference, expressed as a percent of the loan principal, is the grant element. A loan repayable over thirty years with an interest rate of 2 percent would have a grant element of 53.92 percent. An outright grant would have a "grant element" of 100 percent.

In terms of total world trade, the mixed credit issue is not as large a problem as is commonly thought. The annual volume of mixed credit offers is in the magnitude of $5 billion, but much of this figure represents either projects which could not be viable if only export credit terms were available, or duplicate offers from two or more countries for the same project. A more realistic estimate of annual purchase decisions influenced by mixed credits is $2 billion, which is approximately 5 percent of export credits for capital goods. However, mixed credits are a problem for certain industries and if not checked could grow into a more serious general problem.

The most hopeful sign is that no country is completely satisfied with the present system, and all want to restrict, in one way or another, the practices of their competitors. The United States, the United Kingdom, and Germany see a sudden increase in minimum grant element as the best hope to reducing trade-distorting mixed credits. Others, such as France, want parallel financing and low-grant element tied aid to be placed under the same rules as mixed credits. Others will accept this broadening of the rules but only if it is accompanied by a modest increase in grant element. It is necessary to gather the various wishes into a package which will be ideal for no one country, but an improvement in the eyes of all OECD countries.

Some progress has been made. In 1985 the minimum grant element for tied aid credits was increased from 20 percent to 25 percent, and twenty-day prior notification of the intent to offer a mixed credit with a grant element below 50 percent was made mandatory (previously prior notification of only ten days applied only to mixed credits with grant elements in the range of 20 percent to 25 percent). Also, a study was ordered which should examine other conceivable ways of reducing the frequency of trade-distorting tied aid. This study contained a number of useful rec-

ommendations. In the spring of 1986, the European Community proposed a plan based on two of these recommendations: raise the minimum grant element in two annual stages from 25 percent to 35 percent for most countries (to 50 percent for the least developed group of about thirty countries); and calculate the grant element not with an unchanging discount factor of 10 percent as the DAC has done for seventeen years but with a different and variable rate for each currency to reflect the cost of funds in that currency. The United States delegation to the OECD including Eximbank supports the thrust of the European Community's proposal, although the U.S continues to maintain that the minimum grant element needs to be raised to a high figure—50 percent was the original U.S. proposal and 35 percent would be an unsatisfactory final stopping point. Other countries where interest rates are very low—notably Japan—objected to the proposal in the spring OECD meetings, but have agreed to discuss this proposal and other possible technical improvements in the Arrangement when the participating countries meet again in autumn.

There are grounds for hope that a relatively sharp distinction between export credits and true development funding can be drawn, so that normal trade finance will be free of the distorting bias of concessional financing, and development funds will not be diminished but rather directed to the countries and purposes where such funds are most needed.