BACKGROUND PAPER

U.S. Government Involvement in Commercial Exports: Program Goals and Budgetary Costs

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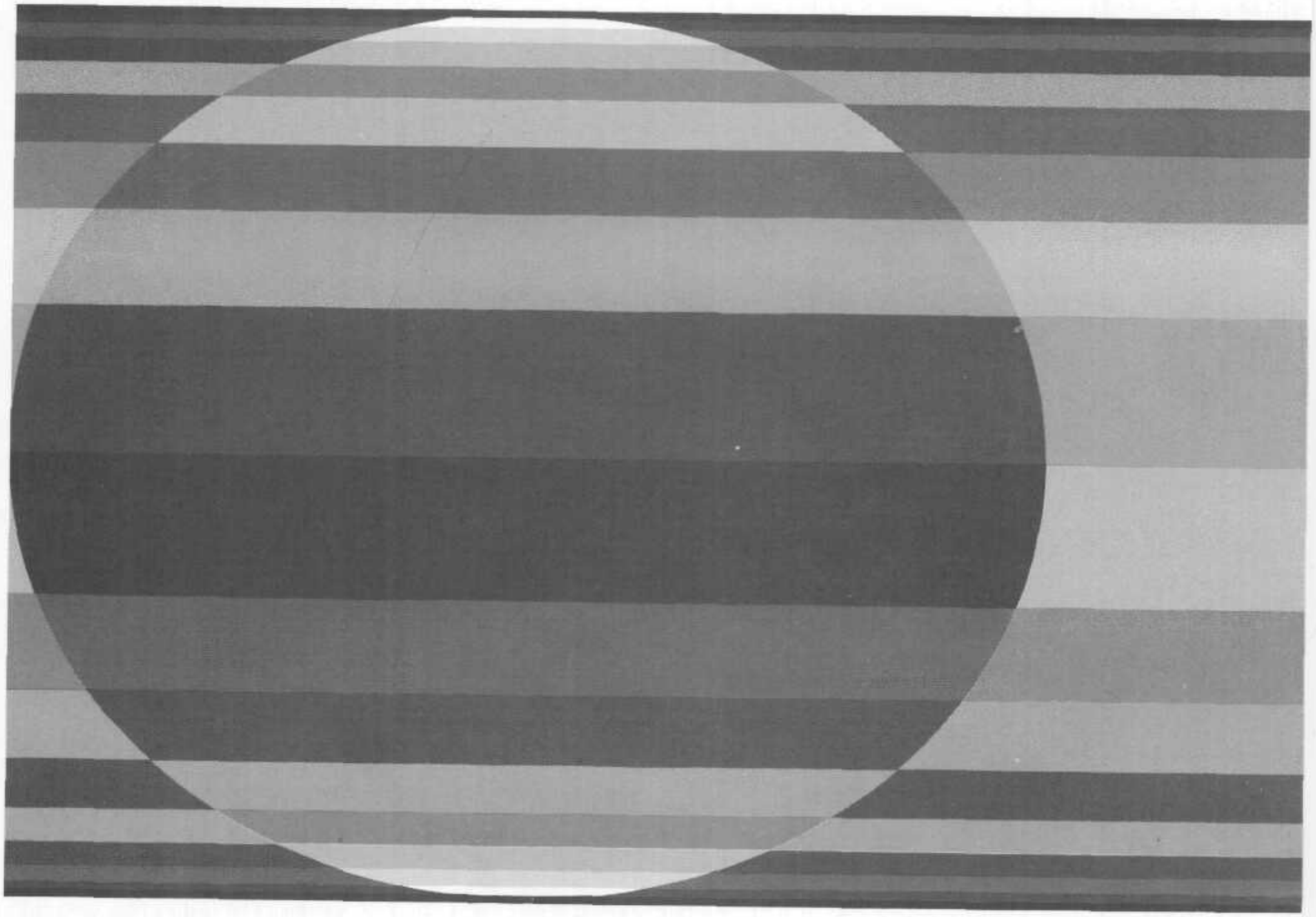

Congress of the United States
Congressional Budget Office

U.S. GOVERNMENT INVOLVEMENT IN COMMERCIAL EXPORTS: PROGRAM GOALS AND BUDGETARY COSTS

The Congress of the United States
Congressional Budget Office

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PREFACE

U.S. Government Involvement in Commercial Exports was prepared at the request of the Senate Budget Committee. The paper discusses the implications of reauthorizing the present mix of programs that provide government support for commercial exports, with a view toward analyzing the distinction between budgetary costs and economic effects. Special attention is given to the potential of these programs to achieve both their legislative and other goals. The study builds on the Congressional Budget Office's previous work on the Export-Import Bank. In accordance with CBO's mandate to provide nonpartisan analysis, the paper offers no recommendations.

Rosemary E. Minyard of CBO's National Security and International Affairs Division wrote the paper under the supervision of John E. Koehler. The author wishes to acknowledge the assistance of Ramon Espinosa, who helped prepare the cost analyses discussed in the paper. The manuscript was edited by Johanna Zacharias and prepared for publication under her supervision with Tricia Knapick's assistance.

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Director

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SUMMARY

The U.S. government provides financial support for export transactions primarily through three credit programs and one tax incentive program. Credit is extended through the Export-Import Bank of the United States (Eximbank); Title I of the Agriculture, Food, and Development Act of 1954, as amended (P.L. 480-I); and the Commodity Credit Corporation's Short-Term Export Sales program. A tax incentive is provided through Domestic International Sales Corporations (DISCs).

In the coming months, the Congress will undertake a major legislative review of the Eximbank because the operating authority for this program will have to be extended for the bank to operate beyond fiscal year 1978. In addition, the DISC legislation, though amended by the Tax Reform Act of 1976, may also appear on the Congressional agenda. This is because, in December 1976, a panel of experts contracted by the Council of the General Agreement on Tariffs and Trade (GATT) declared the DISC tax benefit to be in violation of GATT. Reform of the DISC legislation may be part of the Administration's tax-revision plan that may be presented to the Congress before the end of the year.

Each of these programs generates some form of annual budgetary cost. The budgetary cost for the three credit programs is equal to the outlays of these programs. The outlays of Eximbank in fiscal year 1977 are expected to be $500.0 million. P.L. 480-I is expected to generate $428.3 million in outlays, and Short-Term Export Credit Sales, $425.7 million. 1/ For DISC, the budgetary cost is the estimated tax revenue foregone--projected at $950 million in fiscal year 1977.

The outlays of most of these programs cannot be controlled by the Congress on a yearly basis, and their effect on the federal budget is much like that of a nonadjustable entitlement program such as social security. 2/ Credit programs are mostly uncontrollable by the budget process because lending activity, which is monitored by the Executive Branch, continues until its dollar volume hits a statutory

1/ Budget of the U.S. Government, Fiscal Year 1978 Appendix.

