PN-ABE-573

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INTRODUCTORY PRESENTATION ON TRADE FINANCING

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FOR

THE PRESIDENT'S TASK FORCE ON INTERNATIONAL PRIVATE ENTERPRISE

DECEMBER 1983

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EXECUTIVE SUMMARY

The world marketplace presents U.S. exporters with an unprecedented challenge. Not only must they be able to compete in overcrowded, high-risk markets with products priced in an overvalued currency, but they must also match foreign competitors supported by determined governments in offering attractive credit terms.

For U.S. exporters, the only resource able to provide that credit support (risk mitigants and low-cost funding) is the United States Government. The commercial banks -- those which have remained active in trade finance since the seemingly unremitting series of balance of payments crises among the LDCs began last year -- are overwhelmed with demand; nor would they ever be able to provide the long-term financing at the below-current market interest rates demanded by foreign customers.

The U.S. Government's export support programs are constrained by U.S. adherence to three international agreements: the GATT Subsidy Code, the OECD Arrangement on Export Credits, and the Berne Union Guidelines on Export Credits. The OECD Arrangement is the most relevant for the Task Force since it delineates maximum repayment terms and minimum interest rates, and provides guidelines for intergovernmental notification when mixed credits are to be offered.

Unfortunately, government export support has begun recently to evolve in new directions, unaffected by the constraints established in the Arrangement. U.S. exporters are now faced with competition from non-traditional suppliers (e.g. Brazil and Korea) whose governments do not adhere to the OECD Arrangement Guidelines. They additionally are encountering demands from increasing numbers of countries that countertrade be used in lieu of cash to pay for imports. Although initially slow to respond, traditional competitors from Europe and Japan have begun to cooperate with these mandated countertrade requirements. In a few instances, their governments have established official units to assist in completing countertrade contracts. Many governments are also willing to offer government-to-government credits at very low interest rates in order to exempt their exporters from a countertrade requirement.

The exasperation of U.S. exporters in having to compete in this environment without being able to offset the predatory financing is understandable. The U.S. exporter offerring an Eximbank loan in adherence to the OECD Arrangement is at a substantial disadvantage when compared to competitors offerring concessionary loans, as the following summary table demonstrates. (The full table may be found on page 24 of this report.) In this example, the contract value is $5 million and the amount financed after the mandatory 15% cash payment is $4,250,000.

	Arrangement	Derogation	Mixed Credit	Countertrade
Last payment date	5 years	8 years	11 years	5 years
Initial payment	$ 425,000	$ 265,625	$ 288,636	$ 325,000
Net Interest Difference	---	$ +447,844	$ -422,510	$ -187,264
Government Subsidy	None	$ 361,250	$1,236,250	None
Exporter Subsidy	None	None	None	$ 50,000

The primary role of the commercial bank in the financing of trade is to assist the bank's customer by taking risks and by providing loans. How a bank decides whether or not to take a particular risk or to fund a loan at a particular interest rate is of critical importance, but is rarely understood by exporters. In its simplest format, the decision-making process consists of four interdependent factors: relationship, risk, repayment term, and rate of interest. Beginning with relationship, each factor must be satisfactory to the bank before the next factor can be addressed. Each, however, has complexities which are rarely understood by bank customers and sometimes earn reputations for banks which are unjustified:

- Relationships are developed by hard work, loyalty on both sides (bank-to-customer and customer-to-bank), and profitability to the bank.
- Risk has two facets: foreign risks which the bank is prepared to take and for which it is being paid, and the risk which relates to the exporter's ability to perform either contractually or with respect to loan or guarantee documentation.
- Repayment term must be appropriate for the product being exported and not represent a growing capital loan in disguise, and the bank must be willing to take the risks for the repayment term.
- Rate of interest derives from each of the three aforementioned factors: rates must be appropriate for the risk and repayment term, and allow the bank to make a profit.

Understanding the importance of these factors in a bank's decision-making process is critical for the U.S. Government if it is to establish export support programs that utilize the resources of the private sector to the maximum degree possible.

The major source of export support to meet the new forms of officially-sponsored competition must come from the Federal Government. State governments have limited resources and are parochial in their perspective. Only the Federal Government can negotiate with foreign governments to modify predatory trade practices or to provide comparable support for U.S. exporters when negotiations fail.

Before recommending a plan of action, the Task Force must analyze the type of support being offered by the foreign competition, and why. It must understand why those programs are attractive to foreign importers and what credit terms U.S. exporters must be able to provide in order to be competitive. The process of identification may have to be done on an industry by industry sector basis. Identification will also include private sector resources (those which currently exist and those which could be encouraged to exist) to support U.S. exports.

It is critical that the Task Force proposals be realistic in what can be achieved and be carefully formulated for success. They must be easily accessible by and responsive to the needs of the end users. Unless the Government dedicates its own resources in a cooperative effort (Eximbank, CCC, OPIC, SBA), the effort will lack credibility and the private sector will not be responsive. The resources of the private sector can be organized, but the decisive leadership can come only from the U.S. Government.

1.0 INTRODUCTION

Many U.S. exporters enter into the arena of world trade without a clear understanding of the competition they will encounter. For these exporters, as well as for their more experienced counterparts, the complexities of meeting the competition of foreign government-supported export financing are beyond their control; therefore, they look to their bankers and ultimately to their government for assistance. When a prospective contract is lost because their government is unable to take unbankable foreign risks or to provide concessional financing terms, some exporters believe that they have a serious complaint. Is that complaint justified? If it is, what should be the role of government in this process?

The objective of this paper is to assist the President's Task Force on International Private Enterprise to answer that question. The discussion has been guided by the Task Force's "objectives" and by the adage which summarizes my viewpoint: "Promote current trade -- not future indebtedness".

The discussion is organized around three topics: the marketplace for U.S. exports; the commercial bank decision-making process as it relates to the financing of exports; and identifying the components of an effective government export support program. In my conclusion, I offer a list of principles for the consideration of the Task Force.

2.0 THE ENVIRONMENT FOR U.S. EXPORTS

2.1 Current World Conditions For Trade

U.S. exporters face challenges unprecedented in recent memory. Economic stagnation is prevalent in their best foreign markets. Business must be transacted in an overvalued dollar whose cost of financing is charged at high interest rates. Economists warn that the uncertainty which characterizes the international business climate will continue into the foreseeable future.

Unfortunately for U.S. exporters, these are not the only factors which affect their ability to compete. Retaining competitiveness in the arena of world trade is a more complex and multi-dimensional endeavor than has ever been the case in the domestic U.S. market. For the export transactions which are the concern of the Task Force, three factors are of particular concern. These are the perception of risk, with its concomitants; the growth of competition from non-traditional foreign competitors; and the availability of government-sponsored credit facilities on concessional terms.

Risk taking is the business of the international banks. Thus, when exporters are uncertain as to whether or not their foreign customers will be able to pay them on time, they should be able to request and to obtain support from their bankers. This support has traditionally been provided through the confirmation of letters of credit, the purchase of foreign receivables, and the extension of loans directly to the foreign importers.

Times have changed, however, and today it is virtually impossible for U.S. exporters to obtain bank confirmation on letters of credit from or bank loans to many important markets. Exporters faced with this new market condition have stopped shipping to those countries. Mexico, Brazil, Venezuela, Argentina, Nigeria, and the Philippines are a few of the more obvious countries.

