For Release on Delivery
Wednesday, May 21, 1969
9:00 a.m., E.D.T.

EXPORT EXPANSION, EXPORT FINANCING AND THE U.S. BALANCE OF PAYMENTS

A Paper Presented

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At the

47th Annual Meeting of the
Bankers' Association for Foreign Trade

Boca Raton Hotel

Boca Raton, Florida

May 21, 1969

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The expansion of exports has been a major objective of U.S. foreign trade policy throughout the present decade. Moreover, as our foreign trade surplus has shrunk year-by-year since 1964, the campaign to stimulate exports has gained in intensity, with both private industry and Federal Government agencies devoting increasing amounts of time and resources to the effort. A central theme characteristic of virtually all of these efforts has been the persistent quest for means of expanding the availability of export financing. Unfortunately, in far too many instances, it seems that many participants in the export expansion campaign are failing to distinguish clearly between the desirable goal of expanding exports and the equally desirable goal of minimizing unnecessary capital outflow -- including the extension of U.S. credit against export shipments for which foreign buyers can pay cash or which can be financed with foreign funds.

In my opinion, the time has come for us to move beyond the familiar rhetoric of foreign trade promotion to a careful reassessment of the role which increased U.S. financing (particularly that originating with commercial banks) can play in facilitating a more rapid growth of

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*Member, Board of Governors of the Federal Reserve System. I am grateful for the assistance of several members of the Board's staff in the preparation of this paper. I am particularly indebted to Messrs. Bernard Norwood and Gordon Grimwood who work closely with me in the administration of the Voluntary Foreign Credit Restraint Program. Mr. Daniel Roxon was primarily responsible for the analysis long-run trends in U.S. foreign trade.

exports. One such reassessment was recently completed in the Federal Reserve System in connection with a basic review of the Voluntary Foreign Credit Restraint Program (VFCR). Numerous aspects of export financing were explored in a series of seven regional meetings which I held between late January and mid-March with representatives of commercial banks and nonbank financial institutions participating in the VFCR. From the findings in these meetings, plus the evidence submitted subsequently by many of the lenders, I am convinced more than ever that this country does not face a shortage of funds to finance its exports. Moreover, I am also convinced that a drastic increase in bank credit geared to exports would produce little in the way of additional export shipments -- while adding greatly to capital outflow.

For these reasons, I did not recommend to the Federal Reserve Board that the VFCR be modified to provide substantially greater leeway for the reporting banks to extend loans to foreign borrowers. Furthermore, I saw no need whatsoever to recommend that export credits generally be exempt from the ceilings established under the VFCR program. More fundamentally, I see no reason at all to support the suggestion (made by a number of observers) that a facility be established in the Federal Reserve Banks to discount export paper -- preferably at a subsidized interest rate.

In the remainder of this paper, I shall set forth the evidence and lines of reasoning on which the above conclusions rest. The substance of my views can be summarized briefly:

- Although our trade surplus has declined sharply over the last few years (and virtually disappeared in 1968), our exports have generally performed quite well. Rather, the deterioration can be traced almost entirely to the enormous rise in imports stimulated by mounting domestic inflation. On the other hand, our performance in particular export markets abroad has been spotty. The adverse effects of the growth of trade within the Common Market, which had been severe, moderated last year. Nevertheless, rising domestic inflationary pressures, and the concomitant climb in U.S. export prices, are having an increasingly detrimental impact on U.S. export performance.

- Commercial banks apparently finance a much smaller proportion of U.S. exports than is generally supposed. While any quantitative estimate must necessarily be imprecise, it appears that banks as a group finance no more than one-fifth of our export shipments. If this estimate is even approximately correct, the capacity of commercial banks to finance exports (despite the restraints imposed by the VFCR program) is apparently more than adequate.

- In fact, the real effect of the VFCR as far as export financing is concerned has been to increase the inequities among banks of different size or location with respect to their ability to share in foreign business. In recognition of this situation, all of the additional leeway allowed under the revised VFCR guidelines published in early April was restricted to small and medium-sized banks.

- I would not support the establishment of a re-discount facility in Federal Reserve Banks for export paper. Aside from the lack of conviction as to the need for such a facility, I hold firmly to the view that central bank credit should not be used to subsidize a particular sector of the economy.