2/ The fiscal year 1978 Agriculture Bill does provide for annual control of P.L. 480-I outlays through the appropriations process.

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limit on the total amount of credit that can be outstanding. Similarly, the amount of tax revenue loss from DISC depends on the level of income from affected export sales, whose value is not subject to direct control by the Congress.

All export supports generate some form of subsidy. These programs affect the economy through the subsidies granted and through any redirection of credit or credit market imperfections overcome. The Congressional Budget Office has measured the subsidy as the cost to the government when either a credit program or tax incentive results in revenue loss. Under some conditions (Chapter II), the subsidy imposes a direct cost on the taxpayer. Eximbank and Short-Term Export Credit Sales generate subsidies but do not impose a direct cost on the taxpayer. P.L. 480-I also generates a subsidy, but only part of that impinges directly on the taxpayer. In the case of DISC, the subsidy equals the tax revenue foregone and is a direct cost to the taxpayer.

Overall Objective

The general objective of government export support is to induce more export sales than there would otherwise be. It is difficult to ascertain how great the programs' effects are. Since these programs were instituted when countries were trading under a fixed exchange-rate system, they were expected to induce a significant volume of additional exports. Under a fixed exchange-rate system, when total exports increased, net exports (that is, exports minus imports) did also. Now, flexible exchange rates, by affecting imports too, can mitigate the effect of export supports on aggregate net exports. (It has also been argued that, since the movement of flexible exchange rates can be manipulated, export supports can still induce additional net exports.)

The incremental effect of these programs, according to some estimates, could be as much as $5 billion in any fiscal year. Still, this is only a small fraction of total U.S. exports. In addition, since firms from only a few industries benefit from the programs, their effect on certain industries is concentrated.

Industrial Composition

Although Eximbank may legally participate in export transactions in any business, firms in only a few industries avail themselves of the subsidy to any great extent. 3/ The DISC tax advantage is likewise

3/ The Arms Export Control Act prohibits the Eximbank from participating in any extention of credit in connection with any agreement to sell defense articles or services to economically less developed countries.

nonrestrictive, but is also used more by some industries than by others. Export sales supported by these two programs account for more than 90 percent of all exports affected by the four programs. The major manufacturing industry groups that use DISC and Eximbank are chemicals and capital goods industries. DISC is also used by many agricultural products exporters. The P.L. 480-I and Short-Term Export Credit Sales programs are designed specifically to finance agricultural exports. The products most affected by all the programs are rice, feed grains, tobacco, soybeans, chemical products, steel mills, aircraft, and nuclear power plants.

Effects of the Export Support Programs on the Economy

These effects must be evaluated in the context of the programs' goals and limitations. The programs' stated goals--and the grounds on which they have been defended--are:

- That they contribute to a satisfactory balance of payments;
- That they increase the number of domestic jobs available; and
- That some programs (particularly Eximbank) counter export promotion moves made by other countries with subsidies that enhance the profitability of producing goods for export (i.e., "financing sweeteners").

Other goals, too, have been cited as reasons why the government should consider export subsidies. They are:

- To help distribute aggregate income equally among workers in different economic sectors, between wage earners and capitalists, and among countries;
- To promote economic stabilization;
- To promote national security;
- To offset trade barriers or distortions in goods and credit markets; and
- To foster infant industries.

Among the programs' limitations is the fact that the general adoption of floating exchange rates has lessened the ability of the programs to contribute to a satisfactory balance of payments. With fixed exchange rates, successful export promotion, along with other forms of nontariff barriers, could help the U.S. trade sector contribute to national income. This was possible because export incentives could raise the net surplus in the balance of trade, and the ensuing accumulation of reserves would help the balance of payments. The increase in net exports meant higher domestic output and employment.

To focus on changes in the balance of payments, however, is a less effective policy in a world with flexible exchange rates. Export supports will tend to increase U.S. export sales and cause the U.S. dollar to appreciate, thus mitigating the effect of the export subsidy. Also, as the dollar goes up in value, imports may increase as U.S. citizens become able to purchase foreign goods more cheaply.

Export programs generally offer little help for problems of aggregate unemployment, especially since the exporting industries use capital and skilled labor more intensively than do sectors oriented mainly toward the domestic market. Export incentives are useful primarily in supporting employment in specific industries. Should international competition or an economic slump depress sales in some export industries, the attendant decline in production might bring about cutbacks or shifts in the labor force in those industries. Mobilizing labor again if and when sales pick up is difficult. If export incentives avert the decline of income in industries producing for export, they can only be considered supportive of those industries' jobs.

Discussion of U.S. export subsidies and credit programs has often centered on how they can be effective in countering financial sweeteners offered by other countries, particularly by offering loans with low interest rates. Attention should not, however, focus only on interest-rate differences. Competition among countries based on rates of interest does not fully reflect the types or amounts of resources many industrial countries channel to their export sector.

Eximbank and DISC have never been justifiable as tools to facilitate the redistribution of income. Nor can the support given to agricultural exports from P.L. 480-I and Short-Term Export Credit Sales be justified on those grounds. U.S. agricultural production is capital-intensive, not labor-intensive; farm workers' wage levels probably are not increased by these programs because the subsidies may be captured by farm owners.

While the programs have contributed little to income distribution, they are beneficial in the area of food distribution: they do supply agricultural commodities to foreign countries that need them the most. Thus, they help fulfill the economic development and disaster relief objectives of U.S. foreign economic assistance.

U.S. export subsidy programs are not designed to act as economic stabilizers; nor have they been administered to do so. Eximbank extends loans independent of changes in U.S. national income. Historically, the volume of Eximbank loans has not declined appreciably during periods when domestic income was rising. Nor has the application of DISC been countercyclical.

Neither the Congress nor the Executive Branch has ever used national security as a rationale for Eximbank loans. Nonetheless, national security may justify supporting exports in the two categories that receive nearly half of all Eximbank assistance: aerospace and nuclear power generation products.

The Eximbank and Short-Term Export Credit Sales programs do try to offset distortions in both goods and credit markets. Eximbank loans appear to fill something of a gap in domestic credit markets for long-term financing of capital goods exports. Both programs attempt to overcome barriers to trade or seemingly unfair competitive practices put in the way of U.S. exports by foreign governments. To fulfill these aims, Eximbank has extended loans at less-than-market rates of interest; the Short-Term Export Credit Sales program has not. When DISC came into existence, it focused on eliminating a perceived distortion: the undervaluation of other countries' exchange rates relative to the dollar. Since the general adoption of floating exchange rates, however, DISC has lost this purpose. Indeed, because DISC was declared in violation of the General Agreement on Tariffs and Trade, it can be argued that the existence of DISC may only increase international distortions.

