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Revitalizing the Export-Import Bank

Gary Clyde Hufbauer, Meera Fickling, and Woan Foong Wong

Gary Clyde Hufbauer, *Reginald Jones Senior Fellow since 1992, was formerly the Maurice Greenberg Chair and Director of Studies at the Council on Foreign Relations (1996–98), the Marcus Wallenberg Professor of International Finance Diplomacy at Georgetown University (1985–92), senior fellow at the Institute (1981–85), deputy director of the International Law Institute at Georgetown University (1979–81); deputy assistant secretary for international trade and investment policy of the US Treasury (1977–79); and director of the international tax staff at the Treasury (1974–76). His numerous publications include* The Ex-Im Bank in the 21st Century *(2001).* **Meera Fickling** *and* **Woan Foong Wong** *are research analysts at the Peterson Institute for International Economics.*

TRADE FINANCE: AN OVERVIEW

The United States has experienced persistent trade deficits for decades, and thoughtful observers have concluded that deficits cannot be sustained at levels much exceeding 4 percent of GDP annually (see box 1). There are only two ways to decrease the trade deficit: reduce imports or increase exports. For global economic health, increased exports are a far better proposition.

Yet most firms cannot export without some form of trade finance, whether credit, credit insurance, or loan guarantees. About 80 to 90 percent of exporters avail themselves of these financial tools (Auboin 2007, Chauffer and Farole 2009). Exporting firms often need to insure against the higher risk of default by an unknown buyer situated in a foreign legal system (Amiti and Weinstein 2009). In addition, export orders often require more working capital, relative to sales, than domestic orders. Exporters rarely recoup their production expenses immediately, waiting an average of three to five months between shipment and payment (Amiti and Weinstein 2009). In the fourth quarter of 2007, for example, importers paid in advance of taking delivery of goods in only 19 percent of international trade transactions (IMF/Bankers' Association 2009).

Most trade finance does not come from official export credit agencies (ECAs) but rather from the private sector. Approximately 65 to 90 percent of finance is extended between firms in a supply chain relationship or between individual units of the same firm (Chauffour and Farole 2009). Aside from a firm's supply chain, 80 percent of the remaining providers of trade finance are private banks (Amiti and Weinstein 2009). Private insurers are also important sources of export finance.

Although they are relatively small players in the whole scheme of export finance, ECAs occupy a crucial niche. Created in 1934 by President Franklin Delano Roosevelt, the US Export-Import Bank does not see its mission as competing with private finance; rather, its mission is to be a "lender of last resort" responding to private market failure. The comparative advantage of the Ex-Im Bank and other ECAs is their ability, both technical and political, to take risks shunned by the private market. Accordingly, in recent decades, the bank has focused on exports to developing countries and exports by small- and medium-sized enterprises (SMEs), which are often unable to access commercial funding (Rodriguez 2001).

Another function of the US Ex-Im Bank is to offset the support of other ECAs, so as to level the playing field and prevent foreign exporters from enjoying an undue advantage. According to congressional directives issued in 1971 and 1983, the Ex-Im Bank must be "fully competitive" with other ECAs.

It is important for the Ex-Im Bank to perform these functions in times of financial crisis, since private trade finance—particularly for developing countries and SMEs—declines sharply when banks experience uncertainty. In trying to fulfill its various mandates, however, the Ex-Im Bank must cope with the sharp decline in its funding authority, relative to the magnitude of US exports, over the past 40 years. Structural impediments, notably excessive US content requirements,

Box 1 Defining sustainable trade deficits

One measure of sustainability is the political acceptability of trade deficits. A trade deficit of 4 percent of GDP translates into around $600 billion annually, given the current US GDP level of around $15,000 billion. When unemployment is above 8 percent, it's reasonable to assume that each $1 billion in the trade deficit translates into about 6,000 jobs, so $600 billion translates into about 3.6 million jobs, a hefty portion of the US unemployment count of around 13.5 million persons. This economic arithmetic translates into political arithmetic that is hostile to globalization, despite its enormous long-term benefits (Bradford, Grieco, and Hufbauer 2005).

