December 31, 1946

Mr. Raymond W. Duning, Secretary
Robert Morris Associates
1417 Sansom Street
Philadelphia 2, Pennsylvania

Dear Mr. Duning:

Mr. Martin has asked me to send you the enclosed article on "Foreign Trade Financing Through the Export-Import Bank", for use in the January issue of your Bulletin. He is temporarily out of the city and therefore unable to send it to you himself.

I should appreciate it if you would letme know whether the article meets your desires as to length and content.

Very truly yours,

August Maffry
Vice President

Enclosure

AM:mc

ARTICLE FOR ROBERT MORRIS ASSOCIATES

FOREIGN TRADE FINANCING THROUGH THE EXPORT-IMPORT BANK

By Wm. McC. Martin, Jr., Chairman
Board of Directors
Export-Import Bank of Washington

The activities of the Export-Import Bank in financing foreign trade go back to February, 1934, when it was established to assist in the revival of the foreign trade of the United States. The Bank was continued as an agency of the United States by Acts of Congress in 1935, 1937, 1939, and 1940. In 1945, it was made a permanent independent agency by the Export-Import Bank Act approved on July 31 of that year. The operations of the Export-Import Bank extend, therefore, over a period of nearly thirteen years characterized by abnormal conditions in foreign trade and international finance.

General Policies

From the time of its establishment, the Export-Import Bank has had broad powers to engage in practically any type of banking operation. It is limited in the exercise of these powers, however, by its fundamental purpose of promoting the foreign trade of the United States and by the statutory ceiling on the amount of its loans. As a matter of prudent management and as required by law, it confines itself to loans which are for specific purposes, which in the opinion of its Board of Directors offer reasonable assurance of repayment, and which do not compete with private capital. Under these several limitations, the Bank avoids, for example, the financing of exports and imports on customary short terms, which is the proper business of commercial banking institutions, and, for another example, the making of loans to foreign governments and other foreign borrowers who can obtain funds on reasonable terms from the private capital market.

Early Operations

The foreign trade financing of the Export-Import Bank over the years may be classified for convenience into three general types. During the first six years of the Bank's existence, it confined itself largely to assisting in financing specific export and import transactions, chiefly the former, on application of United States exporters and importers. The assistance of the Bank was usually sought in order to make possible terms of credit to foreign purchasers of United States products longer than customary and longer than commercial banks were prepared to accommodate. For example, the Bank financed exports of raw cotton during this period with terms running up to 27 months and exports of equipment for terms running up to several years. Since the Bank was offered as security in most instances only the good faith and credit of the foreign purchaser, and this during a period of general shortage of dollar exchange, many of its early credits for the purpose of financing exports were made with full recourse on the exporter and at rates of interest as high as or even higher than commercial rates of interest to compensate for the extraordinary risks involved. However, where other assurances could be obtained, such as foreign bank or government guaranties or exchange assurances from the foreign exchange authorities of foreign countries, the Bank extended credits to finance exports on a nonrecourse basis; that is, it assumed the full risk of the transaction up to a given percentage of the amount of credit involved.

Precedents were set during this early period of the Bank's history for credits to foreign governments and their agencies to finance development projects and programs and for credits to provide dollar exchange for purchases of essential United States products by foreign countries during periods of temporary deficits in balances of payments. Loans for development purposes subsequently became a major type of operation for the Export-Import Bank, while the dollar-exchange loan was the forerunner of the reconstruction loans which have recently dominated its operations. These two types of credits, together with the direct exporter-importer credits, constitute the three general categories of financing by the Bank.

Development Loans

Development loans to Latin American countries through the Export-Import Bank were given special status in 1940 by the action of Congress in twice increasing the lending authority of the Bank from $100,000,000 to $200,000,000 and again from $200,000,000 to $700,000,000. The second increase was to enable the Bank "to assist in the development of the resources, the stabilization of the economies, and the orderly marketing of the products of the countries of the Western Hemisphere." This elaboration of the purposes of the Export-Import Bank and the increase in lending authority which accompanied it were designed to make it possible for the Bank to render financial aid to the Latin American countries during the period of adjustment occasioned by the war in Europe and the consequent cutting off of their markets and sources of supply on the Continent.

During the next few years the Bank arranged a series of credits to Latin American countries to assist them in carrying out public works programs and to purchase the United States goods and services required for such programs. These loans also afforded substantial budgetary relief during a critical period in the public finances of the southern republics. With the entrance of the United States into the war, the advent of shortages of suppy and shipping, and the opening of other sources of dollar income for the Latin American countries, development loans by the Bank to this area were sharply curtailed. During the war, the Bank carried out its earlier commitments, in so far as the availability of goods and ships permitted, and also played a role in financing the production and import into the United States of strategic and critical materials required for the prosecution of the war.

Reconstruction Loans

Early in 1945, steps were taken by the President to equip the Export-Import Bank to deal with the immediate post-war problem of financing our foreign trade. The principal need, as then foreseen, was for large-scale reconstruction loans to liberated and war-devastated countries to enable them to purchase urgently required products from the United States after the termination of lend-lease and before the coming into operation of the International Bank for Reconstruction and Development. With this purpose in view, Congress passed the Export-Import Bank Act of 1945, which granted an increase in the lending authority of the Bank from $700,000,000 to $3,500,000,000, removed the prohibition on loans by the Bank to governments in default on their obligations to the United States Government (which otherwise would have made many of the war-torn countries ineligible for Export-Import Bank loans), and put the Bank under a new bipartisan, full-time Board of Directors to replace the previous interdepartmental *ex officio* Board of Trustees.