P.L. 480-I, Short-Term Export Credit Sales, and DISC do not support infant industries or new products. Only in the case of the Eximbank could it be argued that export subsidies are for infant products, because of the bank's support for nuclear reactors. Nevertheless, it has not been demonstrated that nuclear reactor export sales are critical to the long-run profitability of the nuclear industry. In addition, U.S. policy on nuclear proliferation is still changing. Supporting the industry through export incentives may simultaneously increase the risk of nuclear proliferation.

Alternative Domestic Programs. If the overall goal of export programs is to increase output in particular industries, alternative forms of domestic support or subsidies could reasonably be considered. Benefits from a support or subsidy could go to domestic consumers and producers, as opposed to being split between domestic producers and foreign consumers. For example, the Congress might want to consider subsidies or credits that would be extended to domestic utilities or airlines.

Budgetary Benefits and Losses from Export Supports

Unless the Congress were to increase on a large scale the government's support for exports of products now affected, the rise in total U.S. exports would still be small. An extensive change would affect the reallocation, rather than the level, of exports supported. As DISC involves a direct transfer of taxpayers' money, it may be the likeliest candidate for revision. The decline of exports in industries affected by DISC probably would not be large. Thus, a decrease in export supports would benefit taxpayers more if DISC, not the Eximbank or other credit programs, were decreased.

CHAPTER I. THE MAJOR FEDERAL EXPORT PROGRAMS AND THEIR BUDGETARY SIGNIFICANCE

The U.S. government has adopted several programs by which it intervenes in export transactions. The aims of these programs are varied and complex. Their primary objectives, as set forth in the statutes, range from increasing exports to providing disaster relief. In addition, some observers maintain that U.S. involvement in exports can yield secondary domestic benefits by relieving unemployment, helping to maintain the balance of payments, and strengthening small businesses. 1/

The federal government intervenes in exports through three major credit programs and one major tax incentive program. Credit for U.S. exports is provided by the Export-Import Bank of the United States (Eximbank), the Commodity Credit Corporation's (CCC) Short-Term Export Credit Sales program, and Title I of the Agriculture, Food, and Development Act of 1954, Public Law 480, as amended. Loans offered by Eximbank and P.L. 480-I (as this section of the 1954 act is most commonly called) are often distinguished from commercial loans by special interest rates and unusually lengthy maturities; loans from the Short-Term Export Credit Sales program are generally like commercial loans. The major tax incentive scheme, the Domestic International Sales Corporation (DISC), allows firms to lower the tax liability on their incomes from export sales. The two largest programs are Eximbank and DISC.

A major legislative review of the Eximbank is expected for fiscal year 1979. The Congress may also review the DISC program's legislation in the coming fiscal year. A panel of experts, contracted by the Council of the General Agreement on Tariffs and Trade (GATT) to investigate DISC, has declared DISC to be incompatible with GATT because it constitutes a tax-supported subsidy to exports. This issue is also likely to come before the Congress soon.

This chapter describes how these programs facilitate exports and explains why the Congress has limited control over them through the budget process. Each program generates subsidies; the following chapter distinguishes how the subsidies are measured and describes conditions under which they generate a direct cost to the taxpayer, as

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1/ Office of Management and Budget, Interagency Report on U.S. Government Export Promotion Policies and Programs, April 1975 (draft), Chapter 3.

well as how they affect the federal budget and the economy as a whole.

DESCRIPTION OF THE PROGRAMS

Eximbank stimulates exports primarily by extending loans to foreign buyers to purchase U.S. goods. The maturities of these loans range from six to 12 years. In the past, these loans were extended at interest rates substantially below what borrowers would have had to pay to commercial lenders. At present, the bank is charging a higher interest rate than it used to. (Eximbank's current average lending rate is 8.6 percent.) The bank also extends credit insurance and guarantees against commercial risks and the political uncertainties inherent in lending to foreign state-owned corporations. Although much of Eximbank's annual lending is financed by loans that are repaid each year, the bank usually borrows from the government to help finance its loan portfolio. 2/

The Commodity Credit Corporation Charter Act of 1948 (P.L. 806, as amended) authorized the CCC to provide short-term credits. By extending loans to foreign purchasers, the CCC's Short-Term Export Credit Sales program promotes U.S. agricultural products determined by the Department of Agriculture to be in surplus. These loans have maturities of up to three years at interest rates that approximate commercial ones. At present, the program earns income, but Section 4 of the Food for Peace Act of 1966 (P.L. 89-808) gives CCC the authority to request an appropriation to cover any losses it might incur.

Loans are also extended by P.L. 480-I to foreign purchasers of agricultural commodities but at interest rates substantially lower than commercial ones. P.L. 480-I loans also differ from CCC loans because their maturities can range up to 40 years. Because of its low-interest, long-maturity loans, P.L. 480-I resembles a grant program.

When the Congress approved the DISC program in 1971, the program's original objective was to increase exports and improve the balance of payments by means of a tax reduction. At that time, the currencies of other countries were perceived as undervalued with respect to the dollar, giving those countries an apparently unfair competitive advantage in international trade. The DISC provision of the tax code allows companies to lower the tax rate on taxable income from DISC export sales from the regular rate of 48 percent

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2/ For a discussion of this process in relation to the federal budget, see The Export-Import Bank: Implications for the Federal Budget and the Credit Market, Chapter II, CBO Staff Working Paper (October 27, 1976).

to 36 percent. Business firms can do this by deferring part of the corporation's tax liability on DISC sales. Restricted from the export receipts of the DISC subsidiary are the receipts from any export sales that receive other federal support such as from an Eximbank loan. In addition, the DISC subsidiary can only encompass sales and not production activities of the parent firm. 3/

BUDGETARY SIGNIFICANCE AND CONTROL

Export credit programs affect the budget authority and outlays of two budget functions: international affairs (150) and agriculture (350). Outlays for fiscal year 1977 for Eximbank and P.L. 480-I are estimated to equal approximately $928 million, or approximately 15 percent of the outlays in the international affairs function. Outlays of the Short-Term Export Credit Sales program for fiscal year 1977 are estimated to equal about $426 million, or 10 percent of total agricultural outlays.

These credit programs, except P.L. 480-I, belong to a group whose outlays are not, and that probably cannot be, controlled directly by the Congress through the appropriations process--at least not under present legislation. Outlays derive from the level of lending activity, which is at the discretion of the Executive Branch. 4/

Similarly, the amount of the tax revenue loss from a program such as DISC is not subject to direct budgetary control. The Congress prescribed the formula by which the reduction in tax liability is computed, but the yearly tax revenue loss depends on the level of income from export sales affected by the programs. The expected tax revenue loss for fiscal year 1977 from the DISC incentive is estimated to be $1.03 billion. 5/ The tax loss changes with economic conditions, when the Congress alters the law, or when newly eligible firms decide to take

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3/ For a discussion of the history and provisions of the DISC statute, see Chapter 2 of the DISC 1975 Annual Report, U.S. Department of the Treasury, April 1977, pp. 4-9.

