Reauthorization of The Export-Import Bank of the United States

Statement of
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on behalf of the
Bankers' Association for Finance and Trade

before the United States Senate
Committee on Banking, Housing, and Urban Affairs,
Subcommittee on International Trade and Finance

March 8, 2006

Introduction

I am pleased to be with you today to discuss the banking industry's views on reauthorization of the Export-Import Bank of the United States. I am testifying today as a banker who has worked with the Ex-Im Bank for over 32 years and as a member of Trade Finance Committee of the Bankers' Association for Finance and Trade (BAFT), an organization founded in 1921. Today BAFT is an affiliate of the American Bankers Association and its membership includes most of the major American banks that are active in trade finance and other international banking activities and also many of the major international banks chartered outside of this country.

My employer, PNC Bank, is part of the PNC Financial Services Group, one of the nation's largest financial services firms. PNC is headquartered in Pittsburgh, Pennsylvania, and has a diversified business mix, which includes providing a broad range of international banking solutions such as trade finance, foreign exchange, correspondent banking, international cash management, and online trade services applications. For more than 30 years, PNC Bank has supported export growth by providing export financing and trade facilitation to companies nationwide. In 2005 our bank received the Presidential "E" Award for export service on the basis of the bank's record of export promotion and continuing efforts to educate U.S. companies about trade finance resources.

Why We Need the Export-Import Bank

Every so often, and particularly during the process of reauthorizing the Export-Import Bank, someone will express the view that the United States doesn't need and shouldn't have such an agency. They contend that the Bank is unnecessary and constitutes nothing more or less than corporate welfare. If the Bank actually were serving an important purpose, they argue, the private sector would meet that need without requiring any taxpayer support. In their view, the Bank simply is a mechanism to hand out taxpayer money to special interests.

In my view, these critics are wrong. The reality is that the Bank serves the interests of our nation by providing credit support that is a vital component in the competitiveness of American products in international markets. For example:

- An American software developer with 60 high-paying U.S. jobs in the Southeast started exporting products in 2004. The company had a contract to provide software priced at $1.6 million to a foreign purchaser but could neither get financing approval from its principal bank nor find another lender. The company went to the Ex-Im Bank and obtained single-buyer export insurance for $1.6 million and a $900,000 Working Capital Guarantee Program transaction-specific guarantee. It then was able to obtain financing from a local bank. The insurance policy from the Ex-Im Bank was critically important to the software company's success for several reasons: (i) it is a pay-as-you-go policy which the private sector does not provide (small businesses often cannot afford the large up-front premiums the private sector requires regardless of usage); (ii) it covers countries and situations that the private sector will not (because of long lead-times to project completion and installation); and (iii) Ex-Im was able to provide a fast and very reasonable response to a small, but complex transaction.

- A small family-held company in the Northeast, which employs 100 people, manufactures machine tools used to maintain transportation equipment. The company also has a larger, German affiliate that manufactures the same equipment (and which can obtain export credit financing from Germany's export credit agency). The company has a large customer in Eastern Europe on which it relies for a significant portion of its annual revenue, and this customer's needs can be met by products made by the company in America or by its affiliate in Germany. The customer is undertaking an extensive, long-term refurbishment of its operations and when it makes equipment purchases it specifically seeks export credit financing. Medium term guarantees from the Ex-Im Bank on two occasions (approximately $10 million and $6 million) played an important part in the company's sales of equipment manufactured in the U.S.

- A guarantee provided by the Ex-Im Bank has enabled a company in Arizona that manufactures electronic test products to obtain working capital financing that otherwise would not have been available. The company's sales in foreign markets have expanded in the face of international competition and exports now contribute about 45% of the company's total sales. The total number of employees at the company has grown by 25% per year since 2003, largely on the basis of the expanded foreign sales made possible by the Ex-Im Bank's guarantee.

- An American company that employs 70 people in the Southeast emerged from bankruptcy in 2005. It is the last producer of its product in the U.S. and Europe, and it is facing substantial competition from producers in Japan. More than 30% of the company's sales are outside the U.S. and it expects that to grow to 50% in the next few years. Without Ex-Im Bank multi-buyer insurance coverage, the company's asset-based lender would not be willing to include the foreign receivables in the company's borrowing base and it could not survive. The pay-as-you-go feature and Ex-Im's quick response time on special buyer credit limits were essential to meeting this company's financial needs.

- An American company based in the Midwest employs 77 people in manufacturing operations that produce processing equipment. It competes with companies from Taiwan, Japan and China. The company sold equipment to a buyer in Eastern Europe. The buyer made a down payment of 15% of the purchase price. An American bank was willing to finance the remaining 85% only because the company obtained an Ex-Im Bank guarantee under its medium-term financing program. The bank also used the Ex-Im Bank's Working Capital Guarantee Program to extend a $1.5 million transaction-specific line of credit to the company to enable it to meet the payment guarantee bond and work-in-process financing needs of this transaction. Ex-Im's credit support of this company has enabled it to be successful against its foreign competition in the global marketplace.