Another measure of sustainability is the size of net US external liabilities. The counterpart transactions of US trade deficits are net US inflows of capital from abroad—meaning net acquisitions by foreigners of US assets such as bank accounts, bonds, shares, and real estate. These acquisitions add to net US liabilities to foreign holders. Net US external liabilities are now about $2.9 trillion, or about 20.6 percent of US GDP (BEA 2011). US trade deficits at a rate of 4 percent of GDP annually will approximately maintain (or slowly decrease) the ratio of net US external liabilities to US GDP (which, over a period of time should grow at around 3 percent annually in real terms and 5 percent annually in nominal terms, taking inflation into account).

also make the Ex-Im Bank less competitive than its ECA peers. Moreover, China and a few other emerging export powerhouses have adopted creative financing mechanisms that provide government support to exports while skirting the boundaries of OECD rules, putting US firms at a disadvantage. In this policy brief, we discuss such challenges and propose how the US Congress should respond.

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Mid-2011 is an opportune time to consider the role of the Export-Import Bank because reauthorization legislation is being crafted in the House of Representatives and Senate. The current authorization is set to expire September 30, 2011, the end of fiscal year 2011. As new authorization legislation is drafted, Congress should address issues raised in this policy brief.

AVAILABILITY OF EXPORT FINANCE

For several years, the ratio of Ex-Im finance to US exports has been well below comparable ratios in other OECD countries (Hufbauer 2001). Recently, ratios in other countries have similarly declined, but the United States is still on the low end of the OECD scale. Table 1 shows that France and Italy supported 2 percent of exports through medium- and long-term ECA financing between 2005 and 2008, while the United States supported only 1 percent. In 2009, France increased its medium- and long-term export financing to reach 6 percent of its merchandise export volume—far more than the United States—in response to the financial crisis. Emerging markets have extended even higher levels of export finance relative to their exports. Brazil averaged over 4 percent between 2005 and 2008, while India and China averaged over 3 percent. Germany, the United Kingdom, and Japan reduced their official export finance ratios between 2005 and 2008—but Japan's reported value is misleading, as the country engages in export support (tied aid) outside the 1978 OECD Arrangement on Guidelines for Officially Supported Export Credits.[1]

In the wake of the Great Recession, the United States announced an additional $4 billion in annual short-term insurance and $8 billion in longer-term financing for exports to emerging markets (Mora and Powers 2009). The Small Business Administration's (SBA) capacity to support SME exporters was boosted: The loan limit on the SBA export working capital program and the International Trade Loan facility were raised to $5 million from $2 million, and the Export Express program's loan cap was increased from $250,000 to $500,000. Some $30 million was allocated for Department of Commerce outreach and assistance for smaller exporters.

Despite these efforts, total official US export support still amounts to only 2.5 percent of US exports—the same level as in 1998. Meanwhile, the April 2009 G-20 London

1. Japan also changed its reporting guidelines between 2006 and 2007, so comparison across this time frame is impossible (Ex-Im Bank 2010, 11).

Table 1 Medium- and long-term ECA financing as a share of merchandise exports (percent)

Country	Average, 2005–08	2009
Canada	0.9	1.6
France	1.9	6.0
Germany	1.0	1.2
Italy	2.2	2.6
Japan	0.7	0.1
United Kingdom	0.7	0.7
United States	1.0	1.8
Brazil	4.1	n.a.
China	3.2	n.a.
India	3.3	n.a.

n.a. = not available

Source: Ex-Im Bank (2010); UN Comtrade database, 2010.

Declaration called on countries to fill a global $250 billion gap in trade finance to combat the recession. In order to make a dent in the finance gap, and to materially boost US exports, the United States will need to triple or quadruple its own Ex-Im funding over 2008 levels (then $14 billion), requiring an extra $20 billion to $40 billion of annual lending capacity. To date, this has not been forthcoming.

The volume of Ex-Im finance is currently constrained by a $100 billion lending cap. Bhatia (2011) points out that, with $87 billion of loans already outstanding and even more lending in the pipeline, Ex-Im disbursements will soon run up against this limit. The cap should be raised in the 2011 reauthorization bill in order to enable additional financial flows to exporting firms. Although draft legislation is still forthcoming, President Barack Obama's FY2012 budget proposes an increase in Ex-Im lending from $20 billion in 2010 to $32 billion annually, which would require a total lending limit of at least $160 billion for five years. The Coalition for Employment through Exports (2011) recommends raising the limit to $200 billion.