The justification for this negative policy by banks is based upon unduly burdensome foreign debt which must be rescheduled to prevent default; erratic commodity prices which reduce dollar exchange availability; and domestic political and civil strife. The only U.S. banks currently financing U.S. export trade in significant volume are the money center banks and the few large regional banks with long-term commitments to world trade. They are, quite obviously, overwhelmed with demand. Foreign risk allocations, always a scarce resource in most of these banks, have become even scarcer and are reserved for only their best customers. Many of the regional U.S. banks have withdrawn from the foreign market. Some were badly hurt in recent years, especially those whose major foreign exposure had been restricted to the purportedly "safe" countries such as Mexico, Brazil and Venezuela. Local U.S. banks -- the natural affiliates of the small exporter -- had only begun to investigate the financing of trade in recent years and will probably never re-enter the foreign market.

Despite this widespread perception of risk among commercial banks, an intense, highly competitive atmosphere remains prevalent among exporters. This phenomenon is caused partially by exporters desiring to maintain market presence in otherwise poor markets and by suppliers who are desperate to use foreign sales to support excess manufacturing capacity. More importantly, however, this atmosphere is nurtured by foreign governments which have long-term commitments to export their unemployment, utilizing whatever methods may be necessary. These methods include the taking of unbankable risks and the providing of extraordinary and even predatory export support programs.

The competition which U.S. exporters encounter in this government-supported market has two facets, each with a different set of associated problems.

The government support programs provided in the mature, industrialized countries, in the United States, Europe and Japan, are tempered through adherence to a voluntary arrangement on export credits developed under the auspices of the Organization of Economic Cooperation and Development (OECD). That arrangement establishes a mutually agreed upon set of maximum repayment terms and minimum interest rates. However, in order to give their exporters a competitive edge, many foreign governments (primarily in Europe) enhance their otherwise standard financing packages with extraordinary features. Examples of such enhancements include financial support for the local currency costs of turnkey projects, inflation insurance for large contracts requiring long construction periods, exchange risk insurance for foreign currency-denominated loans, and mixed or tied-aid credits which utilize the government's foreign assistance programs to induce the decision in their exporter's favor.

In contrast to these mature competitors, the government support programs in the newly industrialized countries usually lack subtlety and are based upon the policy that the government is willing to buy its exporters into targeted foreign markets. Programs such as Brazil's FINEX, Mexico's FOMEX and Korea's EXIMBANK loans provide a combination of below-market interest rates and longer-than-customary repayment terms which are always in derogation from the terms of the OECD "Arrangement". Thus, many U.S. exporters (together with their European and Japanese counterparts) encounter increasing competition in formerly sacrosanct markets from non-traditional suppliers. The list of products in which this competition is being faced is quite diverse and growing: offshore oil drilling rigs from Korea, compressors from Taiwan, general purpose aircraft from Brazil, and electric motors from Argentina.

Foreign importers have moved adeptly to take advantage of government-sponsored export programs. The OECD minimum interest rates are usually the maximum acceptable rates in bid invitations, etc. Another more recent program which foreign importers are rapidly learning to exploit is the use of countertrade in lieu of cash as a payment mechanism. Long utilized in trade with Eastern Europe, countertrade has become a sina qua non for import contracts in many foreign countries. Indonesia, for example, requires a 100% countertrade component for all import contracts with the Indonesian Government in excess of $500,000. It is estimated that only 20 to 30 of the 155 countries in the United Nations do not engage officially in countertrade.

2.2 International Agreements Which Affect Government Export Support Programs

The United States Government adheres to three international agreements which delineate the parameters within which its export support programs operate. The three agreements are the General Agreement on Tariffs and Trade (GATT) Subsidy Code, the OECD Arrangement on Export Credits, and the Berne Union Guidelines on Export Credits. Only the GATT Subsidy Code is legally binding on the United States, it being enacted as a commitment of the U.S. Government by an Executive Agreement authorized and approved by both houses of Congress. The OECD Arrangement and the Berne Union guidelines are voluntary agreements in which the United States Government has played an important leadership role.

2.2.1 The GATT Subsidy Code

The GATT Subsidy Code is relevant to this discussion in two areas. Item (l) proscribes any charge on the public account as constituting an export subsidy. This is the basket provision of the Subsidy Code which is designed to catch export subsidies which do not fall precisely within the terms of the "illustrative list" of export subsidies.

Item (k) prohibits granting export credits at interest rates below those the Government has to pay. It further prohibits the payment by the Government of all or part of the costs incurred by exporters in obtaining export credits. Compliance with the OECD Arrangement guidelines on interest rates is deemed to be compliance to the Subsidy Code even when the interest rates fall below the actual cost to the Government.

2.2.2 The OECD Arrangement

The OECD Arrangement originated in the Export Credits Group of the OECD more than a decade ago. Through a series of accords beginning with the "Gentleman's Agreement" of 1974, the Arrangement has endeavored to impose discipline on the extension of official export support by participating governments. The need for this discipline can be demonstrated by the changes which raised the minimum interest rates for officially-supported export credits in 1982. It is estimated by the U.S. Export-Import Bank that those changes reduced the aggregate interest rate subsidy provided by the participating countries by more than $5 billion in 1982 -- more than 50% of the interest rate subsidy expended the prior year.

The fact that the Arrangement is a voluntary agreement reached within the context of an official inter-governmental agency is very important. Only 22

OECD members are participants in the Export Credits Group: The United States, Canada, the Economic Community countries, Japan, Switzerland, Australia, and New Zealand. OECD member countries which do not want to adhere to the Arrangement are not required to do so.

The Arrangement delineates minimum interest rates and maximum repayment terms for officially-supported credits of two years or longer. The basic guidelines of the Arrangement include the following features:

- Cash payment equal to 15% of the export contract value must be paid prior to shipment.
- Repayment must occur not later than six months after shipment, installation, or project completion.
- Repayment must occur in equal installments of principal which may be no less frequent than semi-annually.
- Maximum repayment terms range from 2 to 10 years, with most products not exceeding 5 years and small projects not exceeding 7 years.
- Minimum interest rates are determined by repayment term and the wealth classification of the importing country based upon GNP.
- Separate payment terms and interest rate levels have been concluded for special industry sectors including conventional power plants, ground satellite communications centers, commercial aircraft, and LNG tankers.
- Local cost support may be provided through either guarantees of private source loans or direct funding. In aggregate, local cost support may not be greater than the value of the cash payment (e.g. 15% of contract value).
- Mixed credits with a grant element of less than 20% of the export contract value are prohibited.

Because mixed credits are the principal method by which members of the OECD Arrangement can circumvent the constraints of the guidelines, the Arrangement has established special guidelines on their usage:

- For mixed credit grants of 20% to 25% of the export contract value, the granting government must give 10 days advance notice to the other OECD Arrangement adherents to enable them to match terms.

- For mixed credit grants of 25% or more of the export credit value, the granting government must give prompt advance notice (ed. "prompt" is not defined).

- Governments wishing to meet grant terms may derogate from established OECD guidelines as long as the concessionary terms are not more generous than the value of the mixed credit terms. Among the possibilities for derogation include lower interest rates, longer grace period, longer repayment terms, and level (mortgage-type) installments.

The United States Government has been seeking to tighten the OECD discipline with respect to mixed credits by tightening the threshold for a grant element of not less than 30% of the export contract value. This attempt has not been successful, however, primarily because the United States has become more competitive in the interest rates which it is willing to offer. (For the first time in recent years, all loans made under all of the Eximbank's loan programs will bear an interest rate at the OECD minimum interest rate level.) The major opponent to the tighter mixed credit discipline is France with support purportedly from Italy. The major supporters of the United States position for higher threshold guidelines are the United Kingdom, Japan, and Germany.