- Instead, as far as export financing is concerned, I think encouragement should be given to private efforts to employ private funds to finance those exports (such as aircraft) which are beyond the capacity of individual lenders. In this context, the efforts to establish a Private Export Finance Corporation should be commended.

- At the same time, however, we should make sure that even private U. S. financing is available only for those exports which otherwise would be lost without it.

Trends in U. S. Foreign Trade

As is generally known, last year, the U. S. merchandise export surplus virtually disappeared--amounting to only about $100 million. This was about $3-1/2 billion less than in 1966 and 1967 and in sharp contrast to an average export surplus of over $5 billion between 1960 and 1965. For the first quarter of this year, the trade balance showed a deficit of about $1-1/4 billion at a seasonally adjusted annual rate. This deficit can be traced to the recently-ended dock strike. Principally because the backlog of exports has been greater than of imports, the resumption of trade can be expected to show an export surplus in the second quarter. The strike makes any assessment of our basic trade position extremely difficult. However, a rough guess at this time would place the strike-adjusted export surplus in the first quarter at an annual rate of slightly more than $1/2 billion -- somewhat better than the rate in the last half of 1968.

Imports: The major factor in the worsened trade performance last year was the exceptionally large year-to-year increase in the value of imports. Measured from the second half of 1967 to the second half of 1968, the increase was 25 per cent. A year earlier (that is, from the second half of 1966 to the second half of 1967) imports had advanced by about 3 per cent. The different experience points up the slowdown in domestic economic activity in the first half of 1967 and the sharp cyclical rise that started late that year. On the average in the 1960-67 period, imports grew less than 10 per cent annually.

The extraordinarily large rise in imports last year resulted primarily from the very strong expansion in aggregate demand, as the current value of Gross National Product (GNP) increased by 9 per cent. The continuing sharp rise in domestic prices in recent years has probably also been a major factor in the expansion in sales of foreign goods here, though this influence is difficult to measure separately. The differential price changes between the United States and foreign countries may be of increasing importance, because they have reinforced the long-term shift in the composition of U.S. imports away from foods and industrial materials toward more highly finished goods. It is in the latter category of commodities that foreign suppliers have been most successful in making gains in the domestic market.

With imports in 1968 rising nearly 2-1/2 times as fast as domestic expenditures, the ratio of imports to GNP reached a peak 3.9 per cent for the year. Even with imports at a relatively low level in the first quarter of this year, the import-GNP ratio(at about 3.4 per cent) was still high.

Many foreign items that at times have been regarded as merely the marginal or supplemental items required when domestic supplies are insufficient to meet demand are now widely recognized to have a permanent and increasing share of the total supply in their respective product lines. Last year -- for the first time -- imports of finished manufactures reached about one-half of total imports. In 1960 such goods were only about a third of the total. Long-term uptrends in the import share of domestic expenditures for the major components of finished manufactures (automobiles, other nonfood consumer goods, and capital equipment) continued in 1968. The highest rate of increase in imports last year was in imports of automobiles, with both U. S. types made in Canada and foreign types imported from Europe and Japan increasing by 60 per cent. Imports of other nonfood consumer goods in 1968 accounted for nearly double the proportion of total domestic expenditures on such goods in 1960.

The 20 per cent increase in purchases of foreign capital equipment in 1968 was nearly triple the rate of increase in total domestic investment expenditures. The share of imports in these total capital outlays was about 5-1/2 per cent in 1968, almost twice the 3 per cent share of 5 years ago. The increase in imports of electrical machinery last year was particularly heavy, reflecting with a lag the surge in public utility investment that began around the end of 1966. Purchases of food and industrial materials, other than steel and copper, increased in 1968 by 15 per cent.

Exports: Last year exports did well, gaining about 10 per cent in value in response to the general upswing in world demand. This was considerably more than the average 6-1/2 per cent annual increase recorded between 1960 and 1967. It may be noted that the suggested national export target figure of $50 billion by 1973 would represent an average annual increase of about 8 per cent from the $33 billion in 1968, about the same rate of advance during the years 1965-1968, and below the strong rise last year.