- *Policy recommendation: Encourage substantially more private finance.* The Ex-Im Bank is not well-equipped to deal with small and medium-sized exporters. Precautionary mandates and credit investigations are too onerous and time consuming, and the bank simply does not have the resources to deal with thousands of SMEs. Private banks must be drawn into this segment of export finance. To provide an incentive, private banks should be permitted to book a loan loss reserve equal to 25 percent of new export credit and guarantee transactions for SMEs. This unusual reserve would not be counted as bank earnings until the credit was repaid or the guarantee expired. This approach would defer taxes on bank profits, creating an incentive for private banks to enlarge their portfolios of SME export finance. Meanwhile, the proposed Basel III rules should be rolled back for export credits: Capital reserves of 15 percent are generally adequate as backing for export sales.

- *Policy recommendation: Enlarge Ex-Im Bank's funding level.* The Ex-Im Bank needs more funding authority. This need not add to the federal budget deficit since, under budget scoring rules, the bank's profits count against its losses. The Ex-Im Bank has been profitable for the past few decades, and with recovery in the world economy, this record should continue. As a reasonable goal, Ex-Im funding should be enlarged to the point where it can finance, through credits or guarantees, 5 percent of US exports of goods and services. At current export levels, that means $75 billion of finance annually. The level would make the Ex-Im Bank fully competitive not only with its Canadian, European, and Japanese counterparts but also with China. Moreover, if President Obama's goal of doubling exports in five years is to be attained, Ex-Im financing should be put on a path to support $150 billion of exports annually in 2015. Toward this goal, we call on Congress to raise the Ex-Im Bank's authorization cap from $100 billion to $200 billion and to raise the statutory threshold for congressional notification of Ex-Im deals—which has never before been adjusted for inflation—from $100 million to $400 million.

BARRIERS TO THE USE OF EX-IM FINANCE

Besides sharply increasing the size of its portfolio and its liability cap, the Ex-Im Bank should address structural issues that limit its effectiveness. Today, five major obstacles constrain Ex-Im finance. The most damaging is the stiff domestic content requirements that the Ex-Im Bank imposes on itself—requirements that are far more restrictive than those of ECAs in other countries. Moreover, the bank is not able to adequately support exports of services as its definition of domestic content excludes important service components such as R&D, management, sales, and marketing. Third, the Ex-Im Bank requires transactions above $20 million to be transported on a US-registered vessel, often rendering the cost of the transaction prohibitive. Fourth, the Ex-Im Bank is required to assess the economic impact on domestic firms before it finances transactions, resulting in project delays. Fifth, the Ex-Im Bank faces increasing difficulties keeping up with tied aid and other subsidy devices used by China that bypass OECD export finance rules. In the next sections, we discuss these problems and offer policy recommendations.

Domestic Content Requirements

The Ex-Im Bank sharply limits its scope of operation by casting a shadow on foreign content embedded in domestic goods. If the foreign content exceeds 15 percent of export value, only the domestic portion of a good is supported. This is the lowest supportable percentage of any of the OECD countries (Ex-Im Bank 2009). The next lowest supportable percentage, in Austria, is 50 percent. ECAs in Canada, Europe, and Japan consider that domestic assembly of foreign-originated inputs transforms the foreign inputs into domestic content. The Ex-Im Bank, by contrast, has no such flexibility (table 2).

Besides sharply increasing the size of its portfolio and its liability cap, the Ex-Im Bank should address structural issues that limit its effectiveness.

US domestic content requirements are at odds with the logic of globalized production patterns. An increasing number of Ex-Im transactions involve foreign content. Between 2007 and 2009 around 40 percent of Ex-Im transactions by number had some foreign content, and around 90 percent by value had some foreign content. The average foreign content was approximately 12 percent of export value, suggesting that a significant proportion of US exports embody foreign content that falls outside the 15 percent threshold and are thus not eligible for full coverage by Ex-Im finance (table 3).

Export sales that exceed the 15 percent threshold come under a cloud so far as Ex-Im support is concerned. This is troublesome because multinational corporations often produce a specialty component in one location—e.g., GE produces wind turbine blades in Brazil; light locomotives in Brazil; and heavy locomotives in Pennsylvania. Sometimes development partners pay a good share of the R&D as an "entry price" to join the project from start to finish. These international supply chain realities should be reflected in Ex-Im funding rules. Given current Ex-Im rules, some deals are sourced in countries with "friendly" ECA systems rather than the United States.