During the year and a half since the end of the war, the Export-Import Bank has extended reconstruction credits in excess of $2,000,000,000 to liberated and war-devastated countries in Europe and Asia and has reserved $500,000,000 of its remaining lending authority for possible future credits to China when that country shall have made substantial progress towards peace and unity. Thus, the Export-Import Bank has utilized virtually all of the additional lending authority granted to it by the Export-Import Bank Act of 1945, and is approaching the end of the post-war phase of reconstruction loans. This field of operations will be abandoned to the International Bank for Reconstruction and Development, which was specifically designed to provide the financing required for long-term reconstruction programs at the divided risk of all of its members. The Export-Import Bank was never intended to play more than an interim role, pending the advent of the International Bank, in making reconstruction loans.

Exporter Loans

In the period ahead, the Export-Import Bank will devote itself again to its two traditional types of operations: the financing of individual export and import transactions and of development projects and programs in Latin America and elsewhere. The criteria which will guide the Bank in its future activities are those which have come to be established by its experience over the years. With respect to so-called exporter-importer loans, that is, loans made on application of United States exporters to finance a specific export transaction or series of transactions, one of the principal safeguards of the Bank is to require a substantial participation by the exporter. There are no hard and fast rules for the amount of participation that may be required. In any case, however, the Bank is prepared <u>at a maximum</u> to finance without recourse on the exporter the amount of his actual out-of-pocket cost for labor and materials on a given transaction, after allowance for any cash down payments by the foreign purchaser. In other words, the Bank is not interested in financing the exporters' anticipated gross profit or in risking public funds unless the exporter is willing to risk at least his own profit.

Under this rule of thumb, the Bank is assured that the exporter will exercise usual discretion in the appraisal of the risks involved and will not offer terms of credit beyond what is customary or what he is himself prepared to carry for his own account. If the exporter is able to offer the Export-Import Bank either foreign bank or foreign government guaranties, the Bank is justified in taking a larger percentage of the risk than would otherwise be the case. Conversely, if the Bank is asked to accept a risk without the benefit of such guaranties, the amount of private participation which it can reasonably require is naturally larger. During recent periods the amount of private participation stipulated in connection with the financing by the Bank of specific export transactions has ranged from 10 to 50 percent, depending upon the circumstances in each case.

<u>Private Participation</u>

The Export-Import Bank encourages the employment of private capital in foreign trade financing in various other ways. For instance, in March, 1946, the Bank arranged a credit of $200,000,000 to the Kingdom of the

Netherlands on terms which it was believed would be acceptable to commercial institutions and afforded the opportunity to them to participate. Some 50 commercial banks throughout the country agreed to participate to the extent of approximately $100,000,000. Various commercial banks have participated with the Export-Import Bank in several other recent and smaller credits. As in the case of the Netherlands credit, these participations are at the risk of the private participants and involve no liability or guaranty on the part of the Export-Import Bank.

As of December 31, 1946, approximately $130,000,000 of the Bank's outstanding loans were held by commercial banks pursuant to agreements whereby the commercial banks had made disbursements to borrowers against credit lines established by the Export-Import Bank with an undertaking on the part of the Bank to reimburse them on demand. The Export-Import Bank has a contingent liability for loans disbursed by agent banks under these agreements. Thus, the whole amount of outstanding loans applies against the statutory limitation on loans and guaranties of the Export-Import Bank, although the use of public funds is avoided. Arrangements for disbursements of the greater part of the amount involved in these "takeout" agreements were made prior to the passage of the Export-Import Bank Act of 1945. Since the passage of the Act, with its provision that the Bank may obtain funds directly from the United States Treasury by sale of its capital stock and by borrowing, the Bank has confined the use of commercial banks in this capacity to instances in which they perform special commercial bank services in connection with the disbursements.

Net Earnings

It is clear from the legislative history of the Export-Import Bank that it is intended to operate on a business-like basis and, if possible, without overall cost to the taxpayers. This recognized objective is the more difficult to achieve because the Bank is expected to make loans which are not attractive to private capital, that is, loans which presumably carry a relatively high degree of risk. Nevertheless, the Bank has been able to operate over the twelve years of its existence, not only without cost to the Government, but actually at a substantial profit. It has paid all its administrative expenses out of earnings, covered what small losses it has been obliged to take, and accumulated a reserve against future contingencies which at the end of 1946 will amount to approximately $44,000,000. Under the present method of obtaining its funds from the Treasury — in part by issuing capital stock at no interest cost and in part by borrowing at a modest interest charge — the net earnings of the Bank do not fully reflect the cost of the public funds which it uses. However, the Bank would show substantial net earnings even after full allowance for this cost.

Certain types of operations by the Bank, and in particular the financing of specific export transactions at medium term, have been so uniformly profitable to it that they would seem to be a proper field of financing by commercial banks. The Export-Import Bank is prepared, of course, to abandon these operations to commercial institutions at any time they wish to take them over. In the meantime, it can do no less than carry out its traditional function of assisting American exporters to sell their products in foreign markets on appropriate credit terms whenever the risk assumed by the Bank appears to be a reasonable one and in the public interest.