The expansion of exports last year was entirely in shipments of nonagricultural products, particularly manufactured goods. The value of exports of agricultural products dipped slightly as foodgrain crops reached record amounts both in importing and supplying countries. Our over-all share of total world exports to markets other than the United States has shown little year-to-year variation since 1965, averaging about 19 per cent, and only a slight decline from the 1960 to 1964 average. In world exports of all manufactured goods, the U.S. share has increased in the last two years, and in 1968 our share was higher than in 1965, and about equal to our relative position in 1963 and 1964.

For several categories of manufactures, however, there have been sizable shifts. Our share in exports of commercial aircraft and of automobiles and parts has risen (the latter reflecting the effects of the 1965 Agreement with Canada). Our relative share in chemicals deteriorated from 1965 to 1967 but recovered in 1968, and the share of adjusted world exports of electrical machinery has changed little in the last three years. There has been a further worsening of our position in non-electric machinery, consumer goods, and semifinished industrial products such as paper products, metal manufactures and textile materials.

By geographic areas, the competitive position of the United States has been spotty. Our share of the Canadian market has risen steadily since 1960, but all of the increase since 1965 has resulted from the U.S.-Canadian Automotive Agreement. Our share of total imports of the Latin American countries has moved relatively little from year to year, ranging between 42 and 45 per cent since 1960.

With the strong growth last year in exports to Europe, there was a slowing in the reduction of our share of total imports into this area (adjusted to exclude trade within the European Economic Community.) Before adjustment for intra-EEC trade, our position in this market area had declined sharply; intra-EEC imports had increased from nearly 35 per cent of total imports of the Community countries in 1960 to about 45 per cent last year. Our share of total imports of the United Kingdom has increased steadily since 1963, rising from 10.5 per cent that year to 13.5 per cent last year. However, the increase in the U.S. share is below the gain registered by the EEC countries, particularly Germany. Apparently the sources of the U.K.'s imports have shifted away from Canada and the less-developed countries toward the United States and Europe. However, there appears to have been a considerable worsening in our position in Japan, with our share dropping from over a third of that country's total imports in 1960 to slightly more than one-fourth last year.

It is, of course, difficult to determine the reasons for the weakness in our exports to certain areas and in particular commodities. The increased integration of the Common Market, cyclical changes in activity here and abroad, and competition with regard to delivery time, service facilities and style or design preference undoubtedly contributed to these trade variations. But certainly a major element that should not be overlooked is the relative change in U.S. and foreign export prices, especially in the last few years. The U.S. index of unit values of exported manufactured goods (giving an approximate measure of average export prices) increased by nearly 8 per cent from 1965 to 1968 after changing very little between 1960 and 1964. In contrast exports prices of Germany, a major competitor, have increased only slightly since 1965, and only a moderate rise was recorded for Japan and Italy. The devaluation of sterling in late 1967 succeeded in rolling back the dollar equivalent of British export prices to below those of 1965.

The sharp disparity in these relative price movements suggests that the deterioration in our costs and prices ranked high as a causative factor in the worsening of our competitive position in certain world commodity and area markets.

In general, the performance of U.S. exports in recent years has not been wholly discouraging. While some products have shown little or no progress, others have displayed considerable strength. However, the recent accentuation of the rise in U.S. prices relative to those of a number of industrial countries -- if allowed to continue -- would undoubtedly have a seriously adverse impact on our export performance. This is another reason for bringing domestic inflationary pressures to an end. Unless we succeed on this front, campaigns to expand exports are likely to yield little results.

Commercial Banks and Export Financing

As I mentioned at the outset, a quest for more credit (particularly commercial bank credit) has been a key feature of export expansion efforts for several years. Partly because of this quest, the view that insufficient credit is hampering the growth of U.S. exports has been widely accepted. However, the evidence supporting such a view is far from clear. In fact, it has been extremely difficult to estimate the extent to which U.S. exporters actually export on credit; the degree to which exporters encounter trouble in obtaining bank credit to cover exports has also been difficult to establish.

Although we still cannot provide definitive answers to these questions, the information collected during the review of the VFCR program last winter, when combined with other evidence, does allow us to make a somewhat firmer judgment about the significance of bank financing of U.S. exports. This estimate is presented below. But before pursuing it further, we should try to put into focus the extent to which credit of any kind is used to finance exports.