To source from the United States, a US firm may, for example, require a unique Japanese component to complete a bleach factory in West Africa. But since this component drives the project's foreign content above 15 percent, the deal instead goes to Spain. In this case, US manufacturers lose 80 percent of the sale because the Ex-Im Bank refuses to finance the additional 5 percent of value that comes from a foreign country. To prevent similar outcomes in the future, the Ex-Im Bank needs to adjust its procedures to reflect the reality that the United States cannot manufacture every component of every good.

According to the 2009 Ex-Im Bank Competitiveness Report, exporters and lenders characterize the Ex-Im Bank's domestic content requirement as the Bank's "number one weakness." The International Business Affairs Corporation (2011) reports that the requirement has forced many US corporations to leave bank programs, shrinking the number of medium-term deals.

An alignment of Ex-Im's domestic content requirements with other ECAs will encourage additional US exports and expand the overall US export base.

- *Policy recommendation: Congress should lower the normal local content requirement to a 50 percent threshold.* A common-sense approach would suggest that if a simple majority of content is produced in the United States, the product should be counted as American. The Ex-Im Bank's policies for short-term finance already reflect this reality. However, the Ex-Im Bank's domestic content requirement for medium- and long-term finance should be substantially lowered from 85 percent to a maximum of 50 percent, an amount closer to the requirements of other ECAs. Moreover, inputs from free trade agreement (FTA) partners should be eligible to meet the domestic content requirement, provided that the foreign country's ECA affords reciprocal treatment for inputs from the United States.

Services Exports

The services sector is an increasingly important component of the US trading system. Services trade has almost doubled: Between 1992 and 2002, exports increased from $163 billion to $279 billion, and imports grew from $102 billion to $205 billion (Jensen and Kletzer 2005). US exports of services may double again by 2012. In 2010, the United States was the top country exporting services to the world at $545 billion—more than 14 percent of world services exports (WTO 2010, 29; BEA 2011).

Table 2 Domestic content policies of G-7 ECAs, 2009

Policy	US Export-Import Bank	Export Development Canada	European export credit agencies	Japan Bank for International Cooperation and Nippon Export and Investment Insurance of Japan
Is there a requirement to use domestic flag vessels to ship supported exports from ECA's country?	Yes	No	No	No
Will ECA cover be reduced automatically if foreign content exceeds 15 percent?	Yes	No	No	No
Is a minimum value amount of domestic content required to qualify for cover?	No	No	Yes	Yes
Does domestic assembly of foreign inputs transform the foreign-originated input to domestic content?	No	Yes	Yes	Yes

Source: Ex-Im Bank (2010).

Table 3 Foreign content in Ex-Im transactions

	2005	2006	2007	2008	2009
Total activity					
Export value (millions of dollars)	7,791	8,718	7,833	12,082	17,449
Number of transactions	587	485	412	333	275
Transactions containing foreign content					
Export value (millions of dollars)	6,722	7,235	7,457	10,750	15,946
Percent of total export value	86	83	95	89	91
Number of transactions	156	149	143	141	115
Percent of total number	27	31	35	42	42
Foreign content					
Foreign content value (millions of dollars)	691	855	919	1,164	2,106
Average per transaction as percent of export value	10	12	12	11	13

Source: Ex-Im Bank (2010).

The strength of services exports became apparent during the Great Recession, when US services exports decreased by only 4 percent between 2008 and 2009, whereas US merchandise exports decreased by 12 percent (Ex-Im Bank 2010, 55).

A forthcoming study by J. Bradford Jensen (2011) highlights potential US exports of tradable services. As Jensen shows, the United States is skill abundant relative to other countries. Moreover, while manufacturing accounted for around 10 percent of US employment in 2007, business and personal services accounted for more than 50 percent. Also, 50 percent of workers in tradable services industries hold college degrees, twice the share in tradable manufacturing industries. All this adds up to a strong US comparative advantage in tradable services, particularly the export of business services. Jensen's research leads to important policy conclusions: The United States should push for multilateral liberalization of services barriers, the protection of intellectual property rights, and the provision of finance for services exports.