2.2.3 <u>The Berne Union</u>

The Berne Union is an association of private and government export credit and investment insurers. It was founded in 1934 for the purpose of establishing an international discipline in terms of credit in international trade. The members of the Berne Union meet regularly and exchange credit and related information. The Berne Union generally restricts its discussion to exports with repayment terms of five years or less and does not address itself to the subject of interest rates. Among the guidelines adopted by the Berne Union are maximum repayment terms for coal, fertilizer, buses, automobiles, and construction equipment.

The Berne Union members include official export insurance agencies from most of the non-Socialist bloc exporting countries. Members from the United States include Eximbank and the FCIA. The Berne Union guidelines are consistent with the OECD Arrangement guidelines in those instances where the guidelines overlap.

2.3 The Current Role of Government

U.S. exporters have learned too frequently in recent years that the quality and price of their products are less important to many foreign customers than the terms of their financing packages. They have also learned that lack of competitive financing can be fatal to their prospects of winning the contract.

United States Government export support programs -- in particular those extended by Eximbank -- are viewed by U.S. exporters and bankers as being uncompetitive when compared with the programs offered by the major competitors (Canada, Japan, Germany, U.K., France, and Italy).* Recent changes in the Eximbank programs have improved the bank's competitiveness, but the negative perception among U.S. exporters was well deserved.

Lack of competitive U.S. export support programs can be traced directly to the conflicting sentiments that these programs generate in both the

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*Eximbank Report to the Congress on Export Credit Competition: Survey of U.S. Exporters and Commercial Banks (December 1, 1982).

Executive and Legislative branches of the U.S. Government. Debate has continued for many years over whether or not the U.S. Government should support exports at all. From time to time, in particular during the past two years, the debate has been expanded to whether or not the responsibility should be delegated to the state governments. In the view of most who support the need for government assistance, the primary responsibility for providing export support lies with the Federal Government. State government involvement in export financing can be viewed at best as a secondary source of support.

2.3.1 State Governments

The type of assistance needed to win in a head-on competition with a determined foreign government is beyond the means of all but a few states (if not in financial resources, then in determination). In addition, the issues to be resolved when creating a truly competitive program are too complex for most state governments to address properly. Constitutional prohibitions against extending loans to private individuals or corporations are difficult to overcome. Programs must not violate U.S. Government agreements such as the GATT Subsidy Code or the OECD Arrangement. A minimum state value-added requirement designed to assist only state-manufactured products would exclude virtually any contract of significance.

Thus far, the issue of export support has rarely generated sufficient local support to sustain a serious level of state government involvement anywhere in the country. Of the more than 31 states that have studied the subject officially during the past three years, only nine have passed laws providing some type of support. None has a financing program currently available. Most states have concluded that their efforts should be mainly educational. With respect to financing, their efforts have been toward facilitating access by smaller or new-to-export companies to the export financing facilities provided by the Federal Government.

Recent changes in Eximbank programs will further defuse the demand for state involvement. The prospect is also good that Eximbank support will be more dependable than in the past in particular if some of the proposed changes in the Eximbank Charter currently in Congress for renewal are also implemented.

2.3.2 Federal Government

The U.S. Government supports exports through four agencies: Eximbank, OPIC, CCC and the SBA. Each of the agencies has designated financial resources within its exclusive control which can be utilized to support exports if that support meets the needs of its respective constituency. Only Eximbank is required to support exports per se as its primary mission.

The support of exports by several disparate agencies can be as much a shortcoming of the Federal Government's approach to export support as it can be a strength. In the current marketplace, that diversity will probably be a hindrance. The development of the type of programs needed to meet the competition described in Section 2.0 can only be impeded by the protectiveness of agency prerogatives and the paucity of interagency cooperation that has characterized the Government's export support programs in the past.

This lack of coordination has been evident to the users of the programs for a long time. Among the more important shortcomings which affect banks in particular is the lack of consistency in coverage among the different guarantee programs. All four agencies issue guarantees, but no two are close to being similar, even when they address the same issues. Both Eximbank and

OPIC differentiate among categories of risk, and specify different waiting periods for each type of claim. However, each agency has different guidelines for submitting claims. For Political-Transfer Risk claims, the type of claim which interests banks most these days, OPIC has a standard 60-day waiting period while the Eximbank has a waiting period guideline that ranges from immediate submission to a 360-day waiting period. In contrast, CCC does not differentiate among categories of risk and requires that claims for all losses be submitted within 30 days after default.

Another complicating factor is the different type of coverage provided for past-due interest (accrued after the payment date). CCC past due interest coverage begins the date the claim is submitted and accepted by CCC for processing and is paid at an interest rate determined on the date of shipment (as long as three years earlier). Eximbank provides no past-due interest coverage; the commercial bank extending the loan is at full risk from the date of default until the payment of the claim by Eximbank. OPIC covers all past-due interest until the claim payment date at the same interest rate as the rate on the importer's note.

The comparison on the next page demonstrates how knowledgeable exporters and banks can benefit from the lack of consistency among the agency programs. In the example, the OPIC insurance is considered as an alternative to the Eximbank guarantee. For the importer, the OPIC insurance represents the better value because OPIC does not have restrictions on the country of origin of the equipment to be purchased. Eximbank requires that virtually all of the equipment be purchased in the United States. For the bank extending the financing and taking the risks, the OPIC insurance is also the better value if

COMPARISON
EXIMBANK GUARANTEE VERSUS OPIC INSURANCE

Assumptions: Importer is private sector company in LDC with U.S. investors.

Contract Value	$5,000,000
Less 15% Cash	750,000
Financed Portion	$4,250,000

Interest Rate on Note	13% p.a.
Past-Due Interest	14% p.a.
Treasury Note Rate	11% p.a.

Repayment: 5 years in 10 equal semi-annual installments

Transaction	Eximbank	OPIC
Guarantee Fee	3.5% flat ($148,750)	1.75% p.a. ($241,825)
Maximum foreign content	$ 425,000 (10%)	$4,250,000 (100%)
Commercial Risk Claim		
- Maximum coverage	$3,633,750 (85.5%)	None
- Maximum foreign risk	$ 616,250 (14.5)	$4,250,000 (100%)
- Default waiting period	30 days	N/A
- Claims processing time	120-180 days (est)**	N/A
- Interest coverage	T-note + 1% p.a. (12% p.a.)	None
- Uncovered interest	$ 116,875 (est.)	$1,519,375 (est.)
- Past-due interest	$ None	N/A
- Uncovered past-due	$ 297,500 (est.)	All
Political Risk Claim		
- Maximum coverage	$4,250,000 (100%)	$4,250,000 (100%)
- Default waiting period	0-360 days*	60 days
- Claims processing time	120-180 days (est)**	60 days (max.)
- Interest coverage	T-Note + 1% p.a. (12% p.a.)	13% p.a.
- Uncovered interest	$ 116,875 (est.)	None
- Past-due interest	None	13% p.a.
- Uncovered past-due	$ 297,500 (est.)	$ 21,250 (est.)

*Range of Political-Transfer Risk waiting period. Claims for all other political risk claims can be submitted immediately.
**Processing delay due to unusually large backlog of claims.

the importer is perceived as being a good commercial risk. (The OPIC insurance does not cover commercial risk.) Otherwise, the Eximbank guarantee may be preferable, especially if the exporter provides an interest makeup for the past-due interest.