Each of these situations represents incremental export sales by American companies that support the jobs of American workers and help to reduce our national trade deficit. Many other examples could be cited. These are the "special interests" the Ex-Im Bank serves and I would like to suggest it is in our national interest for it to continue doing so.

It is important for Congress to remember that American businesses are engaged in fierce competition with foreign companies in the global market. Many of those foreign companies come into the market with various advantages, including credit support from their home country export credit agency (ECA). In the midst of this competition we cannot afford to abandon one of the most important factors that helps American business compete—the Export-Import Bank—nor can we afford to impose any new or more onerous restrictions on its ability to support American exports. If we did, the inevitable result would be fewer export sales, loss of jobs, and an even wider trade deficit.

Something that I and other trade bankers have observed in recent years is that the ECAs from other countries are getting to be more strategic and flexible in their approaches to export finance. In addition, new competition is coming from emerging market ECAs, such as those in China, India, Eastern Europe, and Brazil. They all understand the extent of international competition and they are taking new approaches that will enable their exporters to win in the global marketplace. For example, many ECAs are becoming more aggressive when it comes to taking on risk and more willing to provide financing for transactions that generally benefit their country, even if the transaction does not directly involve the export of locally produced goods. I believe that U.S. companies' efforts to compete in international markets will be hampered if our Ex-Im Bank doesn't take a similarly aggressive approach. (This is not to say that Ex-Im hasn't been aggressive in certain respects in the past. Trade bankers have noted the Bank's willingness to take on credits that commercial banks have been unwilling to accept.) I hope that in reauthorizing the Bank, Congress will clearly express its support for an aggressive effort by the Export-Import Bank to meet the needs of American businesses—large and small—competing in global markets.

Issues Related to Ex-Im Bank Operations

I would like to comment on a number of issues that arise out of the Ex-Im Bank's operations and the various requirements imposed on the Bank under current law.

<u>Small Business</u>

The Export-Import Bank is required by law to make available an amount equal to at least 20% of its aggregate loan, guarantee, and insurance authority in each fiscal year to finance exports made directly by small business concerns. The Bank frequently is criticized on Capitol Hill for its repeated failures to satisfy this requirement. We think the criticism is unfair.

In the first place, it should be acknowledged that the 20% standard is a limited and arbitrary measure of the Bank's service to small business. Small business transactions, by number, typically make up more than 80% of the transactions approved by the Ex-Im Bank each year. But when the sole measure is total dollar amount, large business transactions overwhelm those done by small business. By their very nature, the large export products that generally are produced by larger companies (airplanes, heavy equipment, and project work) mean large dollar volumes. If Ex-Im were evaluated on the amount of effort it puts into small business transactions, the 20% standard would be easy to meet because the work put in by the Bank on a small transaction can be as much or more than a large one. Another shortcoming of the test is that it fails to take into account the participation of small business in large business transactions. A single airplane sold by Boeing has myriad components produced by small business, yet Ex-Im gets no credit in its small business ledger for the support it provides to Boeing that indirectly benefits those small businesses. Finally, it also is difficult to understand why 20% is an appropriate test. As a banker, I find it difficult to comprehend why Ex-Im should be considered a failure at 19% and a success at 21%.

I also believe that critics of the Bank are misconstruing the 20% test. The Bank is required to "make available" to small business a specified amount of its authority—the law does not *require* the Bank to actually extend loans, guarantees and insurance equal to that amount. This is appropriate because the Bank is a demand-driven organization. It has no control over the source of credit support requests it receives. All that it can do is educate small businesses about its programs, encourage them to use its programs, and assist them in negotiating their way through the process. We believe that through its small business outreach efforts the Bank is *making available* to small business the *full amount* its authority, thus in reality it is satisfying the statutory requirement.

Thinking of this provision as if it were a *mandatory* 20% requirement also puts the Ex-Im Bank in an untenable position. Suppose that the Bank's loans, guarantees, and insurance extended to support small business exports in a particular fiscal year exceeded 20% of its authority by a small amount near the end of the year. If an exporter that does not qualify as a small business brings a large export transaction to the Bank, the 20% standard gives the Bank an incentive to delay or not do the transaction in order to stay above 20%. That doesn't make sense if the real purpose of the Ex-Im Bank is to promote U.S. exports. At the same time, the 20% standard also creates an incentive for poor credit decisions if the Bank is below 20% and needs more transactions to satisfy the test. Neither incentive is a healthy one for the Bank.

