

Statement of
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NOTICE

This statement is not available for public release until it is delivered at 10:30 a.m. (EDT), on Thursday, May 21, 1987.

Mr. Chairman, I am pleased to have the opportunity to discuss the credit programs of the Export-Import Bank (Eximbank). My statement today will cover three topics:

- o The current budgetary treatment of the **Eximbank's** credit programs;
- o Loan assets sales and prepayments; and
- o The issue of recapitalizing the Bank.

THE CURRENT BUDGETARY TREATMENT OF THE EXIMBANK

The Export-Import Bank was organized in **1934**. Its programs are authorized under the Export-Import Bank Act of **1945**, as amended. The purpose of the Bank is to promote U.S. exports through the provision of direct loans, loan guarantees, and loan insurance to foreign purchasers of U.S. goods. The Eximbank participates in financing most export sales of commercial aircraft and a large portion of the export sales of power equipment and other capital goods. Its clients are a diverse mixture of governments, government-owned corporations, and private firms.

The Eximbank is a wholly owned U.S. government corporation initially capitalized by a \$1 billion appropriation from the Treasury. The Bank is authorized to borrow up to \$6 billion from the Treasury and has unlimited authority to borrow from the Federal Financing Bank (**FFB**), an agency of the Treasury. The Eximbank pays interest on its borrowings.

The budget presents the operations of the Eximbank in a number of ways. The cash flows of the Bank are recorded in the unified budget, which is the accounting system used for the President's annual budget submissions and the annual Congressional budget resolutions. New direct loan obligations and new loan guarantee commitments--measures of the Bank's new credit assistance--are presented in the so-called "credit budget," which is also part of the President's budget and the budget resolutions. Information on the Eximbank included in the unified budget and the credit budget appears in Function 150--International Affairs. The Appendix to the President's budget contains business-type statements of the Bank's revenues and expenses, operating income, and financial condition. Finally, in recent years, the President's budget also has included estimates of the subsidy costs of the Eximbank's new credit assistance, which are the focus of the credit reform proposed by the Administration. I will summarize each of these four different budgetary treatments of the Bank, using data for fiscal years 1980 through 1988.

The Unified Budget

Table 1 shows the unified budget measures of the Eximbank's activities--budget authority and outlays. Outlays measure the Eximbank's net cash flows--payments made by the Bank net of payments received by the Bank from assisted borrowers. The Eximbank's payments include:

- o Disbursements of new loans;
- o Payments to purchase loans guaranteed or insured by the Bank that are in default;

- o Interest on borrowings, primarily from the FFB; and
- o Payments for administrative expenses.

The assisted borrowers' payments to the Bank include:

- o Loan repayments, including prepayments and the proceeds of sales of loan assets;
- o Interest earned on loans; and
- o Guarantee fees and insurance premiums charged borrowers assisted under the Bank's loan guarantee and insurance programs.

The Bank's net outlays are positive when payments made are greater than payments received. As Table 1 shows, this occurred in fiscal years 1980 through 1984. Since fiscal year 1985, the Eximbank's net outlays have

TABLE 1. UNIFIED BUDGET TREATMENT (By fiscal year, in millions of dollars)

	Actual							President's Budget	
	1980	1981	1982	1983	1984	1985	1986	1987	1988
Budget Authority									
Authority to Borrow	1,842	6,908	3,268	0	829	0	0	0	0
Appropriation ^{a/}	0	0	0	0	0	0	0	100	200
Outlays	1,836	2,066	1,173	578	1,068	-384	-1,167	-2,389	-1,564

SOURCE: Office of Management and Budget.

a. For Tied-Aid Credit grants.

been negative, as funds received have exceeded those paid out. The President's budget for fiscal year 1988 projects negative Bank outlays of **\$2.4** billion in fiscal year 1987 and \$1.6 billion in fiscal year 1988. A number of factors have caused the dramatic downward trend in the Eximbank's outlays:

- o As interest rates have fallen, the Bank's new commitments to make direct loans have dropped **significantly** (see Table 2).
- o As rates have gone down, borrowers who had received direct loan commitments from the Eximbank in previous years have opted to use cheaper, private financing and have cancelled their commitments.
- o Outlays in fiscal years 1985 and 1986 reflect loan prepayments by some Bank borrowers who elected to refinance their debt at lower prevailing private rates.
- o Outlay figures for fiscal years 1987 and 1988 reflect proceeds from asset sales of \$1.5 billion and \$750 million, respectively.