Despite the potential, the Ex-Im Bank remains underutilized by service providers. As an example, it is worth noting that, in a recent year, Nokia got over $2 billion of ECA support from Finland while Motorola got less than $8 million of support from the Ex-Im Bank.[2] The difference reflects Ex-Im rules governing US content, which are oriented to manufacturing rather than services. Nokia components may be manufactured abroad, but Finland's rules on export finance take into account the high value added that comes from Nokia's engineers, marketers, and accountants.

The current standards used by the Ex-Im Bank are based on the origin of content; these rules do not fit services exports,

2. Information supplied by an informed expert.

given the difficulty of determining origin in the sector, particularly in the hi-tech and information technology areas. One example was a Cisco network project in Brazil, which could not show the required 85 percent US content and was turned down for Ex-Im support. The project was eventually won by a Chinese competitor.[3]

The Ex-Im Bank's reluctance to score services in satisfying domestic content departs from the policies of other ECAs in the OECD area. The US Ex-Im Bank (2010) reported that all G-7 OECD ECAs appear willing to support services as a general category of exports, with most medium- and long-term support provided for services associated with capital goods exports. Bilateral discussions conducted by the US Ex-Im Bank with other OECD ECAs, along with a 2008 survey, suggested that sectors reported to receive the largest financial support include oil and gas development, power plant construction, mining and refining, and telecommunications (Ex-Im Bank 2010, 56). Projects in all of these sectors have extensive service components. While ECA support for stand-alone services is reported to be relatively uncommon, in January 2010 Euler Hermes, a German credit insurance company, launched an insurance program targeted exclusively at architects, engineers, and other services exporters.

- *Policy recommendation: Authorize the Ex-Im Bank to support service components of merchandise exports and stand-alone services companies in a manner similar to the approach of other OECD ECAs.* European and Asian ECAs support 85 percent of the technology component if the main contract is signed in the exporter's country—the United States, to take the case at hand. Ex-Im content rules should likewise be revised to enable participation by services companies, including participation by technology company services exporters, regardless of where their hardware is manufactured (Bhatia 2011).

The Ex-Im Bank should carve out a facility for services exports that takes into consideration the structural issues surrounding high-tech jobs. These issues include protection of intellectual property, research and development costs, management expenses, and tax payments. Currently, the Ex-Im short-term policy defines content as "cost" and only refers to cost of goods sold (COGS), meaning that the high R&D content of new technologies may not be covered by the current rules (Ex-Im Bank 2010, 5).

The Ex-Im Bank should also announce a comprehensive description of its services program. The bank's commitment to financing services exports is mandated in its charter, Section 2(b)(1)(D), which states that "the Bank shall give full and equal consideration to making loans and providing guarantees for the export of services (independently, or in conjunction with the export of manufactured goods, equipment, hardware, or other capital goods) consistent with the Bank's policy to neutralize foreign subsidized credit competition and to supplement the private capital market" (Ex-Im Bank 2010, 55).

The Ex-Im Bank should carve out a facility for services exports that takes into consideration the structural issues surrounding high-tech jobs.

However, the support for "stand-alone" services (services that are not part of a capital goods or project-related transaction) was only 1.5 percent of total Ex-Im services support in 2009.[4] According to the Ex-Im Bank's own report (2010), it currently does not have a formal program designed around stand-alone services firms, although the framework for a program is in place.

Cargo Preference Requirements

Legislation enacted in 1934 required US government-financed transactions to be shipped in US flag vessels. This legislation was intended to foster a US merchant marine fleet, but in the case of the Ex-Im Bank, the requirement has long outlived its usefulness. Now it serves only to discourage companies engaging in large transactions from seeking Ex-Im finance, harming the competitiveness of US firms.