Congress ought to rethink this requirement and devise a better way to measure the Ex-Im Bank's success in working with small business.

Economic Impact

The Export-Import Bank is required by law to consider the extent to which transactions are likely to have an adverse effect on industries and employment in the United States. The rationale for this requirement is understandable (although I am not aware of any other ECA that is subject to a similar requirement): taxpayer money should not be used to support a transaction if its benefits for U.S. industry and employment are outweighed by the transaction's adverse impact on U.S. producers and employment. In most cases, however, the harm that might result from a transaction will occur whether or not the U.S. exporter seeking Ex-Im support makes the sale. If the U.S. exporter doesn't make the sale, one of its competitors from another country will. The adverse impact on U.S. industry will occur in either case. Thus, it seems that unless the U.S. exporter is the only possible source of the equipment to be sold, the economic impact on the U.S. of an export sale will always be positive. Unfortunately, when it evaluates the economic impact of a transaction, the Ex-Im Bank staff does not consider the availability from another source of the goods to be sold. We believe this is a valid consideration that the Bank should take into account in its analysis and we urge Congress to provide direction to the Bank in that regard.

I have another concern that the Ex-Im Bank and Congress should consider as well—the reputation risk created by the economic impact test. Whenever the Bank turns down a transaction on the basis of economic impact, it has an adverse effect on the perception of U.S. exporters as reliable suppliers: the financing support that was expected didn't come through. If a foreign purchaser has doubts about whether Ex-Im support for the financing of their purchase actually will be made available, the likelihood of the U.S. exporter getting the sale is diminished. For this reason we believe that the economic impact test should be used as little as possible. A step in the right direction would be to raise the minimum transaction size for economic impact assessment from $10 million to $25 million, to take into account the effects of inflation over time.

Co-Financing

Co-financing is an arrangement whereby exports that are sourced from more than one country can receive credit or credit support from two or more ECAs in an efficient manner. Typically the ECA for the country that is the principal source of the products or services takes the lead and is the sole agency with which the purchaser must interact. The co-financing arrangement allows for one set of documents and one source of disbursements, in each case provided by the lead ECA which obtains supporting financial commitments directly from the other participating ECAs.

Bankers that finance these transactions like co-financing arrangements because they are an efficient and convenient way of providing credit support for what otherwise could be extremely complex transactions. As the Export-Import Bank noted in its June 2005 *Report to the U.S. Congress on Export Credit Competition* (the "*2005 Report to Congress*"), the "availability and ease of ECA co-financing has become an important and measurable competitive issue."

According to the Ex-Im Bank's website, it currently has bilateral co-financing agreements with ECAs in four other countries: Canada, Italy, Japan, and the United Kingdom (and a limited agreement with K-Exim of Korea). At a hearing before the Senate Banking Committee prior to the Bank's last reauthorization in 2001, Ex-Im Chairman John Robson reported that the Bank had entered into a bilateral agreement with ECGD of the U.K. and that discussions with EDC of Canada were close to completion. We are disappointed that agreements have been signed with only two other countries in the ensuing four years (a 1998 GAO report said there were more than 70 ECAs operating throughout the world; the UK's ECGD has agreements with ECAs in 24 different countries). Although the Bank has participated in co-financing arrangements on a one-off basis with ECAs in countries with which it does not have a co-financing agreement, having signed agreements is preferable. The agreements make it clear to potential purchasers that co-financing is available and they establish a framework that facilitates co-financing implementation for an actual transaction. When the Bank signed its co-financing agreement with Canada in May 2001, its press release said, "This is another step in the right direction by Ex-Im Bank to deliver the same type of flexibility offered by a number of ECAs." We urge the Bank to take more of these steps and to make co-financing agreements with other ECAs a priority.

MARAD

Transactions supported by Export-Import Bank guarantees in excess of $20 million or that have a repayment period of more than seven years are subject to a requirement (administered by the U.S. Maritime Administration—MARAD) that the goods being financed must be shipped on a U.S.-flag carrier if they are transported by sea. The exporter is required to use a U.S.-flag carrier even though other carriers might (i) be available at lower cost; (ii) have vessels that are more suitable for the particular cargo being shipped; and (iii) provide logistical advantages with respect to their availability and routing. This can result in situations that are nothing short of ridiculous. For example, a West Coast-based exporter that was selling goods to a purchaser in Jamaica was required to use a U.S.-flag carrier and as a result watched its goods in one shipment go from San Diego to Japan, to the Dominican Republic, then finally to Jamaica. Another shipment went from San Diego to Florida, to Spain, and then to Jamaica. If it were not required to use a U.S.-flagged vessel, the exporter could have arranged direct shipment from San Diego to Jamaica. The MARAD requirement added significant costs and weeks of shipping delays. The exporter summed it up as "extortion." It certainly is nonsense. Although waivers are available in certain limited circumstances, the waiver process itself acts as a disincentive for potential purchasers of U.S. goods.

