10

Should Ex-Im Bank Be Retired?

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The US Export-Import Bank is now 65 years old and should soon be retired—but not before completing one remaining task. As summarized in the annual *Budget of the United States Government* (Fiscal Year 2001, appendix, 1138):

> The purpose of the Export-Import Bank (Ex-Im Bank) is to aid in the financing and promotion of U.S. exports. To accomplish its objectives, the bank's authority and resources are used to: assume commercial and political risks that exporters or private institutions are unwilling or unable to undertake; overcome maturity and other limitations in private sector export financing; assist U.S. exporters to meet officially sponsored foreign export credit competition; and provide leadership and guidance in export financing to the U.S. exporting and banking communities and to foreign borrowers.

My assessment of Ex-Im Bank is complicated only by a tension between two of the above objectives. On the one hand, I regard the market-failure rationale for Ex-Im as wholly spurious, and the activities based on this rationale are best described as Aid to Dependent Corporations. On the other hand, I share the broader concern that US firms should not have to compete with governments, either at home or abroad. For the same reasons, I would eliminate most remaining barriers to imports but retain the authority to impose countervailing duties on imports of goods and services subsidized by another government. This chapter summarizes my criticisms of the first objective and my suggestions for how to better serve the second one.

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The "Market-Failure" Rationale

Let me be the first to acknowledge that private credit markets are not perfect. The fact that private credit is sometimes not available on terms that a potential foreign buyer and US exporter would prefer, however, is not sufficient evidence of a market failure. The terms on which credit is available from a private lender reflect the costs, taxes, and regulations to which that lender is subject; its assessment of the commercial and political risks of a specific loan; and the expected return on alternative loans. In a competitive credit market among lenders that face the same costs and alternatives, the best terms will be offered by the potential lender that is *most optimistic* about the commercial and political risks of a specific loan. The lack of private credit on terms acceptable to a foreign borrower is not an example of market failure but an important signal of the risks of lending to that borrower, even by Ex-Im Bank.

In rare cases, some activity in another country generates sufficient benefits to the United States to merit some US subsidy. Such cases might include an increase in the military equipment of a US ally or an investment that improves the US environment in some way. In such cases, however, it is important to recognize that the external benefit of these activities is independent of whether the equipment is purchased from a domestic firm, a US firm, or a third-country firm. In other words, the benefit to the United States is a function of the level of some foreign activity, not of the purchases from a US firm. US interests are best served by purchases from the most efficient supplier. Such cases may merit some US military or environmental assistance, but not Ex-Im credit. More often than not, however, the external-benefits argument is only a thinly disguised rationale for another export subsidy; in fiscal year 1996, for example, the US government spent $7.9 billion to help US companies secure just over $12 billion in agreements for new international arms sales (Hartung 1999).

As a rule, there is no reason to expect the value of Ex-Im credit to be higher than the opportunity cost of the private credit that it displaces. No external benefits are specific to US exports, and the managers of Ex-Im Bank do not have better incentives or more accurate information than the managers of private financial institutions. Two government agencies with a reputation for careful analysis and language have concluded that it is highly doubtful that Ex-Im generates any net benefits to the US economy. A Congressional Research Service study (cited by George Kourous and Tom Barry of the Interhemispheric Resource Center, 1996, 3) noted:

> Most economists doubt . . . that a nation can improve its welfare over the long run by subsidizing exports. Internal economic policies ultimately determine the overall level of a nation's exports. . . . By providing financing or insurance for exporters, Ex-Im Bank's activities draw from the financial resources within the

> economy that would be available for other uses. Such opportunity costs, while impossible to estimate, potentially could be significant.

Similarly, a senior official at the US General Accounting Office testified:

> Government export finance assistance programs may largely shift production among sectors within the economy rather than raise the overall level of employment in the economy.[1]

Moreover, the net effects of subsidized export credit are more likely to be worse than neutral. Any effects of market failure are likely to be small and transient in comparison with the effects of government failure. Many Ex-Im loans go to foreign competitors of other US firms, such as foreign airlines and energy companies. Loans to firms in some countries create a moral hazard problem by reducing the incentive of the host governments to implement the measures necessary to increase foreign private investment.

More important, access to Ex-Im credit subsidies invites the corruption of US politics. About 80 percent of Ex-Im activities support the exports of only a few dozen large firms, and all Ex-Im activities support only about 2 percent of total US exports. Those few firms that are supported by these activities, however well represented in Congress, are among the few beneficiaries of a negative-sum game in which the rest of us are losers. And the larger number of firms and business associations that usually support free markets and free trade undermine their case by endorsing subsidized credit for US exports.

Moreover, the market window operations of the German and Canadian export credit agencies, as described in this book by Hans Reich and Ian Gillespie, seem like a distinction without a difference. Reich, for example, claims that the market operations of Kreditanstalt für Wiederaufbau "take place in a competitive environment without government support" (see chapter 15 below). And Gillespie claims that an export credit agency (ECA) is not providing a subsidy "if the terms and conditions of the financing are no more favorable than those that are otherwise available to the borrower in the commercial marketplace" (see chapter 16 below). At the same time, however, he claims that a commercial ECA

> can take on higher levels of risk in a greater number of markets, including emerging markets. It can provide higher levels of assistance to market segments not entirely serviced by the private sector, such as small exporters. It can create the right conditions in emerging markets for the return of private capital. And it can avoid subsidies entirely, while at the same time conservatively provisioning for the future.

1. US General Accounting Office, "Key Factors in Considering Ex-Im Bank Reauthorization," testimony by JayEtta Hecker to the Subcommittee on Banking, Housing, and Urban Affairs, 1997.