2.4 Important Future Trends

2.4.1 Increasingly Competitive Marketplace

The world has entered into a period of no growth for exports. Most LDC markets will remain poor markets for trade, even after the rescheduling agreements have been put into effect. This is a critical factor for U.S. exports since LDCs represented the fastest growing foreign markets for U.S. exports during the past decade. Foreign exchange availability for discretionary imports will remain restricted if commodity prices are unstable or depressed even where rescheduling is not an issue. Predictions about the effect of an economic recovery in Canada, Europe, and Japan are conjectural as long as the dollar remains overvalued.

For many of the important U.S. export industries, new foreign contracts will be obtained only by displacement of traditional suppliers. This trend is already evident in many of the country's foremost exporting industries, especially machine tools, telecommunications equipment, construction and agricultural equipment, and general purpose aircraft.

Probably the most important challenge the U.S. exporters of capital equipment currently encounter in their foreign markets is finding a competitive financing package to submit with their contract proposals. For the most part, the private sector (in particular the commercial banks) will continue to be the major source of this financial assistance. However, the inability of commercial banks to extend substantial and/or longer-term loans in most of the markets where financing is needed forces U.S. exporters to place greater reliance on the U.S. Government export support programs. The availability of those programs is critical in a head-on competition with a determined foreign government supporting its national exporters.

The challenge which will confront the U.S. Government in this situation will be its ability to provide assistance within the OECD Arrangement guidelines and still counter the predatory methods of foreign competitors in a meaningful manner. The major source of predatory competition will come from three areas: mixed credits, derogation, and countertrade.

- Mixed credits will be increasingly offered by OECD Arrangement adherents, if only defensively to enable their exporters to compete against the few countries (e.g. France) which use this form of support extensively, or to circumvent mandatory countertrade requirements (e.g. Indonesia).

- Derogation from the OECD Arrangement guidelines will continue to be offered by non-Arrangement countries as long as they believe it a necessity in order to buy their way into new markets.

- Countertrade components in import contracts will be required by LDCs as they have success themselves in demanding it or view the apparent success of others (and which exporters will increasingly volunteer to provide if all else fails to win the contract or to provide concessionary financing terms).

The countertrade issue is a particularly important development for U.S. exporters. Despite the attractiveness of long-term loans at low interest rates, most LDCs prefer financing packages which offer export opportunities in non-traditional products. In this context, therefore, the challenge of meeting predatory foreign government export support programs includes an opportunity for innovation. It will also require cooperation between private sector resources and government resources (which in itself will require an unprecedented government-wide cooperative effort).

2.4.2 Government Use of Non-commercial Terms

The exasperation of U.S. exporters attempting to compete against foreign government supported financing on non-commercial terms can probably be best understood in the context of an example: a comparison between the financing available from the Eximbank made in accordance with the OECD Arrangement guidelines, and the same transaction as it would be financed with a derogation loan, a mixed credit, and countertrade. The financing involved in these transactions is summarized and compared in the table in Section 2.4.2.5.

2.4.2.1 OECD Arrangement Guidelines. The financing package in this example is based upon the availability of an Eximbank loan on terms and conditions made in accordance with the OECD Arrangement guidelines.* (Assumption: the cost of 5-year Treasury borrowing is 10.85% p.a.)

Contract Amount	:	$5,000,000
Less 15% Cash Payment	:	750,000
Financed Portion	:	$4,250,000
Repayment Term	:	5 years beginning 6 months after shipment
Principal Installments	:	10 equal semi-annual installments of $425,000 each
Average life of loan	:	2.75 years
Interest rate	:	10.85% p.a.
Total interest cost for Importer	:	$1,268,094
Interest subsidy by U.S. Government	:	None

*At the date of this writing, a new minimum interest rate which will change from time to time, based upon a complex formula linked to the cost of borrowing for the governments of the major exporting countries, became effective in early November 1983.

2.4.2.2 Derogation. The term derogation is used in this discussion to mean the offering of export support programs on terms and conditions which differ from the OECD Arrangement guidelines. Examples of derogation are loans at interest rates below OECD minimum levels and repayment terms longer than OECD maximum periods.

Foremost among the countries which derogate is Brazil. The primary vehicle for derogation used by the Brazilians is the FINEX program (Fundo de Financiamento a Exportacao), which is an interest subsidy program similar to those used by several of the European members of the OECD arrangement. The FINEX program is administered by CACEX (Carteira de Comercio Exterio), the Brazilian government trade authority which is a department of Banco de Brasil. All loans, however, are made by commercial banks which are also required to absorb all of the foreign importer risk.

Under the FINEX program, the foreign importer is charged a preferential fixed interest rate (e.g. 9.5% p.a.). The commercial bank lenders, however, receive from FINEX the difference between the fixed rate and the cost of funds (e.g. the 6-month LIBOR - London InterBank Offered Rate) plus a predetermined interest rate spread (e.g. 1.5% p.a.).

In the example on the next page, the semi-annual principal installment has been reduced by 37.5% ($159,375) because the average life of the loan has been increased by more than 50%. Although the total interest cost for the importer is ultimately higher, the overall effect is a lower cost of servicing the debt.

When the Brazilian FINEX program extends a commitment, the CACEX is unable to predict the amount of subsidy which will ultimately be provided. Obviously the higher the LIBOR, the greater the FINEX subsidy.

(<u>Assumption</u>: 6-month LIBOR will average on a weighted basis 10.0% p.a. during the life of the loan.)

Contract Amount	:	$5,000,000
Less 15% Cash Payment	:	750,000
<u>Financed Portion</u>	:	$4,250,000
<u>Repayment Term</u>	:	8 years beginning 6 months after shipment
<u>Principal Installments</u>	:	16 equal semi-annual installments of $265,625 each
<u>Average life of loan</u>	:	4.25 years
<u>Interest rate</u>	:	9.5% p.a.
<u>Total interest cost for importer</u>	:	$1,715,938
<u>Interest subsidy by Brazilian Government</u>	:	$ 361,250*

* LIBOR @ 10.0% p.a. <u>plus</u> commercial bank spread @ 1.5% p.a. <u>minus</u> interest rate on note @ 9.5% p.a. equals FINEX subsidy @ 2.0% p.a. <u>times</u> Financed Portion @ $4,250,000 <u>times</u> average life of loan @ 4.25 years <u>equals</u> FINEX subsidy @ $361.250.

2.4.2.3 Mixed Credits. The term mixed credit refers to export contracts which are financed partially by the country's official export credit program on terms consistent with the OECD Arrangement guidelines and partially by the country's developmental assistance program on concessionary terms. The experience of Eximbank, which has been studying the problem of mixed credits on an ongoing basis for several years, indicates no set pattern to mixed credit financing terms, even within donor countries. Mixed credits may be an integral part of a financing package for a particular contract, or it may be a form of tied aid on a "quid pro quo" basis. Mixed credits may be offered on a one-off basis or as a line of credit for use with one or more prospective projects to be chosen by the recipient. (The latter format enables importers to use mixed credit facilities to negotiate with strength on several contracts simultaneously since the competing suppliers would not know whether they are truly competing against a mixed credit financing package.)

The financing terms of mixed credits also vary among donor countries and products or projects being financed. Government developmental loans average 20% to 25% of export contract value, but may exceed 50% in some cases. Interest rates range from 2% p.a. to 5% p.a. but some loans may be interest free. Repayment terms always exceed 10 years, and may reach 30 to 50 years.

In the example below, the format used by the Italian Government is used as the basis of calculation. As with derogation, the semi-annual installments have been reduced because the average life of the loan has been increased, and the interest subsidy is substantial.