At a time when the U.S. is recording record merchandise trade deficits, it seems foolish to burden U.S. exporters with requirements of this kind. According to the *2005 Report to*

Congress, "None of the other G-7 ECAs have similar cargo preference restrictions." Congress should seriously consider rethinking the MARAD requirement and, at the very least, restrict its application by raising the minimum amount from $20 million to $30 million or more.

<u>Domestic Content</u>

The Export-Import Bank's mission is to support U.S. jobs through exports. In pursuing that mission, the Bank has adopted a restrictive policy of only providing credit support for the value of the U.S. content in an export. The Bank limits its involvement in a transaction to the lesser of: (i) 85% of the value of eligible goods and services, and (ii) 100% of the U.S. content in those goods and services. Thus, if a U.S. export consists of 50% U.S.-made components and 50% non-U.S., the Bank's support would be limited to 50% of the contract's value. This is problematic in several related respects. First, as complexity increases in manufacturing processes and the sourcing of components, it is becoming increasingly difficult to track the levels and sources of non-U.S. content. This is particularly true for small businesses that don't have the resources to devote to it. Second, requiring such strict proportionality likely results in fewer U.S. exports than could otherwise be achieved. The question is: how much support should Ex-Im be willing to provide in order for an export transaction to occur? It is not at all clear that the correct answer is tied to the proportion of U.S. content. What is clear is that other countries have concluded that strict proportionality—and thus strict accounting for content—is not required. For example, the *2005 Report to Congress* indicates that Japan's ECA does not reduce its support of transactions that have at least 30% Japanese content and Canada decides its level of support on a case-by-case basis. Italy's ECA announced in 2004 that it would shift its standard from "Made in Italy" to "Made by Italy" and Ex-Im reported that other countries were moving to this approach as well. We believe that Ex-Im should adopt a case-by-case approach that balances the costs and benefits of individual transactions, rather than adhering to a strict formula that requires precise tracking of U.S. content, and we urge Congress to express its support for that approach as well.

Tied Aid

The Export-Import Bank's tied aid War Chest was established to enable the Bank to combat export subsidies provided by foreign governments in the form of financing for public-sector projects that is tied to the purchase of goods and services from exporters in the donor country. Although the Bank's *2005 Report to Congress* expressed the view that OECD tied aid rules have been a "great success in reducing the level and distortive influence of tied aid," there is a general perception among American bankers and exporters that the use by other countries of tied aid and implicitly tied aid (referred to as "untied aid") is growing. The particular countries that are mentioned include China, Japan, Germany, and Denmark. We are concerned that the Bank has not utilized any tied aid funds *since 2002*, possibly because the Bank is unwilling to act unless it has overt proof and possibly because of the unwieldy procedures that govern the relationship between the Treasury Department and the Bank regarding use of the War Chest (and the Treasury Department's unwillingness to use the War Chest funds). We believe that the Bank should re-examine what is happening in the market and then determine whether greater use of the War Chest is needed. Congress should review the procedures followed by the Treasury Department and Ex-Im Bank for utilizing the War Chest and consider whether they could be simplified and whether clarifying the Bank's authority to utilize the War Chest would facilitate the use of those funds to combat the use of tied aid by other countries.

Dual-Use Products

The Export-Import Bank generally is prohibited from providing credit or credit support in connection with the sale of defense articles or services to any country, with the exception that the Bank may provide such support if it determines that the articles or services are non-lethal and that their primary end use will be for civilian purposes. This exception, which we believe is useful and appropriate, sunsets and requires periodic renewal. It currently is set to expire on October 1, 2006. In 1997 the U.S. General Accounting Office reported, "the Eximbank appears to have established procedures that provide a sound basis for determining whether these exports are nonlethal and primarily used for civilian purposes, as required by law." We believe the time has come to make this a permanent provision that does not require periodic renewal.

Conclusion

We believe that, within the constraints of its budget and other resources, the Export-Import Bank generally is doing a good job in promoting the export of American goods and services to international markets, but improvements always can be made. The Export-Import Bank plays a key role in helping U.S. businesses of all sizes compete in markets around the world, but we believe the Bank is hampered by having too few people and too many requirements imposed on it that do not relate to its primary mission. Consequently, we urge the Congress to provide the Bank with significant additional resources in its administrative budget, and to act on our recommendations to reduce the Bank's administrative burdens that inhibit its functions. We look forward to continuing to work with Members of Congress and with the Bank to maximize its effectiveness in promoting American exports.