The only systematic attempt to measure the use of credit for this purpose was made by the U.S. Treasury at the end of 1965 -- when there was concern that the tightening of domestic credit conditions and the VFCR program might be hindering exports.* The response indicated only very mild concern about credit problems at that time (the response to the same questions now might be sharper). It turned out that -- if the response was representative -- about 1/4 of export sales were accompanied by credit (defined as terms calling for payment in more than 90 days). The results also indicated that about 40 per cent of the credit extended went to foreign subsidiaries of the exporters. Moreover, the respondents were aware of only small amounts of credit being extended to their foreign customers by U.S. financial institutions -- about $200 - 300 million in 1964 and 1965.

As I stressed above, there are no data available from which to calculate accurately the proportion of total U.S. exports that is financed by U.S. bank loans to foreigners. Partly to remedy this deficiency, in connection with the recent evaluation of the VFCR program, the banks most prominent in the international area were asked to prepare a calculation showing export credits as a percentage of total foreign credits outstanding.

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*The results were published in Survey of Export Financing, September, 1966.

The banks which responded to the request account for approximately 80 per cent of all foreign assets held by U.S. banks. The percentages reported ranged from 11 per cent to 31 per cent, with most ratios falling within the range of 14 - 16 per cent. However, most banks believed that the ratio as calculated did not include all export credits. In order to take this possibility into account, a rough estimate might place the ratio of export credits to commercial banks' total foreign credits at approximately 20 per cent.

Using these proportions (and making some broad assumptions to relate the flow of foreign loans during 1968 to the amount of foreign loans outstanding at the end of 1967 and 1968), one may make a very rough estimate of the importance of bank financing of U.S. exports. (See Table 1 attached.)

In round numbers, banks may have extended credit covering more than $6 billion (or somewhat less than 20 per cent) of the $33 billion of total U.S. exports in 1968. This estimate is biased toward export financing as a percentage of total foreign lending by banks, since it is derived by using the upper end of the range of ratios reported by the larger banks, and it assumes that <u>all</u> foreign loans of the smaller banks financed U.S. exports.

As of January 1, 1969, banks reporting under the VFCR program could increase their foreign lending during 1969 by approximately $750 million. This figure is derived from the leeway of $475 million available at the end of 1968, plus $400 million added by the revised guidelines announced in early April -- from which an estimated $125 million must be deducted to reflect the expected repayment of term loans to Western Europe during 1969. Fragmentary information supplied by the large banks indicates that short-term export credits to foreigners exceed long-term credits by a ratio of 60-40. Using that ratio, and assuming that the average short-term maturity is 180 days, one can place the banks' potential export financing capacity during 1969 at about $1.2 billion. It should be noted that this figure is in addition to the $9.3 billion of total foreign credits subject to the VFCR ceiling at the end of 1968 -- much of which will be repaid during the current year and thus available for relending to finance exports.

If our estimate of the ratio of bank export financing to total exports derived above is within the correct range, $1.2 billion of additional credit made available could support an increase in U.S. exports in 1969 of about $6 billion -- or 18 per cent above the $33 billion of exports recorded last year. Such a potential increase far exceeds even the most optimistic projection of exports for 1969 -- and it would exceed any annual increase in the last eight years.

Export Financing and the Voluntary Foreign Credit Restraint Program

As the Federal Reserve has emphasized many times since the VFCR program was launched in early 1965, a cardinal objective has been to restrain banks' foreign lending while at the same time providing for the financing necessary for the maximum possible expansion of exports. The

VFCR program has been assessed frequently since 1965, and it has been the judgment of those who administer the program that it has fulfilled this objective. Nevertheless, some observers (both in the banking industry and in the Federal Government) have argued that the program has had an adverse effect on exports, and they have urged that more flexibility be allowed for export financing -- and particularly that export credits be exempt from the VFCR guidelines.

When the Federal Reserve Board announced last December that the VFCR program would be continued, it also said that it would review the program early in 1969 to determine whether additional flexibility for financing U.S. exports might be provided in the guidelines. As indicated above, such a review was carried out, partly through a series of regional meetings held during January, February and March with bankers and other lenders participating in the program. Prior to these meetings, a detailed questionnaire was sent to the 160 banks which submit monthly reports under the VFCR program. While the review covered the program in its entirety, the primary emphasis was given to the banks' experience in financing exports under the VFCR guidelines. The completed questionnaires were supplemented by views and statements given in the meetings, and most of the banks later confirmed these in letters providing more detailed information.