The cargo preference requirement currently applies to all direct loans and to guarantee transactions of over $20 million or that have a repayment period exceeding seven years. If vessels are not available within a "reasonable" time at a "reasonable" price, firms seeking Ex-Im support may apply to the US Maritime Administration (MARAD) for a waiver. However, firms can apply for waivers only after MARAD itself has determined it cannot supply a US vessel, and MARAD is an agency devoted first and foremost to the welfare of US flag vessels, not to the promotion of US exports. MARAD

3. Ibid.

4. In 2009, "stand-alone" services received Ex-Im support of $59.8 million, while "associated services" (services that are associated with capital goods exports and/or large projects) received $3,731.3 million. The total support for services in 2009 was $3,791.1 million. Numbers are from Ex-Im Bank (2010, 56, figure 13).

will often attempt to divert the ship itineraries of US carriers rather than allow firms to ship via foreign vessels.

Though US container vessels are often cost competitive, break-bulk shipping is not. There are only six break-bulk shippers in the whole US fleet. The waiver process does not take into account cost or competitiveness with foreign vessels, which invites collusion and price gouging. As a result, MARAD has granted few waivers to date; in 2009, only seven waivers were granted.[5] Often these waivers had to be requested well in advance or with the help of an outside consultant (Ex-Im Bank 2010). Unsurprisingly, this cumbersome and costly process has deterred firms from applying for Ex-Im financing.

The cargo preference requirement puts US firms at a disadvantage relative to other countries. Of the G-7 countries, only France and Italy have similar cargo preference rules—and they appear to be more easily waived (Ex-Im Bank 2010). In the Ex-Im Bank's annual competitiveness study, lenders and exporters reported that the cargo preference requirement was sometimes the sole reason why they lost business to foreign competitors (Ex-Im Bank 2010).

- ***Policy recommendation: Repeal the cargo preference requirement.*** The cargo preference requirement is outdated and harms businesses seeking to export high-value shipments. Ideally, transactions financed by the Ex-Im Bank should no longer be subject to the cargo preference requirement. If this is not possible, the burden should be placed on MARAD to provide a compelling reason, within 30 days, to decline a waiver request. Congress should enact an automatic exception for shipments when the price difference between using a US-registered vessel and an alternative vessel exceeds 10 percent.[6]

Economic Impact Assessments

The US Ex-Im Bank is the only ECA that is required to analyze the impact of its operations on domestic production. Ex-Im finance must avoid "substantial injury" to any US industry and must not assist any production abroad subject to US import restraints, including antidumping duties, countervailing duties, and escape clause relief. In 2010, about $115 billion of US exports were headed to countries under one or more of these clouds (table 4). In 2009, 27 percent of transactions were examined for adverse impacts on US industry, since they indirectly supported the production of foreign goods that also happen to be produced and exported by US firms. Less than 3 percent of transactions—seven in total—required a detailed analysis, and those that were not withdrawn were eventually approved. This process does not significantly reduce Ex-Im transactions but is a time-consuming hurdle that dissuades some exporters from applying for loans (Ex-Im Bank 2010).

- ***Policy recommendation: Move economic impact determinations to the US International Trade Commission and limit restrictions to countries already subject to antidumping duties, countervailing duties, and safeguard orders.*** Currently, economic impact determinations are expensive and delay the disbursement of finance. They are also ad hoc; the Government Accountability Office (GAO 2007) has criticized the Ex-Im Bank for failing to clarify its economic impact assessment methods to the public and has called on the bank to publicize its economic impact conclusions.[7] The cost and uncertainty of the impact assessments discourage firms from using the Ex-Im Bank to its fullest potential. Instead, the economic impact determination should be taken out of the Ex-Im Bank and moved to the International Trade Commission (ITC). The ITC already performs antidumping, countervailing duty, and safeguard investigations and could easily formulate a list of foreign firms or industries that should not be allowed as beneficiaries of Ex-Im financing. Its findings would serve as a simple, straightforward means of determining whether certain transactions are off limits for Ex-Im support.

Tied Aid and Chinese Competition

Domestic barriers (many of them self-imposed) are not the only challenge for the US Ex-Im Bank. The bank also needs to adapt to practices abroad that follow the letter but bypass the spirit of the 1978 OECD Arrangement, which was negotiated in order to level the playing field.[8] All OECD members face a competitive threat from China, a country where export finance is not constrained by OECD rules.[9]

5. These seven were granted due to vessel availability; more were granted due to other reasons outside the scope of this policy brief.

6. Alternatively, the government could offset the additional cost of shipping via a US vessel. Bhatia (2011) suggests that this could be done through the Ocean Freight Differential (OFD) program.