All federal agencies require budget authority in order to obligate the government to make payments. The payments the Eximbank receives from the public are sources of budget authority. In fiscal years 1980 through 1982 and in 1984, these receipts—known as offsetting collections—did not provide enough budget authority to cover the Bank's obligations (net of loan cancellations, redemption of debt owed the FFB, and changes in unobligated balances). In those years, the **unified** budget shows budget authority for the

amounts of borrowing authority required by the Bank to finance all its obligations, as shown in Table 1. This borrowing authority did not require any appropriations.

Last year the Congress appropriated \$100 million for Tied-Aid Credits, a form of grant that lowers the cost of export financing. The President's fiscal year 1988 budget proposed an additional \$200 million appropriation for the credits next year. Both amounts are also shown as budget authority in Table 1.

The Credit Budget

The Bank is also included in the federal credit budget, which measures new direct loan obligations and new loan guarantee **commitments--the** legally binding agreements by the government to provide credit assistance to private borrowers. In recent years, the Foreign Assistance and Related Programs Appropriations Acts have included language that sets ceilings on the Eximbank's new loan obligations and guarantee commitments in order to limit the maximum amount of new Bank credit assistance. Table 2 shows the appropriation act limitations on new **obligations** and commitments for each year and, for prior years, the actual amounts of obligations made and commitments incurred. Note that the "loose fit" between the limitations and the actual levels since fiscal year 1981 implies that constraints other than legislated ceilings were the limiting factors on the Eximbank's activity.

Operating Budget

Neither the unified budget nor the credit budget tells us about the Eximbank's financial **performance--whether** the Bank is making or losing

money. For that we need a concept of net operating income--the difference between the Eximbank's interest and fee income and all its costs. The Bank's total net operating income has declined dramatically, falling from \$109 million in fiscal year 1980 to about negative \$350 million in each of fiscal years 1984 through 1986 (see Table 3). The President's fiscal year 1988 budget projects that the Eximbank's total net operating income will drop to negative \$638 million in that year. The operating losses--most of which stem from the Eximbank's direct loan program--are reflected in an equal erosion of the Bank's capital position.

Why has the net operating income on the Bank's direct loan program declined? In late 1979 and early 1980, interest rates increased sharply, but export finance agencies abroad did not raise their lending rates commensurably. Because the Eximbank is required by law to remain competitive with the export finance agencies of other governments, the Bank could not raise the rates it charged as much as the increase in its borrowing costs—

TABLE 2. CREDIT BUDGET TREATMENT (By fiscal year, in millions of dollars)

Credit Activity	1980	1981	1982	Actual				President's Budget	
				1983	1984	1985	1986	1987	1988
Direct Loan Obligations									
Appropriation Limitation	N.A.	5,461	4,400	4,400	3,865	3,865	1,059	900	1,000
Actual	4,365	5,431	3,516	3,845	1,467	660	578	N.A.	N.A.
Loan Guarantee Commitments									
Appropriation Limitation	N.A.	8,059	9,220	9,000	10,000	10,000	11,484	11,355	10,000
Actual	8,031	7,416	5,832	8,524	7,149	7,849	5,508	N.A.	N.A.

SOURCE: Office of Management and Budget.

which are tied to rates on Treasury debt. As a result, new loans by the Eximbank began to carry deep interest-rate subsidies. In fiscal year 1981, for example, the Bank committed to make \$5.4 billion in loans at rates between 8.75 percent and 9.75 percent, and financed the lending by borrowing from the FFB at double-digit rates that peaked at 15.7 percent. Because of the deep subsidies on new loans, the difference between the average interest rates the Eximbank paid on all its debt and earned on its whole loan portfolio has risen steadily, reaching 3.4 percent in mid-1986. In addition to the losses caused by interest-rate subsidies, the losses on the direct loan program, shown in Table 3, include expected losses on loan asset sales of \$270 million in fiscal year 1987 and \$300 million in fiscal year 1988.