4/ In the case of both P.L. 480-I and Eximbank, lending can continue until its outstanding dollar volume hits a statutory constraint. Credit outstanding for the programs has hardly ever approached the statutory limit, however, and when it has, the limit was simply raised. No major reexamination of the budgetary effect of this action was undertaken.

5/ See CBO Five-Year Budget Projections for Fiscal Years 1978-1982, Supplement on Tax Expenditures, Report (April 1977), p. 7.

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advantage of the DISC provision. The Tax Reform Act of 1976 (P.L. 94-455) for example, reduced the tax revenue loss from DISC for fiscal year 1977 by an estimated $468 million. 6/

6/ Joint Committee on Taxation, Summary of the Tax Reform Act of 1976, October 4, 1976, p. 111.

CHAPTER II. SUBSIDIES RELATED TO EXPORT SUPPORT PROGRAMS

MEASURING THE COSTS

All export supports generate some form of subsidy as a cost either to the government or to the taxpayer or both. The value of an export subsidy can be measured in at least two ways: as the benefit to both buyer and seller; or as the cost to the federal government when either a credit program or a tax incentive results in revenue loss.

To estimate the second measure is easier than to estimate the first. Evaluating the subsidy as a benefit would require, for example, a case-by-case estimate of a buyer's willingness to pay a particular interest rate if he borrowed without government assistance. To measure the cost to the government, one needs only the dollar amount of the program, the interest rate charged (if the program is a credit one) or the tax reduction (if a tax incentive), and the alternative commercial rate of interest or tax rate expected by the Internal Revenue Service.

Direct Costs to the Taxpayer

Export credit supports can result in a direct cost to the U.S. taxpayer when the cost of government funds is higher than the interest charged on government loans. In such instances, the government is paying out more than it is getting back. How much depends on the difference in the interest rate at which the U.S. Government borrows its funds and the interest rate charged on loans.

In principle, any lending program can create an indirect cost to the taxpayer. Program activity increases net federal borrowing, which can cause the rate to be paid on the federal debt to rise. When this happens, there is an indirect cost to the taxpayer. Such an indirect cost is likely to be negligible, however, because increased borrowing for these programs is a small proportion of net federal borrowing, and because the U.S. government can usually borrow additional funds with little increase in interest rates. The potential amount of cost to the taxpayer, however, varies from program to program.

Since Eximbank usually lends at an interest rate higher than the rate at which it borrows, it can operate without causing any direct cost to the taxpayer. The Short-Term Export Credit Sales program operates similarly. P.L. 480-I charges less for its loans than the government borrowing cost; thus it incurs a direct cost to the taxpayer. CCC, because it has the authority to seek an appropriation should its export credit sales program operate at a loss, could bring about a direct cost to the taxpayer in a year in which the program operated at a loss. DISC also imposes a cost on the taxpayer by the amount of the tax revenue loss; in this case, the tax revenue loss is the value of the subsidy.

Budgetary Costs. All programs generate a cost to the federal budget. The budgetary costs are represented by the value of outlays and tax expenditures in any fiscal year. Outlays and tax expenditures are the net credits disbursed and revenues foregone, respectively, in any fiscal year. Table 1 lists the value of the DISC tax expenditures for fiscal years 1972 through 1982. Table 2 lists outlays for the Eximbank, P.L. 480-I, and Short-Term Export Credit Sales program for fiscal years 1970 through 1977.

TABLE 1. ESTIMATES OF DISC TAX EXPENDITURES: FISCAL YEARS 1972-1982, IN BILLIONS OF DOLLARS

Year	Revenue Foregone
1972	0.10
1973	0.46
1974	0.85
1975	1.20
1976	1.23
1977	0.95
1978	1.14
1979	1.33
1980	1.52
1981	1.63
1982	1.70

SOURCE: DISC 1975 Annual Report, U.S. Department of the Treasury, p. 24.

TABLE 2. OUTLAYS FOR THE EXIMBANK, P.L. 480-I, AND SHORT-TERM EXPORT CREDIT SALES: FISCAL YEARS 1970-1977, IN MILLIONS OF DOLLARS

Year	Eximbank	P.L. 480-I	Short-Term Export Credit Sales
1970	219.06	586.34	28.01
1971	-184.34 a/	522.52	126.30
1972	183.95	468.81	42.40
1973	548.06	357.83	676.14
1974	1,228.28	254.11	-396.16 a/
1975	1,503.70	473.51	-324.54 a/
1976	855.67	363.70	17.95
1977 est.	500.00	428.30	425.75

SOURCE: Budget of the U.S. Government, Fiscal Years 1973-1978, Appendixes.

a/ Negative numbers mean that repayments on old loans were greater than disbursements on new ones.

CHAPTER III. THE INDUSTRIAL COMPOSITION OF GOVERNMENT-SUPPORTED EXPORT PROGRAMS

Which industries use subsidy and credit programs most?

The enabling legislation for Eximbank does not restrict the bank to facilitating export transactions of any particular firms, products, or industries. But, although firms in nearly all types of business have used the bank, those in a few industries take particular advantage of the program. Similarly, DISC has no restrictions, but the DISC tax advantage is nonetheless used more by some industries than by others. The major industrial groups that DISC and Eximbank affect are chemicals and capital goods industries.

The Short-Term Export Credit Sales and P.L. 480-I programs are designed to finance agricultural exports, specifically certain commodities chosen by the Department of Agriculture. The department designates certain items available for export under the programs after an analysis of which crops will be in surplus when commercial demands are satisfied. Market conditions in foreign countries are then analyzed to match those countries' needs with the United States' need to sell surpluses. Finally, the Department of Agriculture announces that a line of credit will be available to a particular country chosen to purchase U.S. commodities.

Eximbank. Eximbank loans support a large variety of capital goods exports. Table 3 lists the major groups of Eximbank direct loans and their share of total disbursements. Roughly three-fourths of all loan disbursements in fiscal year 1975 were for loans in four industrial groups: transportation (aircraft, railroad locomotives, ships, and motor vehicles); nuclear power (plants and equipment); hydroelectric power (plants and equipment); and special heavy manufacturing equipment (such as steel mills). Loans in just the first two of these four categories accounted for one-half of all Eximbank disbursements, which totaled $2.69 billion.