Ninety-one reporting banks responded to the questionnaire, including all of those which play a significant role in international lending. Some of the banks replied in general -- rather than in specific -- terms. In the case of 78 banks, the responses were quite specific. An analysis of these replies indicates the following:

- Twenty-eight banks reported specifically that they had not been limited in extending export credits to foreigners by the VFCR ceiling.

- Sixteen banks, almost all banks with small lending ceilings, reported specific instances of export credits lost because of the VFCR. In most of these cases, the financing had been done by another U.S. bank.

- Twenty-seven banks believed that U.S. exports had been indirectly affected by the program. The point most often cited was that banks no longer were aggressively seeking new export financing business. Another factor mentioned was the reduction of acceptance lines of credit to foreign banks (usually Japanese banks) which the U.S. bankers believed might have been used to finance exports.

- Only seven banks reported cases where they believed that exports had been lost to the country because of a lack of financing. In some of these cases, however, it appeared that factors other than the VFCR program, mainly credit terms, were responsible.

As a result of this review, it appeared that exports have not been hampered by the VFCR program -- that is, no significant amount of exports has been lost by the United States and gained by other countries because of the program. However, many bankers appeared to believe (although little evidence was supplied to support their belief) that exports might have been higher in the absence of the program. But, from the review of the program, it was also clear that a guideline exemption for export credits probably would increase U.S. bank financing of exports. Unfortunately, it was equally clear that the credit expansion would lead to a substitution of sales on credit for sales that otherwise would take place on terms more favorable to the U.S. balance of payments.

In the absence of clear evidence that U.S. exports are being adversely affected by the VFCR program, and in the belief that foreign lending potential available under the revised ceiling is more than sufficient to finance any reasonably expected expansion of exports, the Board decided against exempting export credits from the ceiling. Any marginal improvement in the trade account related to an export credit exemption almost certainly would be more than offset by a deterioration in the capital account.

The Equity Problem and Export Financing

As is generally known, the Board did allow some additional leeway to banks when the VFCR program was revised in early April. This greater flexibility was intended primarily to ease some of the inequities inherent in the program, but it should also be helpful in providing a modest stimulus to exports.

The complaint most frequently heard during the regional meetings, particularly those outside of New York and San Francisco, was that the program had had an inequitable effect among banks. Many banks had just started in the international business when the program was announced. Others did a seasonal business, such as the financing of commodity trade, and were caught at a low point by the selection of the December, 1964 base date.

Banks in this position said that, under their restricted guideline ceilings, they were unable to handle the growing international business of many of their largest customers and that this business was being taken by banks (primarily banks in New York City) that had been long established in the international business -- and thus have larger ceilings, foreign branches, and greater flexibility. In some cases, these smaller banks said, the domestic business of their customers had followed the migration of their international business to another bank.

When the VFCR program originally was designed, the Board recognized that the selection of a base date would tend to freeze the competitive situation as of the date chosen and that there would be inequities in the program no matter which date was chosen. However, the Board decided that the inequity must be tolerated in view of the seriousness of the overall balance of payments problem, in view of the fact that the restraint program was designed to be temporary in nature, and in view of the prospect that other techniques would entail other drawbacks at least as objectionable.

As it has become necessary to carry this program forward from year-to-year, we have become increasingly concerned about its effect upon the competitive situation. In November, 1967, we acted to reduce the inequity to some extent by providing that banks whose foreign assets were small in relation to total assets could use a percentage of total assets in calculating their ceilings for 1968. Unfortunately, the serious balance of payments situation that developed in the fourth quarter of 1967 made it necessary to adopt a more restrictive program on January 1, 1968. Consequently, about two-thirds of the additional ceiling which had been provided had to be taken back. We did, however, preserve the principle of calculating a ceiling based upon total assets.

The distribution of foreign assets among banks as distinguished by the amount of total assets has not changed greatly since the beginning of the program (Table 2). Banks with assets of $2 billion and over accounted for about 84 per cent of covered foreign assets outstanding on December 31, 1964, and on March 31, 1969, the latest date for which detailed data are available. There were some relatively minor shifts in the proportions held by banks in the smaller size groups.