Does this sound too good to be true? That is because it *is* too good to be true. There is no way to meet these noncommercial policy objectives without a subsidy. Although these market window operations receive no annual appropriation, the commercial ECAs borrow at little more than the cost of funds to the government, and they pay little taxes and no dividends. The US financial institutions that most closely approximate these commercial ECAs are the several huge government-sponsored enterprises that now dominate the mortgage market, which are financed by a total debt that will soon be larger than the explicit debt of the federal government. Gillespie invites us to consider the commercial ECAs not as "a competitive threat, but rather an opportunity. It is an opportunity to embrace a model that ultimately addresses customer needs––exporter and foreign buyers alike." As an American, I can hardly imagine worse advice than to create another huge government-sponsored enterprise, in this case to provide general trade finance.

The "Other Governments Do It" Rationale

I share the broader concern that US firms should not have to compete with governments, either at home or abroad. Moreover, I apply this standard to both exporters and financial institutions. US exporters should not have to compete with foreign firms that are supported by subsidized credit from other governments. And US financial institutions should not have to compete with an export credit bank financed by our own government. A "level playing field" among the national export credit agencies is a necessary condition to meet the first criterion. Reducing the common level of export credit subsidies, preferably to zero, is the necessary condition to meet the second criterion. The fine essay by Peter Evans and Kenneth Oye in this volume (see chapter 8) concludes that

> the United States competes on a reasonably even footing on terms, conditions, and implicit levels of subsidization in formal ECA activities regulated under the [1978] OECD Arrangement and in sectors regulated by annexes to the Arrangement. The US strategy of regulation and retaliation has been a qualified success. But in areas that are not regulated under the Arrangement, US practices differ markedly from those of other industrial countries. And many of these differences operate to the detriment of potential US exporters.

Fortunately, the governments of the countries that belong to the Organization for Economic Cooperation and Development (OECD) have recognized that competition among the export credit agencies serves no one's interests and is costly to taxpayers. The OECD Arrangement, in that sense, is similar to an arms control agreement, an attempt to constrain counterproductive, costly competition. The Arrangement, moreover, has been unusually effective in constraining competition in the broad areas that it covers. As with any arms control agreement, some governments have initiated or maintained favorable terms in areas where the Arrangement is silent, subject to interpretation, or not enforced. But in my judgment, the areas not covered by the Arrangement seem relatively minor.

The important issue is where we should go from here. Maintaining common terms on subsidized export credit protects our exporters but is still costly to our taxpayers. What is the best strategy to reduce the current roughly equal level of export credit subsidies? As developed in Robert Axelrod's elegant book *The Evolution of Cooperation* (Axelrod 1984), the best opening move in a prisoner's dilemma game (of an uncertain number of plays and in which no one play is "lethal") is a cooperative move, made in hopes of eliciting cooperative moves by the other players in response. In a similar spirit, Evans and Oye write in chapter 8:

> Even without substantial US pressure, Japanese and European positions may evolve toward the American position in some areas. This is particularly true for project risk and untied ODA, because of growing internal financial constraints. The growing Japanese fiscal crisis and continuing European budgetary constraints have already compelled reappraisals of the more expensive export financing activities discussed above. European and Japanese countermeasures against each other are having an effect. Even without aggressive US matching, it seems likely that the next financial crisis in emerging markets may become an object lesson on the virtue of conservative project risk standards.

So the first move should be a unilateral *reduction* of US export credit subsidies, accompanied by a commitment to a series of further reductions if the governments of the other OECD nations respond in kind and in magnitude.

Axelrod further counsels that subsequent moves should be on a tit-for-tat basis. If the other governments respond cooperatively, our government should make another reduction of export credit subsidies, and so on. If the other governments, however, do not respond with a corresponding reduction of their export credit subsidies, some countermeasure by the US government is the appropriate next step. The most effective countermeasure may not be the restoration of the prior level of US export credit subsidies. This conventional response puts the few foreign firms that would benefit from maintaining a differential export credit subsidy at odds only with their taxpayers, a contest that the taxpayers usually lose.

My suggestion is to change the nature of the US countermeasure—*from* a measure that merely neutralizes a differential export credit subsidy by some government in third markets *to* a measure that penalizes all exports from that country to the US market. Such a measure, for example, might be a uniform 10 percent incremental US tariff on all goods and services imported from any country for which the government maintains an export credit subsidy in third markets. This response would put the few firms that would benefit from maintaining a differential export credit subsidy at odds with all firms from that country that export to the US market, a contest that the few firms would usually lose.

The US government has a huge, almost unique advantage in implementing this type of response: For most countries, the benefits of general "most-favored-nation" access to the huge US market are much larger than the benefits to those few firms with exports that are supported by a credit subsidy in third markets. In effect, this measure would apply a countervailing duty to all imports by the United States from any country for which the government maintains subsidized export credits in third markets. This type of US response, of course, would require the approval of other governments belonging to the World Trade Organization for a narrow exemption from the most-favored-nation standard of world trade—but the benefits would be substantial to all countries. This measure, I suggest, is the only type of US response that has any prospect of leading to a progressive reduction, and possible elimination, of export credit subsidies by all governments.

The Export-Import Bank was established in 1934, initially to provide export credit to the Soviet Union. The Soviet Union has collapsed, and there is now an opportunity to end the continuing cold war of export credit subsidies. At such time that the US government is prepared to broaden the use of countervailing duties as the countermeasure for export credit subsidies by other governments, Ex-Im Bank should be retired with the rare honors due an agency that has actually completed its major mission.

References

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