Although the official Italian export agency Mediocredito provides an interest rate subsidy format similar to the Brazilian FINEX program, the portion of the example loan financed under that program will be excluded from this discussion because that portion of the loan is in conformity with the OECD Arrangement guidelines and does not constitute derogation. The issue addressed here is the cost of the Mixed Credit loan. (Assumption: The Italian Government cost of 11 year funding is 10.85% p.a.)

Contract Amount	:	$5,000,000
Less 15% Cash Payment	:	750,000
Financed Portion	:	$4,250,000
of which		
- Mediocredito loan	:	$1,750,000
- Mixed Credit loan	:	$2,500,000
Repayment Term		
- Mediocredito loan	:	5 years beginning 6 months after shipment
- Mixed Credit loan	:	11 years beginning 6 months after shipment
Principal Installments		
- Mediocredito loan	:	10 equal semi-annual installments of $175,000 each
- Mixed credit loan	:	22 equal semi-annual installments of $113,636 each
Average life of loan		
- Mediocredito loan	:	2.75 years
- Mixed credit loan	:	5.75 years
Interest Rate		
- Mediocredito loan	:	10.85% p.a.
- Mixed Credit loan	:	2.25% p.a.
Total interest cost for importer		
- Mediocredito loan	:	$ 522,156
- Mixed Credit loan:	:	$ 323,438
Total		$ 845,594
Interest subsidy by Italian Government		
- Mediocredito loan	:	None
- Mixed credit loan	:	$1,236,250*

*Italian Government cost of funds @ 10.85% p.a. minus Mixed Credit interest @ 2.25% p.a. equals Italian subsidy @ 8.60% p.a. times Financed Portion @ $2,500,000 times average life of loan @ 5.75 years equals Italian Subsidy @ $1,236,250.

2.4.2.4 Countertrade. Even in their simplest formats, countertrade transactions are less efficient and more expensive for at least one of the parties than sales for cash and credit. The components of each countertrade transaction are bespoken for that transaction: the structure, the countertrade products, the mitigation of risk, and the timing of payment. Countertrade specialists have emerged to expedite the most feasible of these transactions because of their complexity. It is estimated that fewer than one per cent of the countertrade proposals under discussion will ever be consummated.

Nonetheless, there will be a growing demand for government intervention in the OECD Arrangement countries to make the more difficult transactions doable. Evidence of this is the recent decision of the Government of France to establish a committee of senior government and industry leaders to "monitor" countertrade to assure that France "gets the best deal".

In addition, increased use of countertrade will give a marketing advantage to Eastern European exporters in many traditional U.S. export markets. These countries have used countertrade for many years and have developed trade channels for its use. Moreover, these countries represent incremental (i.e. new) markets for the commodity exports of many LDCs and their demand for high quality is not usually as stringent as for U.S. or European buyers. Among the Latin American countries with clearing agreements* with one or more Eastern European countries are Brazil, Colombia, Mexico, Peru, Ecuador, and Venezuela.

*Government-to-government agreements to buy/sell specified products up to a global amount during a defined period of time.

Countertrade, as it is usually practiced, takes one of four basic patterns:

- Barter: the direct exchange of goods or services with no money changing hands.

- Counterpurchase: the payment by local purchase and the export of unrelated products or services.

- Compensation: the seller accepts payment through delivery of products manufactured by the exporter's machinery or technology in the importer's country.

- Offset: the seller creates industries in the importing country which will export and thereby pay for the imports.

The format of countertrade which most concerns this discussion is counterpurchase. In most countries which mandate counterpurchase components to import contracts, the compensation component usually ranges from 15% to 25% of the contract value. The most extreme case is Indonesia which mandates 100% counterpurchase for contracts with the government of $500,000 or more, except for sales financed by government-to-government or concessional export credits with interest rates below 3.0% p.a. According to a recent study by Business International, European governments have been actively using concessional financing packages to assist their national exporters to win contracts without counterpurchase in Indonesia "while U.S. companies do not have this advantage".

The critical factors in counterpurchase transactions are in the amount of discount which the importer (qua exporter) must provide on the price of the products being exported to induce them into the world marketplace, and the discount/placement fee which the countertrade specialist charges for disposing of the products in behalf of the exporter.

The financing package used as an example of the cost of the countertrade transaction (on the following page) is based upon the 20% countertrade component of an export contract. The features which distort the financing are the absorption by the importer of a 10% price discount on the domestic price of the product countertraded for export in order to provide these products valued at the counterpurchase value; and the payment by the exporter of a 5% arrangement fee on the counterpurchase value charged by the countertrade specialist for disposing of the products. The balance of the contract is financed with a loan conforming to the OECD Arrangement guidelines.

Contract Amount	:	$5,000,000
Less 15% Cash Payment	:	750,000
Financed Portion	:	$4,250,000
of which		
- Arrangement loan	:	$3,250,000
- Counterpurchase	:	$1,000,000
Repayment Term		
- Arrangement loan	:	5 years beginning 6 months after shipment
- Counterpurchase	:	During 1 year after shipment
Principal installments		
- Arrangement loan	:	10 equal semi-annual installments of $325,000 each
- Counterpurchase	:	As shipped during year
Average life of loan		
- Arrangement loan	:	2.75 years
- Counterpurchase	:	0.50 years
Interest/Discount/Fee		
- Arrangement loan	:	10.85% p.a.
- Counterpurchase	:	10.00% flat discount absorbed by importer 5.00% flat arrangement fee paid by exporter
Total interest cost for importer		
- Arrangement loan	:	$ 969,719
- Counterpurchase	:	$ 111,111
Total		$1,080,830
Total Arrangement fee for exporter	:	$ 50,000
Total Interest/ Discount/Fee	:	$1,130,830

2.4.2.5 Summary Comparison. The table below compares the OECD arrangement guidelines with the components of concessionary loans (derogation, mixed credits, and countertrade).

SUMMARY COMPARISON BETWEEN
OECD ARRANGEMENT GUIDELINES AND CONCESSIONARY LOANS

	Arrangement	Derogation	Mixed Credit	Countertrade
Finance Portion				
- Arrangement	$4,250,000	---	$1,750,000	$3,250,000
- Concessionary	---	$4,250,000	$2,500,000	$1,000,000
Repayment Term				
- Arrangement	5 years	---	5 years	5 years
- Concessionary	---	8 years	11 years	1 year
Principal Installment				
- Arrangement	10 esap	---	10 esap	10 esap
- Concessionary	---	16 esap	22 esap	During 1 year
Principal Installment				
- Arrangement	$ 425,000	---	$ 175,000	$ 325,000
- Concessionary	---	$ 265,625	$ 113,636	As shipped
Average life of loan				
- Arrangement	2.75 years	---	2.75 years	2.75 years
- Concessionary		4.25 years	5.75 years	0.50 years
Interest Rate				
- Arrangement	10.85% p.a.	---	10.85% p.a.	10.85% p.a.
- Concessionary	---	9.5% p.a.	2.25% p.a.	10.00% flat*
Interest cost for importer				
- Arrangement	$1,268,094	---	$ 522,156	$ 969,719
- Concessionary	---	$1,715,938	$ 323,438	$ 111,111*
TOTAL	$1,268,094	$1,715,938	$ 845,584	$1,080,830
Government Subsidy	None	$ 361,250	$1,236,250	$ None
Exporter Subsidy	None	None	None	$ 50,000

*The cost of financing includes a 10% flat discount on the $1,111,111 domestic price of the counterpurchased products paid for by the importer-qua-exporter to yield the $1,000,000 counterpurchased value; and a 5% flat arrangement fee on $1,000,000 counterpurchase value paid by the exporter to the countertrade specialist to dispose of the products.