To estimate this subsidy, total receipts of principal and interest are calculated for each commodity class at an Eximbank rate of 6 percent. (Most loan disbursements in fiscal year 1975 were made at 6 percent interest.) The present value of those yearly receipts of principal and interest are then calculated at an estimated market rate of 12 percent. (Twelve percent is chosen as an arbitrary but reasonable estimate of what Eximbank could have earned by lending domestically; it is only two

TABLE 3. MAJOR PRODUCT GROUPS OF EXPORT-IMPORT BANK DIRECT LOANS: FISCAL YEAR 1975

Product Group	Percent of Total Loan Disbursements
Aircraft, Railroad Locomotives, Ships, Motor Vehicles	34.35
Nuclear Power Plants and Equipment	17.76
Hydroelectric Power Plants, Equipment, and Generators	12.15
Special Heavy Manufacturing Machinery	10.89
Construction and Mining Equipment	9.04
Primary Metals Mining and Processing	4.37
Building Construction and General Contracting	3.92
Electrical Power and Electronic Machinery, Communications Equipment and Supplies	3.01
Other	4.50

SOURCE: Eximbank data.

points above the average prime rate charged by banks to their most credit-worthy borrowers between July 1974 and June 1975. 1/) The subsidy was estimated to be $638 million. 2/

DISC. The effect on an industry of the DISC tax deferral depends on the proportion of that industry's output sold as exports. The more a business relies on export receipts, the greater the likelihood that companies in that industry will form DISC subsidiaries. Table 4 shows the distribution of DISC profits by industry of the DISC subsidiary. The industries with large amounts of DISC profits are chemicals, agriculture, transportation equipment, industrial machinery (electrical and mechanical), and professional and scientific instruments.

The reduction in tax liability from DISC is about 25 percent, and the distribution of DISC profits by industry is somewhat a guide to the distribution of the tax reduction from DISC. This is only somewhat of a guide because a firm will use a domestic international sales program, along with other tax reduction provisions in the tax code, to lower taxes. In doing so it can try to maximize the reduction in the total statutory tax rate by choosing among alternative tax reduction opportunities. For example, a firm might make less use of DISC because it can achieve a greater reduction in total tax liability by allowing all profits to remain with the parent corporation and by taking advantage of a "carry forward" of a net operating loss about to expire.

P.L. 480-I and Short-Term Export Credit Sales. P.L. 480-I and Short-Term Export Credit Sales support the export of similar commodities: 86 percent of P.L. 480-I sales are of wheat and rice, and 79 percent of Short-Term Export Credit Sales are for wheat, cotton, and tobacco. Table 5 shows the value of shipments by commodities under P.L. 480-I for fiscal year 1976, and Table 6 shows the value of Short-Term Export Credit Sales by commodity for fiscal years 1975 and 1976. Both programs have concentrated on supporting these commodities for the last three fiscal years, although Short-Term Export Credit Sales increased in importance as the value of sales increased nearly $400 million from fiscal year 1975 to 1976.

1/ A comparable market rate for loans in the 7- to 15-year maturity class is not available. An alternative might be a 20-year BAA-rated corporate bond rate.

2/ It is important to note that, if some other alternative rate were considered appropriate, the magnitude of the Eximbank implicit subsidy would change, but its distribution by industry would not.

TABLE 4. DISTRIBUTION OF DISC PROFITS BY INDUSTRY OF DISC SUBSIDIARY: FISCAL YEAR 1975, IN MILLIONS OF DOLLARS

Industry	Net Income or Profit
Chemicals and Allied Products	1,090.0
Industrial Machinery (Except Electrical)	759.5
Agriculture and Other Nonmanufactured Products	647.2
Transportation (Aircraft, Motor Vehicles, and Other)	640.0
Electrical Machinery	350.7
Professional and Scientific Instruments	226.8
Iron and Steel Foundries	198.0
Paper and Allied Products	176.9
Heating and Plumbing Products	133.3
Processed Foods	109.1
Lumber and Mill Products	85.7
Petroleum and Related Products	69.0
Textile and Apparel	53.4
Tobacco Manufactures	24.1
All Other Manufactures	217.1

SOURCE: DISC 1975 Annual Report, U.S. Department of the Treasury, pp. 36-37.

TABLE 5. PUBLIC LAW 480, TITLE I--VALUE OF SHIPMENTS BY COMMODITY: FISCAL YEAR 1976, IN MILLIONS OF DOLLARS

Commodity	Value
Wheat	386.7
Rice	135.1
Vegetable Oils	37.1
Upland Cotton	28.4
Tobacco	15.0
Blended Food Products	1.1
Feed Grains	
Corn	a/
Grain sorghum	a/
Total feed grains	a/
TOTAL	603.4

SOURCE: U.S. Department of Agriculture, Budget Explanatory Notes for Fiscal Year 1978, p. 212.

a/ None in fiscal year 1976.

TABLE 6. SHORT-TERM EXPORT CREDIT SALES--VALUE OF SALES BY COMMODITY: FISCAL YEARS 1975 AND 1976, IN MILLIONS OF DOLLARS

Commodity	Value of Sales 1975	1976
Cotton	97.4	244.9
Feed Grains	34.5	37.8
Rice	20.1	21.9
Soybean, Soybean Meal, and Soy Protein	--	24.0
Tobacco	61.6	81.0
Vegetable Oil	--	33.4
Wheat/Flour	24.4	162.5
Other Commodities a/	10.5	15.9
TOTAL	248.5	621.4

SOURCE: U.S. Department of Agriculture, Quarterly Report of the General Sales Manager, October 1-December 31, 1976, January 1977, Table 13.

a/ Tallow, prunes, raisins, breeding cattle, and swine.

Short-Term Export Credit Sales usually incur no direct cost to the taxpayer because commercial interest rates are charged. The Congressional Budget Office (CBO) has calculated the cost to the taxpayer for fiscal year 1976 of the subsidy related to $603.3 million of P.L. 480-I loans. The average interest rate on these loans was 3 percent, and the average maturity was 31 years. The average grace period was approximately seven years, and only 2 percent interest payments were required during that period.

The total receipts of principal and interest for the $603.3 million in loans were calculated to be $911.1 million. The present value of those repayments, discounted at the government borrowing rate of 8 percent, equals the amount the government could have lent at 8 percent, which would have just covered its borrowing cost. The government borrowing rate was approximated by the interest rate paid by the government on new issues of three- to five-year securities. In fiscal year 1976, that average rate was 8 percent. The amount the government could have lent at 8 percent would have been much smaller than the amount it actually lent at 3 percent. The subsidy is the difference between the present discounted value at 8 percent and the amount of money actually lent. 3/ This subsidy is estimated to be $303 million.

3/ Because P.L. 480-I is a part of the U.S. foreign assistance program, there is an additional policy objective. Much of the subsidy has been extended with the explicit intention of benefiting less developed countries (LDCs). CBO has not attempted to measure those subsidy benefits.