TABLE 3. EXIMBANK OPERATING BUDGET (By fiscal year, in millions of dollars)

Net Operating Income	Actual							President's Budget	
	1980	1981	1982	1983	1984	1985	1986	1987	1988
Direct Loan Program	100	-17	-166	-261	-240	-323	-342	-597	-640
Guarantee and Insurance Program	9	29	-6	13	-103	-50	-1	-1	-2
Total	109	12	-160	-248	-343	-378	-343	-598	-638

SOURCE: Office of Management and Budget.

The Eximbank's negative outlays in recent years might suggest that the Bank earned a profit in each year, a conclusion that is inconsistent with the operating loss figures shown in Table 3. As I noted earlier, the Eximbank's outlays have declined for three reasons: (1) because new loan obligations, and the disbursements which follow them, have fallen; (2) because some borrowers have cancelled their direct loan commitments; and (3) because of loan asset sales and prepayments. The lower disbursements by the Bank, combined with the higher payments to it, have more than offset its net operating losses. This explains why--to use fiscal year 1986 as an example--Table 1 shows outlays of negative \$1.2 billion for the Eximbank, even though Table 3 shows an operating loss of \$343 million. The contrast between these figures also illustrates how the unified budget measure of the Bank's activities--outlays--is a highly misleading indicator of its financial performance.

Subsidy Costs

In recent years, the President's budget has included estimates of the subsidy costs of the new direct loans obligations and new loan guarantee commitments made by the Eximbank and other agencies in each fiscal year. Table 4 shows these estimates for the Bank, for the years they are available. The subsidy cost of a new direct loan obligation or loan guarantee commitment is the amount currently needed to pay all future operating losses arising from the agreement. Since such amounts represent a current measure of resources used by the program in the future, they are comparable to discretionary appropriations for one-time expenditures, such as grants, salaries and expenses, and purchases of goods and services.

The estimated subsidy costs of the Eximbank's new loan guarantee commitments have exceeded the estimated costs of new loan obligations in recent years, reflecting the decline in the Bank's direct loan program (see Table 2). In fiscal year 1988, the subsidy costs of new loan obligations are estimated to be about 13 cents on the dollar, while the estimated costs of new guarantee commitments equal about 6 cents on the dollar. These are relatively low subsidy costs in comparison with many other federal credit programs, in which the subsidies may be as high as 95 cents on the dollar for direct loans (for example, P.L. 480 export credits) and 41 cents on the dollar for guaranteed loans (such as student loans). In the President's fiscal year 1988 budget, the average estimated subsidy cost is 31 cents on the dollar for direct loans and 5 cents on the dollar for guaranteed loans.

TABLE 4. SUBSIDY COSTS OF EXIMBANK CREDIT ASSISTANCE (By fiscal year, in millions of dollars)

Credit Activity	Actual							President's Budget	
	1980	1981	1982	1983	1984	1985	1986	1987	1988
Direct Loan Obligations	1,297	836	641	699	237	42	64	n.a.	105
Loan Guarantee Commitments	700	797	n.a.	n.a.	294	129	110	n.a.	589

SOURCE: Office of Management and Budget.

NOTE: n.a. = not available.

In March, the Administration proposed legislation and amendments to the President's fiscal year 1988 budget that would require reporting the subsidy costs of new credit activity in agency budget accounts. Under the ~~proposal--known~~ as credit ~~reform--the~~ Eximbank would request annual appropriations equal to the amount of subsidies to be provided to borrowers during each fiscal year. These subsidy appropriations would be to a new budget account and would involve budget authority and outlays in the same manner as direct spending programs. They also would be similar in concept to the appropriations to the Eximbank ~~for~~ Tied-Aid Credits.

In **CBO's** view, the unified budget presentation of the Eximbank and of the federal government as a whole would be considerably more informative if it included the subsidy costs of the Bank's and other agencies' credit programs. The credit reform proposed by the Administration would improve budgeting for the Eximbank, for four reasons:

- o The information in the President's budget and Congressional budget resolutions shown in Tables 1 and 2 does not adequately measure the costs of the **Bank's** credit **programs** and, therefore, is a poor means of controlling those costs.
- o While the Eximbank's net operating income, shown in Table 3, reflects subsidy costs, there is a significant time lag between when the Bank makes subsidized commitments and when losses affect net income. Credit reform would show subsidy costs up front when commitments that will result in subsidies are made.