3.0 THE COMMERCIAL BANK DECISION-MAKING PROCESS

3.1 The Role of the Commercial Bank

The primary role of the commercial bank in the financing of trade is to assist the bank's customer to win the foreign contract.* The bank achieves its objective by taking the financial risks inherent in the transaction (i.e. the foreign commercial and political risks) and by providing loans at current market interest rates. The bank is never involved in the transactional aspects of the export such as contract fulfillment, nor can it be expected to extend loans at interest rates below the bank's cost of funds.

3.2 The Four "R's" of Export Finance

Even in the best of times, the process by which a commercial bank decides to take a particular foreign risk or to fund an export loan at a particular interest rate is more complicated than the process for domestic loans. This is especially evident when the bank must service its customer in the marketplace environment described in the previous chapter. The factors which must be addressed in every bank's domestic decision-making process -- relationship, risk, repayment term, and rate of interest -- must also be addressed in its foreign loan decision-making process, but with a revised set of standards. Knowing why prospective export financing transactions may not be bankable should be of critical importance, for the U.S. Government,

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*Although in the context of this paper the term customer is used to mean the U.S. exporter, the bank's customer is frequently the foreign importer or a foreign bank acting as borrower in behalf of the foreign importer. The bank's objective in this scenario is to enable its customer to negotiate the best contract price from the U.S. exporter without regard to the availability or cost of supplier-source financing.

especially if it is to utilize the resources of the private sector in its export support programs to the maximum degree possible.

3.2.1 Relationship

Banking is a service industry. As such, banks are evaluated by their customers on quality of service, product knowledge, personality of bank personnel, availability and cost of renting the bank's money (i.e. interest rates), and supportiveness during hard times.

Banks have traditionally courted prospective customers for potential future business even if the near term held little prospect of success. When exports were an important factor in the customer's banking requirements, the bank would finance the "hard ones" in order to earn the customer's approbation and hopefully to be rewarded with some of the "easy ones". The expectation of a good relationship often weighed as heavily in the bank's strategy with respect to allocation of scarce resources as the existence of an actual relationship.

Today, banks are primarily interested in whether or not a customer offers a good opportunity for near-term profitability. Levels of priority are established among customers for access to the bank's scarce resources. In the export financing area especially, where foreign risk exposure is the scarcest of resources, the customer relationship must justify using that resource for that particular customer.

3.2.2 Risk

The evaluation of risk has two components: the foreign risks which the bank is prepared to take and for which it is being paid; and the risks which relate to the exporter's (and sometimes the bank's) ability to perform either contractually or with respect to loan documentation.

The first component of risk is divided into two categories: commercial risk and political risk. It is against these risks, when they are not acceptable to the bank, that protection will be sought through use of the Eximbank guarantee or the FCIA insurance policy.

Commercial risk is the risk of loss due to the inability of the foreign importer (or foreign bank) to pay its debts in the local currency of the country for reasons such as insolvency or bankruptcy. Among the questions that a bank might ask when evaluating commercial risk (in addition those related to the importer's financial condition) include the following:

-What is the condition of the importer's industry?

-Is a local presence necessary for the U.S. bank to monitor the loan and to collect payment when due?

-Would the bank be better off extending the loan to a local bank for onlending to the importer?

-If a foreign bank is guarantor of the loan, can the bank guarantee be called without first going into a local court?

-Would the U.S. bank be comfortable suing under local law?

-If the importer or guarantor is a foreign government agency, what is the government's reputation? Is it a habitual late payer?

-Will the government waive the right of sovereign immunity in the case of dispute and will it allow adjudication in a foreign legal jurisdiction (e.g. U.S. or U.K. courts)?

Political risk is generally perceived of by most banks as primarily transfer risk. Will the government have sufficient foreign exchange to permit the transfer of dollars in a timely fashion when the foreign importer wants to remit payment to the U.S. exporter or bank? Related questions that the bank will also ask address the other political risks. For example:

-Do businesses operate normally without threat of external (i.e. government) intervention or expropriation?

-Is the political environment stable?

-What changes are expected in the political or business climate?

-Is there threat of civil disturbance or war hostilities? How will prospective events affect the country's ability to meet its foreign debt obligations?

The second category of risk entails those risks for which the bank is not able to protect itself through Eximbank or FCIA coverage. They derive primarily from the bank's relationship with its customer, but include the important factor of the bank's own ability to perform. They are risks which are most affected by loan format and where changing the loan of format is among the easiest methods for the bank to reduce its risk (for example, from a Supplier credit to a Buyer credit).*

Exporter performance risk is the risk that the exporter has not performed according to the export contract or, with respect to Supplier credits, has not

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*Buyer credits loans are extended directly by the U.S. bank to the foreign obligor (importer or bank). The U.S. bank is responsible for all loan documentation and the U.S. exporter usually receives a confirmed letter of credit enabling the exporter to be paid in full at time of shipment. Although Buyer credit loans are generally identified with large projects, they are also used for short-term and medium-term loans when the bank's customer is the foreign importer or bank.

Supplier credit loans are extended directly by the U.S. exporter to the foreign importer, most frequently in the form of open account sales or documentary collections with trade drafts payable at a future date (e.g. 180 days). Supplier credits are also utilized for the medium-term financing of capital goods exports with the foreign importer giving the U.S. exporter a note payable to that exporter. All supplier credit loan documentation is arranged between the U.S. exporter and the foreign importer. The exporter sells the drafts or notes to the U.S. bank which becomes a holder-in-due-course. The exporter is contingently liable for the validity and enforceability of all debt instruments sold to the bank.

provided the bank with a valid and enforceable claim on the foreign importer. When the bank purchases the exporter's receivable based upon assignment of an FCIA insurance policy, that risk is extended to the continued maintenance of a valid and enforceable FCIA policy. (In Buyer credits, the valid and enforceable claim is the responsibility of the bank.)

The first question that the bank must ask therefore if it is purchasing Supplier credit foreign receivables is "How much does the bank trust the exporter to perform?" The second question is whether the exporter could afford to repay the bank if for some reason the exporter were required to repurchase those receivables.

Even when the bank creates Buyer credit loans, export performance must be addressed. The bank does not want to become involved in a counterclaim or offset disagreement between the importer and exporter, and therefore must be certain that the obligation of the foreign importer is unconditional and dis-associated from the actions of the exporter.

Valid guarantee risk is the risk that the terms of a U.S. Government guarantee or insurance policy being used by the bank to mitigate foreign risks have not been met and that the guarantee/insurance is not valid and enforceable.

This risk evolves directly from the aforementioned exporter performance risk. Guarantees and insurance policies are contracts based upon the legal concept of mutuality. Each party to the contract assumes specified obligations. The guarantee/insurance is valid and enforceable only if all of the terms of the contract have been met. For example, has the premium been paid? Can the bank provide evidence with its claim that the shipment actually took place? Have all special conditions of the Eximbank or FCIA been satisfied according to their instructions?

The comparison on the following page demonstrates a few of the differences of risk between Buyer credit and Supplier credit loans. The ability of the bank to change loan format in an export transaction is a useful tool. Shifting to a supplier credit format enables the bank to place more of the foreign risk on the exporter, but increases the exporter performance risk. Using a Buyer credit format requires the bank to take more foreign risk but minimizes the exporter performance risk.

3.2.3 Repayment Term

Two questions are asked by the bank with respect to repayment term. Is the repayment term appropriate for the product or project being financed? Is the bank willing to take the risks in the transaction for the repayment term?