CHAPTER IV. THE EFFECTS OF EXPORT SUPPORT PROGRAMS ON THE ECONOMY AND ON FIRMS

The goals generally ascribed to the present export support programs and the grounds on which they have been defended are that:

- The programs contribute to a satisfactory balance of payments;
- They increase domestic employment; and
- Some programs (particularly Eximbank) counter export promotion moves made by other countries with so-called "financing sweeteners" (that is, subsidies that enhance the profitability of producing goods for export).

Eximbank is also said to be increasing the share of export sales by small businesses in international trade.

In addition, export programs are only a special form of support, and the goals of export supports correspond closely with the goals for domestic subsidies and credit programs. From time to time, therefore, the programs are justified on grounds that:

- They help distribute aggregate income equally among workers in different sectors of the economy, between wage earners and capitalists, and among countries;
- They promote economic stability;
- They safeguard industries for national security;
- They offset the trade barriers or credit market distortions in other markets; and
- They foster infant industries.

POTENTIAL ECONOMIC IMPACTS

The Potential to Increase Net Exports

The overall objective of federal government export supports is to stimulate export sales. But to measure the increases directly attributable to such supports is not easy. Estimating the rise in total export sales is difficult because the government intervenes in a variety of goods and credit markets by various means. The problem is to separate out the goods that would be exported without federal intervention, and to estimate the aggregate amount exported because of government programs. Such estimates cannot be very accurate. Nor can they be very meaningful, since recent measures of support-stimulated sales account for only a small fraction of total U.S. export sales.

In the case of DISC, there have been attempts to estimate what would have been exported without the program's intervention to obtain a measure of its incremental effect on exports. These efforts have produced no conclusive evidence that DISC is at all a powerful incentive. One report, by the Department of the Treasury, estimated the incremental effect of DISC from July 1972 to June 1974 to be approximately $4.6 billion. 1/ The Congressional Research Service's estimate for the same period is only $1.4 billion. 2/ Since total U.S. exports during that time amounted to approximately $104 billion, according to those estimates, DISC accounted for something between just 1 and 4 percent of all exports. By recent Treasury Department estimates for fiscal year 1975, DISC still only accounts for about 2 percent of total U.S. exports. 3/

Eximbank's incremental effect on exports has not been evaluated thus far, but according to the Eximbank, the bank facilitated export sales valued at $12.5 billion in fiscal year 1975; total U.S. exports that year came to about $148.2 billion. If Eximbank's effect on export sales were one-half of the sales it facilitated, that is still only 2 percent of total U.S. exports. The net effect is still smaller than the effect on total exports.

Although precise, program-by-program measurements are difficult to make, a more general evaluation of the effectiveness of export support programs is possible and can be useful. Such an assessment can be approached from the standpoint of the goals stated at the outset of this chapter.

1/ U.S. Department of the Treasury, DISC 1974 Annual Report, April 1976, p. 2.

2/ Congressional Research Service, The Domestic International Sales Corporation and Its Effect on U.S. Foreign Trade and Unemployment, CRS Multilith Report, May 4, 1976, pp. 1-3. This study explains why the methodology of the DISC 1974 Annual Report would result in an overestimate.

3/ U.S. Department of the Treasury, DISC 1975 Annual Report, April 1977, p. 11.

Currency Exchange Rates and the Balance of Payments

The export support programs this paper discusses were instituted at a time when trading nations were dealing in a fixed exchange-rate system. Because countries usually maintained the value of their currencies within a narrow band, currency values could not change much in response to changes in demand for exports. The effect of export subsidies on the trade balance was quite predictable: when total exports increased, so did net exports. Now, however, when several of the major currencies float relative to each other, such predictions are less certain.

In other words, the adoption of floating exchange rates among developed countries may have diminished the ability of export support programs to contribute to a satisfactory balance of payments. An export subsidy will tend to cause the U.S. dollar to appreciate as demand for U.S. exports goes up. If the dollar actually appreciated, purchasing U.S. goods would become more expensive (whether the items are subsidized or not); foreign products would become relatively cheaper. Foreigners will therefore tend to buy less of U.S. products; the United States may also tend to import more, which would offset to some extent any increase in exports the support programs stimulate.

On the other hand, not every U.S. trading partner has a free-floating exchange rate, nor must floating exchange rates necessarily offset the effectiveness of export subsidies. A significant number of currency areas registered by the International Monetary Fund (IMF) fix the value of their currencies at that of the U.S. dollar. 4/ U.S. export subsidies probably exert some upward pressure on the dollar --although exactly how much is incalculable and probably negligible. Nonetheless, how much the upward pressure would be, and when the impact would be felt, are impossible to gauge because the credit programs offer support with different maturities, and because the adjustments in the demand for currency would probably take place at different times under different programs. DISC, if it does increase the demand for exports, is the only program that conceivably could result in immediate increases in the demand for the dollar.

4/ For a general discussion of monetary reform, see A. Kafka, The International Monetary Fund: Reform Without Reconstruction (Princeton University, International Finance Section, 1976), p. 23.

Export Supports as Measures to Offset Distortions in Other Markets

The Eximbank and Short-Term Export Credit Sales programs try to offset imperfections in both goods and credit markets. Eximbank loans appear to fill gaps in domestic credit markets for long-term financing of capital goods exports. 5/ Both programs attempt to overcome barriers to trade or what are deemed unfair competitive practices placed in the way of U.S. exports by foreign governments. In order to achieve these aims, Eximbank has extended loans at lower-than-market rates of interest; the Short-Term Export Credit program has not. When DISC came into existence, it focused on eliminating a perceived distortion: the undervaluation of other countries' exchange rates relative to the U.S. dollar. Since the adoption of generally floating exchange rates, however, DISC has lost such a purpose. Indeed, DISC was declared in violation of the General Agreement on Tariffs and Trade (GATT) in November 1976 by a panel of experts selected by the GATT Council. 6/ Thus, it may be argued that DISC may only serve to increase international distortions.

Effects on Employment

Export programs are probably an ineffective way to approach problems of aggregate domestic unemployment. Most U.S. exports are products whose manufacture uses capital and highly skilled labor. Many jobs in the export sector require advanced skills and job-specific training. The number of jobs created by each billion dollars of additional export demand is likely to be less than the number created if the additional demand were from domestic sources. Under certain conditions, however, export incentives can bolster employment in specific firms. If export incentives avert the decline of income in certain industries, they do support those industries' jobs.

Redistribution of Aggregate Income

The Eximbank and DISC have never been justified as distributional tools. Only those export programs that support U.S. agriculture can be justified on these grounds. This is because wages paid to farm workers are lower, on average, than are wages paid to other workers. Nevertheless, because of the way the industry is organized, subsidies to agriculture such as those offered by current export supports can be captured by the owners of capital, not by the wage earners. In U.S. agriculture there are many small, inefficient farms and a few large,

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5/ CBO Staff Working Paper, The Export-Import Bank: Implications for the Federal Budget and the Credit Market, October 27, 1976.