7. Brannon and Lowell (2011) point out that uncertainty regarding future market trends adds to the difficulty of quantifying the economic impact of funding on various industries.

8. The OECD Arrangement largely eliminates subsidies from export finance and requires countries that violate the arrangement terms to notify partner countries of their derogation, so that the partner countries may respond with their own export subsidy offers.

9. Brazil does not participate in the arrangement either. However, it does participate in the Sector Understanding on Export Credits for Civil Aircraft.

Table 4 US trade defense measures (AD, CVDs, and safeguards) implemented and in the pipeline on countries and sectors, 2011

	Sector										
Country	27-Textile articles other than apparel	31-Products of wood, cork, straw, and plaiting materials	32-Pulp, paper, and paper materials; printed matter and related articles	34-Basic chemicals	35-Other chemical products; man-made fibers	36-Rubber and plastic products	37-Glass and glass products and other nonmetallic products nec	38-Furniture; other transportable goods nec	41-Basic metals	42-Fabricated metal products, except machinery and equipment	44-Special purpose machinery	Total
China	2	1	1	1	1	1	1		4	5		17
Taiwan	1			1	1	1						4
India								1				1
Indonesia			1			1						2
South Korea											1	1
Mexico							1		1	1	1	4
United Arab Emirates										1		1
Vietnam						1						1
2010 US exports to affected destinations (billions of dollars)	0.3	1.2	4.0	6.7	2.7	6.2	1.5	4.3	18.3	1.8	68.3	115.3

AD = antidumping; CVDs = countervailing duties; nec = not elsewhere classified

Note: The sectors affected by trade defence measures are classified by Global Trade Alert using the Customs Procedure Code (CPC). The export numbers are estimated by corresponding CPC and Harmonized Schedule 2007 codes.

Sources: Global Trade Alert, 2011; UN Comtrade database, 2011.

Tied aid used as an export promotion tool has long troubled the United States. Tied aid is development assistance that is conditioned upon the purchase of goods and services from the donor country. In the 1970s and 1980s, France was a major proponent of tied aid as a means of boosting exports, but the tied aid practices of France and other countries were eventually disciplined through OECD understandings. One set of understandings, the 1978 OECD Arrangement on Guidelines for Officially Supported Export Credits, as updated from time to time, differentiated between tied aid that had a very large grant element—in excess of 35 percent on a present value basis—and that had a smaller grant element and looked more like export promotion—under 35 percent. If the grant element was at least 35 percent, and the aid was destined for projects in developing countries that would not otherwise be commercially viable, the terms could be more favorable than those generally allowed by the OECD Arrangement. The same arrangement required OECD ECAs to notify each other, upon request, as to the terms of their export support.

Tied aid is also subject to the 1991 Helsinki Package, which clarified some of the OECD Arrangement restrictions on this form of finance. The Helsinki Package established that developed countries, defined as countries ineligible for 17- and 20-year loans from the World Bank, were ineligible to receive tied aid. The deal also drew a line between countries classified by the United Nations as "least-developed countries," which were not subject to a commercial viability test, and higher-income developing countries. For higher-income destinations, ECAs would have to demonstrate that the project in question could not be funded in a manner that complied with the OECD Arrangement before departing from arrangement terms. In addition, the 2004 Agreement on Untied ODA Credits Transparency requires OECD donors of untied aid to report the nationality of bid winners. Despite these agreements, some US firms continue to report that they are pressured to offer concessional terms in order to compete with foreign aid donors (Ex-Im Bank 2010).

Since 2000, the Export-Import Bank of China (Eximbank) has become a global player; by 2009, it was one of the five foreign ECAs cited most frequently by US lenders as a principal competitor (Ex-Im Bank 2010). China Eximbank supported about $60 billion of medium- and long-term transactions in 2008. The rise of China's ECA poses a unique challenge: China is not a member of the OECD and is thus not constrained by the agreements limiting tied aid, including the OECD Arrangement and the Helsinki Package. Nor is China required to exchange information on its export finance activities. China maintains a "development fund" for subsidized deals of about $5 billion for resource development in sub-Saharan Africa; this fund has disbursed over $700 million to date to procure deals.[10] By this device, China is a major participant in tied aid practices (Ex-Im Bank 2010).