The first question is asked to determine whether the financing period is longer than is customary in international trade for the product and is in fact a working capital loan in disguise.

The OECD Arrangement guidelines define three categories of repayment terms and the products/projects which fall into each.

Short-term: Up to 180 days (360 days for bulk agricultural commodities)
Medium-term: 2 to 5 years (with minimum values of $50,000 for 2 years scaled to $200,000 for 5 years)
Long-term: 5 to 15 years (plus construction grace periods of as long as 5 years)

Repayment terms longer than those designated for each category of product/project are deemed to be derogation: For example, when Poland offers Brazil 3 year terms for coal (the Arrangement guideline is 180 days), or when Brazil offers Venezuela 8 year terms for construction equipment (the Arrangement guideline is 5 years).

COMPARISON BETWEEN BUYER CREDIT AND SUPPLIER CREDIT

Transaction

Product :	Machinery/Capital Equipment
Repayment term :	5 years
Loan structure :	Sight Letter of Credit (L/C) and 5-year Note
Foreign obligor:	Foreign importer guaranteed by foreign bank
U.S. Guarantee :	Eximbank Commercial Bank Guarantee
Bank objective :	To finance the export without recourse to exporter

Basic Differences	Buyer Credit	Supplier Credit
Eximbank Guarantee	Bank is applicant	Bank is applicant
Terms of Loan	Negotiated by Bank	Negotiated by Exporter
Loan Documentation	Negotiated between Bank and foreign Importer/bank	Negotiated between Exporter and foreign Importer/Bank. Note purchase agreement between Exporter and Bank
Evidence of Debt	Note payable to Bank	Note payable to Exporter and endorsed to Bank
Commercial Risk		
Pre-Shipment	Bank usually confirms L/C	Bank confirms L/C only if L/C is advised through Bank and Bank has credit line available.
Exporter's 10% Risk Retention	Bank retains risk	Exporter retains risk unless bank agrees to purchase from exporter
Late payment of local currency (negates Political Risk coverage)	Bank retains risk	Exporter retains risk unless Bank agrees to purchase from exporter
Political Risk		
Extended waiting period before claim can be filed	Bank retains risk of past-due interest	Exporter retains risk of past-due interest
Exporter Performance	Bank retains risk after L/C is negotiated	Bank purchases notes only after shipment when completed notes are delivered by exporter
Valid Guarantee Risk	Bank fully responsible	Exporter fully responsible. Bank retains right to put loan back to exporter if guarantee is invalidated.

The importance of repayment term should not be underestimated as a critical factor in the bank decision-making process. Each bank, when determining its policy for maximum exposure in a particular market, must reflect not only the inherent risk of non-payment but must also balance the projected exposure in the context of the bank's global exposure for medium-term or long-term loans. The availability of the U.S. Government guarantee/insurance programs enables banks to make loans for long repayment periods outside of established global term and country risk limitations.

3.2.4 Rate of Interest

Banks earn more when they take greater risks. Banks therefore prefer to take as much risk as is prudently possible within the constraints of their risk and repayment term guidelines. After a bank has determined that it can take a particular risk for the requisite repayment term, the final question in the decision-making process is whether the bank is able to extend the loan at the interest rate needed to win the contract for the exporter and yet is also able to attain the bank's minimum yield guidelines.

Minimum yield guidelines for banks are the equivalent of gross profit margins for manufacturers or retailers. All banks establish minimum guidelines with different levels for each type of risk and repayment term. In most domestic loans, unseen features of the borrower's relationship with the bank such as compensating balances permit the bank to offer a low nominal rate on the loan. This is not the case with export loans. The yield from export loans is derived entirely from the nominal interest rate on the loan plus related fees (e.g. letters of credit fees, commitment fees, and loan arrangement fees). If the total income from the interest and fees do not meet the bank's minimum yield requirements for the export loan, the bank will seek an interest makeup from the exporter. Income derived from the exporter's domestic relationship is never used to compensate for interest shortfall. The bank will not extend the export loan if the exporter does not provide the interest makeup if it is needed, irrespective of the quality of the customer relationship.

Interest rates for export loans fall into two categories: current market rates and below-market rates. Current market rates are the interest rates available from banks for a particular risk and term without benefit of subsidy. Current market interest rates can be both floating and fixed. Floating interest rates in the United States usually refer to an interest rate based upon the bank's Prime rate. The rate "floats" with the Prime rate, changing whenever the Prime changes.

Fixed interest rates refer to interest rates which are set at the time of disbursement and remain unchanged during the life of the loan. These interest rates are not readily available for export loans. The amounts needed for most medium-term loans are usually too small for the fixed rate placement market and current market interest rates are invariably too high for larger long-term loans in comparison with the Arrangement minimum guidelines.

A hybrid floating-fixed interest rate is the Inter-Bank Offered Rate (in London - LIBOR; in Singapore - SIBOR). Fixed rates are quoted for specific periods of time ranging from 30 days to 1 year, with the most common being 3 and 6 months. Fixed LIBOR rates are available for periods up to 5 years, but availability is sparse for maturity longer than 2 years. The interest rate is fixed for the quoted period and changed at each rollover date. Minimum loan amounts for the best rates for 3-6 months terms begin at $1,000,000. Minimum loan amounts are commensurately larger the longer the term the interest rate is fixed.

Below-market interest rates are the interest rates available from government support programs at levels below the current market for the repayment term. Much of world trade financed for the medium-term and long-term is financed at below-market interest rates which conform to the minimum interest rate guidelines of the OECD Arrangement. Demand for below-market interest rates has accelerated in recent years. Many importing countries use the Arrangement minimum guideline as the maximum rate scale allowable for importers applying for foreign exchange permits to pay for import loans or in competitive bid invitations.

Interest rates which are below the OECD Arrangement guidelines are considered predatory.*

*The importance of even a small differential between interest rates can be demonstrated by the following table. In this example, the U.S. exporter would be using an Eximbank loan with an 10.85% p.a. interest rate in conformity with the Arrangement guidelines. The foreign competitor would be derogate, offering a lower 9.5% p.a. rate but the same 5-year repayment term. In a close competition between comparable products, delivery schedule and contract prices, the seemingly small 1.35% p.a. interest differential becomes critical because it equates to a 3.7% price advantage for the foreign competitor.

Financed Portion	:	$4,250,000
Repayment Term	:	5 years
Average life of loan	:	2.75 years

	OECD Arrangement	Derogation
Interest Rate	10.85% p.a.	9.5% p.a.
Interest Cost to Importer	$1,268,094	$1,110,313
Interest Cost Differential	$ 157,781 higher	---
Contract Price Differential	3.7% higher	---

3.3 Summary

It should be apparent from the aforementioned that the commercial bank decision-making process is a balance among several sometimes conflicting factors, each of which represents a different "best interest" of the bank. The impetus for a bank to consider financing a prospective transaction is usually the customer relationship, but the profit motive will often propel the transaction which has received an initially tepid reception. If the risk is not acceptable to the bank or the repayment term is too long, the bank will chose between terminating further discussions and seeking support from an external source to cure the negating factor or factors. Generally, when the risk or repayment term are the dominant negating factors, private sector risk-takers will probably be operating under similar constraints. Similarly, if the negating factor is a below market interest rate the private sector can be of little assistance. Ultimately, the only entity capable of providing support as a risk-taker and/or lender of last resort is the United States Government.