6/ DISC 1975 Annual Report, U.S. Department of the Treasury, p. 8.

efficient ones that produce most of the agricultural output. Because the ratio of capital and technology to labor in the large, efficient farms is high, export supports may not increase the wages of farm workers by much.

Yet there is merit to the argument that, if the United States is exporting some of its agricultural surplus, it is doing so in an equitable fashion. P.L. 480-I and Short-Term Export Credit Sales presumably help fulfill the economic development and disaster relief objectives of U.S. foreign economic assistance. Countries eligible to receive P.L. 480-I and Short-Term Export Credit Sales aid are those that are less able to meet more stringent credit terms. Many of the countries receiving short-term credit have per capita incomes below $2,000. 7/ By statute, 75 percent of P.L. 480-I commodities must be sold to countries that meet the International Development Association (IDA) poverty criterion.

Export Programs as Stabilization Measures

Management by subsidies or credit-support programs of short-term disruptions in income usually requires that program use be limited to times of recession or other economic disturbance. Timing is important for an export subsidy to have a stabilizing effect on fluctuations in domestic income. U.S. export subsidy programs are not designed to act as fiscal stabilizers, nor have they been administered to do so. First, Eximbank extends loans whether or not U.S. national income is declining. In addition, the volume of Eximbank loans has not declined appreciably during periods when domestic income was rising. The application of DISC is not restrictive either. Flexible exchange rates mitigate the effectiveness of the DISC tax scheme and Eximbank loans on net exports.

POSSIBLE EFFECTS ON FIRMS

Export Programs as National Security Measures

Eximbank loans have been extended by the Executive Branch as part of package deals designed to compensate foreign countries for access to military facilities. 8/ Nevertheless, lending by the bank has never been explicitly directed toward maintaining U.S. or allied military capabilities. Still, national security has been put forth as a justification for export subsidies to those products that receive the bulk

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7/ U.S. per capita income, estimated by the World Bank, is approximately $6,000.

8/ See, for example, Treaty of Friendship and Cooperation with Spain: Supplementary Agreement on Economic Cooperation, September 21, 1976.

of Eximbank credits--nuclear and aerospace products--although neither the Congress nor the Administration has ever cited national security as a rationale for Eximbank loans.

One argument is that, because the aerospace industry relies on civilian and military technologies that are inseparable, a decline in civilian output due to a reduction in exports could affect U.S. military capability. It has been said that exports are important to the aerospace industry because extra sales enable the industry to recoup the very large research and development costs that precede production. While this may be so, the evidence is difficult to assess. The U.S. civilian aircraft industry has had a continuing and growing trade surplus throughout its history; this is some sign of the industry's ability to compete internationally. Unlike other U.S. capital goods industries, the aircraft industry has experienced no growth in import competition. Also, the United States consumes most of the domestic output of that industry. Yet, changing business strategies may in fact be threatening the U.S. aerospace advantage.

International management of the European aerospace industry is now being tried in order to lessen the risk of short production runs resulting from insufficient marketing support for newly developed products. This problem has plagued the European manufacturers. 9/ While the U.S. aerospace industry has always been in a leading position in both technology and management, there may be sufficient technological capability in Europe and Japan eventually to present competition.

Also, because there is a threat to U.S. supremacy in the nuclear industry, U.S. security interests may be in some danger. Nuclear reactors embody one of the most advanced technologies known, and the nonproliferation treaty encourages the nonmilitary use of reactors by other countries. Uncontrolled proliferation of nuclear technology poses one of the greatest threats to international peace.

Subsidies and credit support for nuclear exports raised the issue of what the relationship between technology transfers and nuclear proliferation policies should be and what is the appropriate commercial marketing strategy to achieve the correct mix of these policies. The

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9/ For a discussion of French and English aerospace industries, see M.S. Hochmuth, "Aerospace," Big Business and the State: Changing Relations in Western Europe, ed. Raymond Vernon (Harvard University Press, 1974), pp. 145-169.

arguments in support of any U.S. commercial policy on sales of nuclear reactors are bounded by two extreme views. On the one hand, U.S. nuclear technology has been termed unique and should not be transferred to anyone; the U.S. nuclear monopoly should be maintained at all costs and exports banned. At the other extreme is the view that U.S. technology is so superior, the United States will always be ahead of the game; thus, it should not matter how much is sold or under what conditions.

The present state of nuclear technology does not appear to warrant the United States' embracing either extreme. Rudimentary nuclear technology can be duplicated. At present, other countries can supply both the initial and final stages of the nuclear fuel cycle.10/ Also, the introduction of breeder reactors (reactors that produce plutonium as a by-product of the generation of power) may make U.S. relative strength in technology more tenuous in future. Other countries, notably France, appear to be in the lead in breeder reactor technology. 11/

Countering Financing Sweeteners on Exports from Other Countries

Discussion of export subsidies and credit programs has often centered on countering the advantageous interest rates other countries offer. Attention should not focus exclusively on interest rate differences, however. There is an ongoing attempt to reduce all forms of counterproductive competition in government-supported export financing. 12/ Competition based on interest rates alone almost certainly does not reflect the full extent to which export inducements influence types or amounts of resources channeled within many countries to their export sectors.

Some important factors have received less public attention. Eximbank has monitored these carefully. Japan, for example, has offered both special exchange risk insurance and an export loss reserve system. Exchange risk insurance is a new policy covering foreign exchange losses

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10/ A concise explanation of the nuclear fuel cycle can be found in CBO, Nuclear Reprocessing and Proliferation: Alternative Approaches and their Implications for the Federal Budget, Background Paper (May 1977).

11/ P.A. Joskow, "The International Nuclear Industry Today," Foreign Affairs, Vol. 54, No. 4, (July 1976), pp. 788-803.

12/ Eximbank, Report to the U.S. Congress on Export Credit Competition and the Export-Import Bank of the United States (December 1976), p. 5.

exceeding 3 percent and up to 20 percent on export receipts. The loss reserve system allows exporters to set aside up to 7 percent of the contract value as a nontaxable reserve against loss.

Other factors, too, have received little attention, so far as their effect on export supports is concerned. In some countries, the government owns some of the nation's major exporting companies. In France, for example, five of the top 21 companies are wholly or partly owned by the government. As owner, the government can choose to forego the need for its companies to earn profits on export transactions.

A recent State Department document indicates that financing sweeteners appear to be important for exporters breaking into new markets, rather than maintaining links to established ones. Since the major growth market for sales of aircraft is in the Third World, subsidies may be useful to the U.S. aerospace industry in capturing those new markets. Because most of the markets for nuclear reactor exports are new ones and subsidized financing might make a difference for capturing those markets, it has been argued that nuclear export subsidies pose additional policy problems. These issues have not yet been settled.