This is not to say that there has been no effect upon the competitive situation. It is highly probable that, in the absence of the program, total foreign assets would have been higher, and it is likely that the bulk of the increase would have occurred among the smaller banks.

One should also note the change in the distribution of the available leeway between the end of 1964 and March, 1969. It is evident that the larger banks have continued to be active in the utilization of their ceilings, while the banks in the smaller size groups have tended to be less active.

This is consistent with what we learned at the regional meetings. Many banks, faced with very limited lending ability under the guidelines ceiling, either disbanded their fledgling international departments or did not permit them to grow. These banks are not aggressively seeking new international business, and in some instances they are actively discouraging it. The result is that the leeway available to those banks (which number 110 of the 159 banks shown) tends to remain unused.

In another effort to improve this situation, the guidelines as revised in April permit banks to use their end of 1968 ceiling or 1.5 per cent of total assets as of the end-of-1968, whichever figure is larger. This formula added about $400 million to the aggregate ceiling, and the increase went to just over one-half of the banks reporting under the program. We believed that the $400 million was about the maximum that our balance of payments could afford in 1969, in the light of our assessment of the outlook for the U.S. balance of payments for the year.

The alternative calculation has provided some relief for banks that had been encountering great difficulty in meeting the requirements of their regular customers. In addition, it became apparent during the discussions at the regional meetings that the great bulk of their stated requirement was for the financing of U.S. exports. While it appeared that all of this business was being financed in any event, the additions to the ceilings may encourage some banks to become more active in developing new export business in their trade areas.

Rediscount Facility for Export Paper at Federal Reserve Banks

It was suggested several times during the regional meetings, and it has been suggested by other observers that the Federal Reserve Banks operate a facility in connection with the discount window which would provide concessional treatment to paper representing the financing of U.S. exports. It is argued that some of our most important foreign competitors provide facilities of this sort, thereby giving exporters in those countries an advantage in offering credit terms.

A similar suggestion has been made before in other connections, particularly with respect to Federal Open Market Committee purchases of Federal housing agency paper. The Board of Governors has resisted these suggestions because it believes that such operations are not properly a function of the central monetary authority.

Under its statutory authority, the Federal Reserve attempts to adjust the availability of credit to a sustainable level of economic activity by influencing commercial bank reserves. Within the supply of reserves available, the banks allocate credit according to the demands of the market. A commitment to supply funds for any specified purpose, regardless of the condition of the market, might (and under current circumstances certainly would) run counter to the efforts of the monetary authorities to restrain overall bank lending.

I hardly need to point out that there are many sectors in our economy which people might think have as high a priority as our balance of payments, and which they believe to be just as deserving of special advantages or of being insulated from the effects of a restrictive monetary policy. Obviously, any proliferation of this approach would make the task of the monetary authorities impossible.

The operation of a discount facility for export paper of the type suggested involves a subsidy, and a subsidy implies a diversion of resources which is costly both in financial and real terms. In my opinion, one reason that it is suggested that the facility be operated by the Federal Reserve is that the financing would not come from appropriated funds, and the cost would be hidden in the overall operation of the discount window.

I believe that if the Federal Government should decide that a subsidy is required for export financing for competitive reasons, the cost of that subsidy should be readily apparent and should be available for continuing cost-benefit analyses. There is an agency in the United States Government -- the Export-Import Bank-- which has been created expressly for the purpose of encouraging U. S. exports. The Bank currently is operating a rediscount facility which could be expanded if the Government feels that that is necessary. The staff of the Export-Import Bank is better qualified -- and has a better chance to assess the effectiveness of the facility -- than are the discount officers at the Federal Reserve Banks.

Further, operation of a rediscount facility by the Export-Import Bank does not involve the supplying of reserve funds to commercial banks -- and it must be remembered that such reserves are the basis for a multiple expansion of deposits. Hence, such a facility at the Export-Import Bank is not disruptive of monetary policy. However, whether such a facility should be expanded by the Export-Import Bank is a matter for others to decide.