4.0 CREATING AN EFFECTIVE U.S. GOVERNMENT PROGRAM

It is critical that the Task Force proposals be realistic in what can be achieved and be carefully formulated: i.e. the programs must be readily accessible and responsive to the needs of the end-users. The resources of the private sector also need to be organized. Decisive leadership imbued with a commonly-accepted goal can come only from the U.S. Government. But, unless the Government dedicates its own resources in a cooperative effort, the proposals of the Task Force will lack credibility and the private sector will not be responsive.

4.1 Principles

The following principles are offered to the Task Force to consider when it formulates its proposals.

-All Task Force proposals should be in accordance with existing inter-governmental agreements (i.e. the GATT Subsidy Code and the OECD Arrangement).

-Foreign competitors should not view the U.S. programs as predatory. The U.S. must avoid promoting distortion of historical trade patterns by inducement of concessional financing terms. (This invites retaliation.)

-U.S. programs should be careful not to disturb established markets for U.S. exports (by offering concessional terms when they are not required).

-The U.S. programs should be readily adaptable to market conditions, i.e. either reactive (responding to predatory foreign competition to protect existing U.S. exports) or proactive (creating new markets for U.S. exports).

-The programs should be realistic in what can be achieved. A program without substance (e.g. funding) can be as harmful to foreign perception of U.S. Government determination as no program at all.

-New programs should utilize existing export support programs as much as possible.

-The criteria defining who may have access to the programs must be carefully formulated. Who? When? Why? How much?

-The ability of the program to respond quickly with an authoritative response when needed is critical to success.

-The needs of the U.S. exporters/end users for an accessible and readily implemented program must take priority over government bureaucracy when designing the modus operandi.

-The Task Force programs should be easy to administer.

-Cooperation among government agencies requires dedicated resources at each agency.

-Draw on the resources of the private sector as much as possible (with the ultimate objective of reducing the cost for the U.S. Government to nil whenever possible). Private sector resources include banks, exporters, trading companies, commodity companies, countertraders, private insurance companies, and other financial intermediaries (PEFCO).

-Avoid a "one-size-fits-all" mentality. An objective should be to enable the U.S. exporters to offer the foreign importers several financing alternatives which may be equally or possibly more attractive than the foreign competition.

-Be innovative!

4.2 PREREQUISITES

Despite the perception that U.S. exporters must match each derogation, mixed credit or countertrade offer in order to win foreign contracts, it is not certain that this is always going to be the case. Creative alternatives have proven to be attractive to importers in other circumstances when the alternatives had other features which were desirable to that importer. It is probable that this experience could be transferred to the development of financing alternatives by the Federal Government.

Prior to recommending a plan of action for a new Government export support program, it is recommended that the Task Force take the additional time required to explore the subject thoroughly, in particular, to explore the alternatives available from more effective use of the existing programs. A secondary objective should be to enlist the private sector in a joint public/private sector effort. Recent developments demonstrate that there is increasing awareness in the private sector of opportunities in export financing, given the constraints of the marketplace, through the use of private placements and other domestic financing mechanisms.

The extended Task Force study would have four components: analysis of the programs offered by the foreign competition; analysis of the needs of the foreign importers; identifying the needs of the U.S. exporters; and identifying the resources which might be available in the private sector.

4.2.1 Analyze the Foreign Competition

None of the three major categories of predatory competition described in Section 2.0 is particularly attractive to the major exporting countries. They distort trade and are very expensive. They are usually offered as an option of last resort when conventional financing fails.

The first component of the study should therefore be to determine the nature of the foreign government support for these extraordinary programs. Among the questions that the Task Force should ask in this analysis should include the following:

-Which foreign governments provide extraordinary export support? Which methods of financing are used?

-What are the financial resources available to the respective governments to pursue these programs? Are their resources large or restricted?

-Do these foreign governments designate domestic industries for special support?

-Is government support targeted to a particular foreign market for foreign policy reasons? Is there a historical relationship between the exporting country and the recipient importing country (for example, France and Francophone Africa)?

-Is the targeting effort directed toward historically United States markets? Do any U.S. export industries encounter this targeting (for example, Brazilian Government support for the export of general purpose aircraft, construction equipment, buses, and trucks)?

4.2.2 Understand the Needs of the Foreign Importer

One of the major complaints about the U.S. Government export support programs is that they are based upon a "one-size-fits-all" mentality. In the current competitive environment where the United States is no longer competing only against financing based upon the OECD Arrangement guidelines, lack of flexibility will be increasingly a detriment. To be successful, alternative financing packages will require an understanding of the importing country and its particular financial resources and requirements.

The second component of the study should therefore be to identify the most probable target markets of the U.S.'s most important competitors and to create country trade profiles of each. (Most of this information is available in the Department of Commerce.) The objective of this analysis will be to understand the needs of the foreign importer and to determine which financing alternatives will be attractive.

Among the factors to be included in each profile are trade patterns, dependence upon one principal country for capital equipment imports, potential for import growth, balance of payments problems, potential export capabilities (new products, dependence upon basic commodity exports, etc.), government policy with respect to standardization on one supplier (e.g. telecommunications equipment, vehicles such as buses and trucks, aircraft, power generation equipment, etc.), and an affinity or antipathy for transacting business with the United States.

4.2.3 Understand the Needs of the U.S. Exporter

With the information provided from the prior two analyses, the Task Force should be able to determine which U.S. exporters will encounter predatory financing competition, in which markets, and possibly even the components of acceptable creative alternatives.

Among the questions which could be asked in this analysis include the following:

-What is the cost of meeting each type of competition? (As demonstrated in Section 2.0, each format will have a different cost profile.)

-In which importing countries will competition be most likely met? From whom? What type of inducement will be most attractive to win the contract? Is the inducement based upon lower interest rates, longer repayment terms, increased export trade from the importing country, or increased government grants-in-aid?

-Should the U.S. programs be primarily aggressive or reactive?

-Can the U.S. programs be designed within the context of the international agreements and still be effective?

-What resources are currently available from the various U.S. Government agencies which might be acceptable alternatives? Must these alternatives be only financially related, or could the support be provided by goods or services delivered within the United States by the private sector?

-What resources are available from the private sector? Which private sector resources are desirable for use in these programs? How might they best be utilized?

4.2.4 Identify the Private Sector Resources

Despite the limitations previously mentioned with respect to private sector resources, the private sector has begun to take a greater interest than ever before in the financing of exports and represents an area of opportunity which could be exploited. For example, the entry by several U.S. insurance companies into the area of foreign political risk coverage has already begun to change this marketplace. AIG has evolved into an important competitor of Lloyds of London. They, together with other newcomers such as INA, Chubb, and AFIA, are actively developing new insurance programs, taking greater risks, demonstrating creativity, and lowering premium rates. Several of these companies now offer comprehensive foreign risk insurance (commercial risk as well as political risk coverage) in competition with FCIA/Eximbank.

In the funding area, too, the market is beginning to grow despite the constraints described earlier. Innovative entities such as TRAFCO demonstrate that there is a market -- among both importers and exporters -- for market-level fixed rate loans. The recent movement to market-level interest rates by the OECD Arrangement should be an impetus to the continued expansion of private sector moves into the area of export finance.

Probably the most interesting feature in the development of countertrade has been the movement by many U.S. exporters to create countertrade units in their companies. The demand for countertrade partners has also nurtured the growth of a new industry, the countertrade specialist who packages the transaction and relieves the exporter of the related risks.

From this brief commentary, it should be evident that there are substantial resources in the private sector which might be tapped by the Government. The problem which will face the Government will not be identification of those resources, however, but setting its own priorities and determining how these resources can be utilized.