Export Supports as Encouragements to Infant Industries

The industries that take the most advantage of export credit programs and subsidies are not new ones starting up. Still it has been argued that some products being subsidized or supported are in fact infant products--such as wide-bodied jets and nuclear reactors. Even if this were true, because there is a substantial U.S. market for wide-bodied aircraft, the future of wide-bodied jets seems certain. In addition, while the licensing process may lengthen the lead time on contracts for domestic nuclear reactors, foreign sales are relatively free of these restrictions.

P.L. 480-I, Short-Term Export Credit Sales, and DISC do not support infant industries or products. Only Eximbank does. Nevertheless, it has not been demonstrated that export sales are critical to the long-term profitability of the nuclear industry. In addition, U.S. policy on nuclear proliferation is still forming as a result of the breakdown of the U.S. monopoly and other considerations.

CHAPTER V. CONSEQUENCES OF REAUTHORIZING CURRENT EXPORT SUPPORTS

THE CONTRIBUTION TO NATIONAL INCOME

Export subsidies affect national income as a whole; in general, however, the net effect is different from the sum of the effects on particular industries. This is so because export subsidies that may increase the output of participating industries may have the simultaneous effect of decreasing output in other industries. This redirection of output occurs because of bidding-away of capital and labor from nonsubsidized firms by subsidized ones.

Thus, since the current export support programs reallocate resources to exports, an important standard by which to judge them is their net contribution to national income or output. Any such assessment must be tentative for several reasons:

- How much export promotion programs raise exports cannot be measured. Estimates of the net impact of DISC, for example, range from $1.5 to $4.0 billion in fiscal years 1973-1974. Eximbank effects are even less certain.

- Even if the effect on exports could be measured, the accompanying reduction in the output of other industries would be uncertain.

- Using export subsidies today to sustain an industry that is not thriving may, in the long run, cut into national output.

Thus, when the Congress confronts the question of authorizing continued support for export credit and subsidy programs, it will not only be making decisions on the short-term composition of export subsidies; it may also be influencing the industrial composition of the U.S. economy and the pattern of U.S. trade.

The competitiveness of traded U.S. products relative to those of other countries can be an indicator of their contribution to real U.S. output. Although the notion of international competitiveness is an elusive one, it is often measured by the trade balance of an industry--that is, exports minus imports. Other factors, of course, influence an industry's position in the trade balance. Government supports constitute a factor of some significance, but not an easy one to assess. The problem is also confused by events such as the devaluation of the U.S. dollar, shortages of commodities and fuel, and synchronization of business cycles among industrial countries; in the long run, all these factors affect the U.S. trade position. Despite these difficulties, however, an examination of U.S. trade balances by industry is the only way to get an idea (albeit rough) of the competitiveness of U.S. industries.

Approximately 22 percent of DISC net income is earned by DISC subsidiaries exporting chemical products. DISC and Eximbank each support a large variety of capital goods products (see Chapter III). Both chemicals and capital goods appear relatively competitive. The U.S. trade in chemicals from 1925 to 1970 appeared to be approximately balanced before World War II. Since the end of the war, starting in 1946, a surplus appeared, and it has been growing since 1963. All in all, trade in capital goods (except automotive vehicles) has been growing since 1951. But not all subcategories of capital goods have made a consistent contribution to that growth. Most capital goods products, except civilian aircraft engines and parts, have experienced some significant import competition since the mid-1960s. 1/

As observed in Chapter III, Short-Term Export Credit Sales and P.L. 480-I are limited to the support of agricultural goods. In addition, approximately 14 percent of net income from DISC subsidiaries is from manufactured farm products and nonmanufactured products. From 1925 to 1964, the U.S. balance of trade in agricultural goods fluctuated, but a pattern of deterioration, resulting from rising imports, developed between 1964 and 1970. 2/ The surplus in that period fell from $1.7 billion to $0.5 billion. The erosion in the U.S. agricultural trade balance in the late 1960s, however, appears to have been due principally to two market distortions: the overvaluation of the U.S. dollar that made prices of U.S. commodities artificially high, and European Economic Community's common agricultural policy that made it more difficult for the United States to export agricultural products to European countries. The U.S. balance of trade in agriculture has improved significantly since 1971, rising to a surplus of $11.6 billion by 1974. 3/

1/ William H. Branson and Helen B. Junz, "Trends in U.S. Trade and Comparative Advantage," Brookings Papers in Economic Activity: No. 2, (Brookings Institution, 1971), p. 310. The surplus in capital goods exports exceeded $10 billion in 1970, and since the adoption of flexible exchange rates, it has increased to more than $20 billion in 1975.

2/ William H. Branson and Helen B. Junz, op. cit., p. 288.

3/ U.S. Department of Commerce, 1975 Statistical Supplement to the Survey of Current Business.

Although DISC and Eximbank are supporting exports whose contribution to national income will most likely continue to be significant, the support by DISC of industries such as chemicals, which have been experiencing no import competition, may very well result in larger profits to firms than would be required to elicit the same amount of exports. While the support of agricultural and capital goods may be more justifiable on competitive grounds, the nonselectivity of a program like DISC does not allow industries such as chemicals to be excluded.

At a minimum, it does appear that the principal export subsidies have been directed at relatively productive and progressive sectors of U.S. industry. To the extent that this is so, the programs probably do little damage to the rate of growth of U.S. productivity; such would not be the case if the programs were used to delay the decline of industries that are no longer growing.

ULTIMATE BENEFITS AND LOSSES

In summary, if supports increase exports at all, the rise is very small relative to total U.S. exports. Flexible exchange rates may in part offset the effect of export supports on U.S. employment or income. When a subsidy or credit program is extended, there is a reallocation of resources that benefits some and may harm others; when export programs expand, there is a potential gain to the industries supported and, in cases where direct costs arise, a potential loss to the taxpayer. When export programs contract, there is both a potential loss to some industries and (again, where subsidies occur) a potential reduction in loss to the taxpayer.

Export sales supported by Eximbank and DISC, account for more than 90 percent of total exports facilitated by the U.S. government. The cost to the taxpayer of export supports is greatest through the DISC program, since DISC involves a direct decline in tax receipts. Thus, taxpayers would benefit more directly and to a greater extent if DISC inducements were decreased, rather than if Eximbank or other credit programs were cut back.

ALTERNATIVE DOMESTIC PROGRAMS

If the overall goal of export programs is to increase output in particular industries, the Congress might also want to consider alternative forms of domestic support or subsidies. In such cases, benefits from a support or subsidy go to domestic consumers and producers, as opposed to being split between domestic producers and foreign consumers. For example, the Congress might want to consider subsidies or credits that would be extended to domestic utilities or airlines. Such programs could, in principle, be designed to have the same effects as the current export subsidies on both total output and its composition.