Establishment of a rediscount facility for export paper in the Federal Reserve that would meet the specifications of those who urge it would require an amendment to the Federal Reserve Act, which currently is specific concerning the types and maturities of paper that can be accepted for discount or as collateral for advances from Federal Reserve Banks.

Finally, as I have stressed above, the Federal Reserve Board is not convinced that a lack of export financing is a serious part of our trade problem. As we believe would be the case with an export credit exemption, concessional discount terms for export paper, particularly in times of monetary restraint, certainly would result in more export financing -- but not necessarily in more exports. Credit sales might well be substituted for cash sales, and it would be extremely difficult from an administrative standpoint to assure that funds furnished through the discount of export paper actually were used to provide additional financing of exports.

Private Efforts to Broaden Export Financing

At this point it might be well to take brief note of the private efforts which are being made to organize an institution whose main objective would be to mobilize long-term funds to finance big-ticket export items. These are the efforts to establish a Private Export Financing Corporation (PEFCO). Since these efforts have their origin in the interest expressed by the Bankers Association for Foreign Trade, there is no need at this point to provide an extensive review of the developments to date. However, on the basis of the plans for PEFCO as they are known today, several features of the proposal are of considerable interest to the Federal Reserve Board.

Apparently PEFCO would be a state-chartered company, owned (in whole or in part) by a number of U.S. banks. It seems also that the bank ownership will be principally through bank-owned Edge Corporations. Possibly other U.S. businesses may acquire some of the PEFCO shares at a later date. The business of PEFCO would be devoted primarily to the financing of jet aircraft and other large items. All of its export credits would be guaranteed by the Export-Import Bank.

Of the range of issues involved in the plan to establish PEFCO, the Federal Reserve Board's interest is principally in the questions raised by the proposal to use Edge Corporations as the vehicles through which commercial banks would invest in PEFCO and in the balance of payments implications -- including possible effects of the financing on the VFCR guidelines. Under section 25(a) of the Federal Reserve Act and under Regulation K, the Board's specific consent would be required for individual Edge Corporations to invest in PEFCO shares. Some of the Edge Corporations apparently would be newly chartered, and probably some would be owned by several banks. Under the proposed arrangements as now understood, no one Edge Corporation would have effective control of PEFCO. However, all of the participating Edge Corporations would together own either all or a majority of the shares in PEFCO.

If the final organization of PEFCO does take this form -- and if the Board approves new charters and Edge Corporation investments in PEFCO, a question would also be raised by the provision in section 25(a) of the Federal Reserve Act requiring that the liabilities of an Edge Corporation outstanding at any one time upon its debentures, bonds, and promissory notes not exceed 10 times its paid-in capital and surplus. Apparently those developing the plans for PEFCO anticipate a much higher debt-to-equity ratio. This difficulty would clearly have to be resolved.

Of course, what position the Board would take with respect to the different issues that would be raised by the participation of Edge Corporations in PEFCO would turn on the examination of a specific and definitive proposed organizational arrangement for PEFCO. The Board would also have to assure itself that appropriate conditions could be established under which adequate leeway would be available to PEFCO for the issuance of any necessary debt instruments -- which could be acquired by Edge Corporations.

I obviously cannot predict how the Board might act upon the necessary charter applications for new Edge Corporations or upon the applications by the Edge Corporations for the Board's prior consent to invest in PEFCO. However, I urge those responsible for the organization of PEFCO to present their proposed arrangements -- at least informally -- to the Board's Staff for a review as early as possible.

With respect to the balance of payments implications of the PEFCO proposal, several issues should be considered. The first is the estimate of the volume of exports which might require financing of the type which PEFCO could provide. The latest projection we have received on anticipated jet exports is that they will run to between $13 billion and $20 billion in the period 1968-77. Such shipments might average $1.3 to $2.0 billion annually, although exports would be smaller than that early in the period and would increase along the way. It has been suggested that such a heavy volume requires exceptional financing resources and that some new method to mobilize funds is required.

Under the PEFCO plan, apparently about one-half of the average annual $1.3 to $2.0 billion of jet exports would need financing from PEFCO and from U.S. commercial banks -- and from the Export-Import Bank if those sources failed to produce the funds. The remaining amount would be met by cash purchases and by cash down payments.