- o Because subsidy cost estimates are comparable to the familiar appropriations of budget authority for most discretionary spending, the Congress could use them to weigh the impact of credit against other forms of federal assistance and against the ultimate tax burden they create.
- o Credit reform offers the Congress a way of controlling credit program costs at the time decisions are made, through the appropriations process.

Even if credit reform is not enacted, estimates of the subsidy costs of the **Eximbank's** credit programs could help the Subcommittee and the Congress to evaluate **different** types of credit assistance provided by the Bank and to compare the costs of the Bank's credit programs with those of other government programs.

LOAN ASSET SALES AND PREPAYMENTS

A direct loan by the Eximbank involves an exchange of cash **for** a loan asset, which is a promise by the borrower to pay interest for a number of years and principal when it is due. As I mentioned earlier, in the unified budget, loan principal and interest received are treated as offsetting collections that reduce the **Bank's** outlays. Funds received by the Eximbank when loan assets are sold or when borrowers elect to prepay the outstanding principal on their loans are essentially accelerated loan repayments, and, therefore, are also treated as offsetting collections that reduce outlays. (Interest received contributes to the Bank's net operating income as well.)

The 1986 reconciliation act required the Eximbank to sell enough loan assets to generate offsetting collections of \$1.5 billion in fiscal year 1987. These collections are a major reason why the President's budget shows negative Bank outlays of **\$2.4** billion in fiscal year 1987. The budget also assumes offsetting collections of \$750 million from loan asset sales by the Eximbank in fiscal year 1988.

Loan asset sales do not improve the government's financial condition. The cash the government receives in exchange for loan assets reduces the current cash deficit and federal borrowing. Nonetheless, future deficits and borrowing will be increased because the interest and principal payments will go to the loan asset holder, not the government, and these amounts are equivalent in current dollars to the proceeds of the sales. Moreover, agency loan sales do not reduce the government's demands on the credit markets—the Treasury borrows less, but the sales tap the same pool of saving. In CBO's view, loan asset sales are merely a more expensive form of borrowing than issuing Treasury debt. Such sales may, however, have the virtue of helping to measure the subsidy costs of direct loans.

The Eximbank's loan agreements give borrowers the right to prepay their loans at face value at any time. When interest rates fall, this right to prepay at par exposes the Bank to the risk of significant losses, since it cannot prepay its debts to the FFB without paying a penalty. (As I noted earlier, significant numbers of Bank borrowers prepaid their loans in fiscal years 1985 and 1986.) Recently, a number of Bank borrowers committed to

prepay over \$1.5 billion in loans in fiscal year 1987, thereby generating the collections required by the 1986 reconciliation act. Because the Eximbank may have to pay a penalty to retire an equivalent amount of its own borrowing from the FFB, it may suffer an immediate loss on these transactions. On the other hand, if the Eximbank chooses to retire its lowest cost debt, its interest losses would increase in future years. In any event, prepayments at par will increase the Bank's operating losses and worsen the erosion of its capital.

In CBO's view, sales and prepayments of loans are merely asset exchanges that do not improve the financial condition of the government. Therefore, we believe the unified budget should not treat the proceeds of the transactions as offsetting collections that reduce the deficit. As I mentioned earlier, we believe that the cash flows of credit programs should be replaced by their subsidy costs in the unified budget.

RECAPITALIZATION OF EXIMBANK

The net operating losses incurred by the Eximbank since fiscal year 1981 have significantly reduced the Bank's capital. Table 5 summarizes the Bank's financial condition from fiscal years 1980 through 1988. If, as the General Accounting Office has suggested, the Eximbank established reserves to cover anticipated losses on its portfolio of direct loans and repurchased guaranteed loans, the capital figures for fiscal years 1983 through 1988 would be even lower, as would the net operating income data in Table 3. The steady erosion of the Eximbank's capital has suggested to some that additional funds should be appropriated, or other measures taken, to increase the Bank's capital.