Reports suggest instances where export finance may have given China an unfair edge. Recently, the China Development Bank (CDB) offered a $30 billion dollar credit line to customers of Huawei Technologies Co. This $30 billion headline offer from CDB far exceeds the amount utilized to date; in fact, only $3 billion has been disbursed as of June 2011.[11] However, anecdotal reporting indicates that interest rates are below market in certain cases, though the terms of this lending are not necessarily known to Huawei itself. Tele Norte Leste Participacoes SA (TNLP3), a recent customer of Huawei, reported to Bloomberg News that the CDB had offered an interest rate two percentage points lower than the London interbank rate and a two-year grace period on payments. The Tele Norte chief financial officer indicated that the presence of this below-market credit was a major reason for choosing Huawei over American and European competitors.[12] The chief financial officer of America Movil, the largest mobile phone carrier in Latin America, also made similar comments about a 2009 deal with Huawei.[13]

In order to combat tied aid, the Ex-Im Bank should resort to its "tied aid war chest," which can provide additional funds when there is "reasonable evidentiary basis" to believe that tied aid has been offered to a competitor of a US firm (Ex-Im Bank 2001). This resource has been rarely used to keep up with the proliferation of questionable foreign export finance practices. However, in January 2011, the United States used this tactic to secure a GE contract with the Pakistan government for 150 locomotives.[14] While Chinese terms are often opaque, in Pakistan's case the terms were disclosed and the US Ex-Im Bank was able to match the Chinese loan amount.[15]

- ***Policy recommendation: Bring China into the OECD Arrangement and the Helsinki Package through concerted market pressure.*** OECD rules have contributed to a level playing field for export finance, but China is not a part of the OECD framework. The reason is not because the

10. Tom Minney, "Progress of the $5bn Equity China-Africa Development Fund." African Capital Markets News, May 4, 2010, www.africancapitalmarketsnews.com.

11. E-mail correspondence with William Plummer, vice president for government affairs, Huawei USA, June 29, 2011.

12. Bloomberg News, "Huawei's $30 Billion China Credit Opens Doors in Brazil, Mexico," April 24, 2011.

13. Ibid.

14. Sudeep Reddy. "U.S. Export Financing Challenges China," *Wall Street Journal*, January 12, 2011, http://online.wsj.com.

15. Mark Drajem, "GE's Sale to Pakistan Gets Boost Over China From U.S.," Bloomberg News, January 11, 2011, www.bloomberg.com.

OECD Arrangement is a closed club: According to OECD terms, non-OECD members are welcome to join the arrangement. Rather, the reason is economic. China does not have an incentive to join, as it is now able to undercut other major ECAs, which play by the rules. Member countries can reconfigure the terrain by systematically matching Chinese terms. If China ceases to enjoy an advantage by remaining outside the OECD framework, it will be much more likely to accede to the OECD Arrangement. For its part, the Ex-Im Bank should use its tied aid war chest to offset Chinese practices that violate OECD guidelines. The war chest currently has $180 million in funding and should be enlarged by using the surplus from earnings on other projects. To further level the playing field between the United States and China, the United States should pressure China to follow through on its promise to open central and local government procurement to US firms.[16]

16. In the May 2011 meeting of the Strategic and Economic Dialogue between the United States and China, China promised to open procurement. Follow-through is as important as promises. See "Geithner Hails 'Progress' in China Talks," *Financial Times*, May 11, 2011.

CONCLUSION

Much can be done to bolster private banks and the Ex-Im Bank in promoting US exports through trade finance. The place to start is by encouraging substantially more finance, but reform must not stop there. The Ex-Im Bank must adapt to a world in which supply chains are increasingly integrated, in which services comprise a growing share of US exports, and in which Ex-Im-financed trade volumes exceed the ability of US flag vessels to transport at competitive rates. Meanwhile, the Ex-Im Bank must compete with foreign ECAs that continue to devise new ways to gain an edge in the global marketplace and skirt OECD rules. The rules that govern the Ex-Im Bank should be reformed to reflect these realities.

Ex-Im financing can play a crucial role in President Obama's initiative to double exports by 2015. Our policy recommendations, if followed, will encourage private banks and enable the US Ex-Im Bank to fulfill the financing needs of an expanding array of exporters, helping them remain competitive in the years to come.

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