We do not know whether this division between sales based on U.S. bank credit to foreigners and other sales should be considered normal. First, we do not have data that show the division in recent years. However, we believe it has run some 30 per cent to 50 per cent for both Export-Import Bank and U.S. commercial bank credit to foreigners. Secondly, we do not know whether the anticipated increase in potential export sales will call for a larger proportion of the payments to be financed in the U.S. market.

However, on the basis of what is known to date, it appears that the PEFCO arrangement would not make our balance of payments problem (nor the VFCR program restraints on capital outflow) more difficult than would be the case if PEFCO did not come into existence and if U.S. commercial banks and the Export-Import Bank therefore continued to offer lending facilities. In fact, PEFCO's creation could have some salutary effects.

With no change in the VFCR guidelines, if PEFCO were to come into being, banks could extend credits to foreigners for export of big ticket items to the same extent as they are able to do now. If, as is intended, the PEFCO export credits were guaranteed by the Export-Import Bank (the PEFCO portion of the credit) or were participated in by the Export-Import Bank (the sponsoring bank's portion of the credit), they would be exempt from the VFCR ceilings. This exemption is available to commercial banks now. It is clear that PEFCO is designed to mobilize longer-term funds than are available to commercial banks. This would enable it to provide longer maturities for jet aircraft financing than can the commercial banks. However, this would not necessarily lead to a significantly higher level of U.S. financing than without PEFCO.

While I obviously cannot predict the position the Federal Reserve Board might take with respect to PEFCO, I personally feel that efforts to establish a private financing organization like PEFCO deserve support. There is clearly an enormous amount of aircraft export financing to be done, and I am afraid that virtually all of it would gravitate to the Export-Import Bank in the absence of some such arrangements. Non-bank financial institutions will not have much interest in these financings -- since there is little or no possibility of providing an opportunity for equity participation. Thus, if the Export-Import Bank must support such financing in some form, it seems better that its assistance come through the use of its guarantee rather than through direct loans.

Concluding Remarks

In conclusion, let me repeat that our basic objective should be to make certain that financing is adequate to assure that the growth of exports can be sustained. However, we should be equally alert to avoid expanding the availability of credit to foreigners beyond what is needed to support our exports. To do otherwise would simply add to the capital outflow without providing any real benefits to our balance of payments.

Table 1

Estimate of Bank Financing of Exports in 1968
(Millions of dollars)

I.	Flow of bank credit to foreigners in 1968.		
	A. Short-term (monthly average outstanding)	8,934	
	Assume average maturity 180 days	2	
		17,868	
	B. Long-term (Dec. 1967 minus Dec. 1968)	-432	
	C. Total flow	17,436	
II.	Export credits of large banks		
	A. Large-bank share of total flow (80 per cent)	13,950	
	B. Per cent devoted to exports (20 per cent)		2,790
III.	Export credits of all other banks Assume 100 per cent of foreign credits for exports		3,486
IV.	Total estimated export financing		6,276
V.	Export financing as per cent of total exports, 1968		18.7

Table 2

Distribution of Foreign Assets,
VFCR Ceiling and Leeway by
Size of Bank
(Dollar amounts in millions)

DECEMBER 1964

Total Assets	No. of Banks	Out-standing	% of Total	Ceiling	% of Total	Leeway	% of Total
$5 billion or over	10	6,864	72.3	7,207	72.4	343	72.4
$2-5 billion	13	1,146	12.1	1,203	12.1	57	12.0
$1-2 billion	30	748	7.9	785	7.9	37	7.9
$0.5-1 billion	31	412	4.3	433	4.3	21	4.4
Less than 0.5 billion	75	314	3.3	330	3.3	16	3.3
TOTAL	159	9,484		9,958		474	

MARCH 1969

Total Assets	No. of Banks	Out-standing	% of Total	Ceiling	% of Total	Leeway	% of Total
$5 billion or over	11	6,493	71.1	6,773	69.8	281	49.1
$2-5 billion	12	1,195	13.1	1,235	12.7	40	7.0
$1-2 billion	28	800	8.8	828	8.5	27	4.7
$0.5-1 billion	31	210	2.3	292	3.0	82	14.3
Less than 0.5 billion	79	432	4.7	574	5.9	142	24.8
TOTAL	159	9,130		9,702		572	