The Budgetary Treatment of Recapitalization

The Congress could recapitalize the Eximbank with a direct appropriation, which would be scored as budget authority in the year it was made. Such a transaction would not affect total budget outlays because the Eximbank would use the funds to retire some of its debt to the FFB, thereby reducing its outlays for interest payments, but the lower Bank outlays would be offset dollar for dollar by lower interest receipts at the FFB, causing no change in total government outlays or the unified budget deficit.

The Congress also could effectively recapitalize the Eximbank with new legislation that required the FFB to allow the Bank to prepay some or all of its debt at par without paying a penalty. This option would not require budget authority. Like an appropriation, it would reduce the Bank's outlays for interest payments but would have no impact on the deficit.

TABLE 5. FINANCIAL CONDITION OF EXIMBANK (By fiscal year, in millions of dollars)

	Actual							President's Budget	
	1980	1981	1982	1983	198*	1985	1986	1987	1988
Assets									
Loans receivable	11,859	13,765	16,665	16,983	17,504	15,876	14,351	11,188	8,924
Other	278	326	620	785	909	1,83*	1,889	2,021	1,812
Liabilities									
FFB borrowing	7,953	10,067	13,95*	14,676	15,690	15,409	14,268	11,868	10,052
Other	1,071	836	291	300	273	195	209	177	157
Capital	3,113	3,187	3,039	2,792	2,450	2,106	1,762	1,165	527

SOURCE: Office of Management and Budget.

What Does Capital Mean for a Government Agency?

A brief comparison of the uses of capital in a private firm and in a government agency such as the Eximbank may help put the recent erosion of the Bank's capital and the recapitalization issue in perspective. In the private sector, **capital--the excess of assets over debt claims--is** a measure of a **firm's** ability to sustain losses and still meets its obligations. The greater the cushion against losses provided by capital, the more debt a firm can issue to expand its operations, and the lower the interest rates investors will require on the firm's securities. A portion of **capital--equity--gives** some investors ownership rights in the **firm**.

The capital of a government agency engaged in credit activities consists of an initial appropriation of budget authority, subsequent appropriations, and retained earnings. The agency's authority to borrow from the Treasury or the FFB is nearly always a much more significant source of budget authority than the agency's capital. The Eximbank, for example, has unlimited authority to borrow from the FFB, despite a statutory limit of \$6 billion on direct borrowing from Treasury. Therefore, unlike the capital of a private firm, a government **agency's** capital is a measure neither of its ability to sustain losses and **fulfill** its obligations nor of its ability to borrow.

If this is so, what is the effect on the budgetary treatment of the Eximbank of financing the Bank's activities with **capital--received** through appropriations or offsetting **collections--as** opposed to borrowing from the Treasury? As suggested by my discussion of the budgetary implications of

recapitalization, financing the **Eximbank's** obligations with capital would allow the Bank to avoid paying interest on debt owed to the Treasury or its agency, the FFB. By reducing the **Eximbank's** interest expense, financing with capital would obscure the **Bank's** costs without reducing the costs to the government of its operations.

A Superior Alternative; Credit Reform

In sum, the Eximbank's level of capital has no **effect** on the Bank's ability to provide export credit assistance and thus is economically meaningless. **Recapitalization** of the Eximbank would neither change the government's financial position nor reduce the deficit, but merely shift interest expense from the Bank to the Treasury. Recapitalization would only reduce the apparent costs of the Bank's operations, while leaving the real costs unchanged.

A major purpose of initially appropriating capital to the Eximbank and subsequently keeping business-type books for the Bank is to measure the agency's earnings or **losses--its** net operating income. Regardless of the Eximbank's capital **level--positive**, zero, or **negative--the** Bank's operating income or loss will be reported in the budget and audited by the General Accounting Office each year. Recapitalization will not improve the information available to the Subcommittee and the Congress about the financial performance of the Bank. And as long as the Eximbank retains its ability to **borrow--governed** by **statute--it** has "sufficient capital" to perform its functions.

Credit reform would require that estimates of the subsidy costs of the Eximbank credit programs be included in the budget and would necessitate advance appropriations to fund those costs. Thus, it would better enable the Congress to budget for and control in advance the losses incurred on Bank programs, losses which affect the Bank's net operating income years later. Unlike recapitalization, which would make some of the Bank's costs less visible, credit reform would more clearly indicate the real costs of the Eximbank's activities.