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Budgeting for Eximbank: A Case Study of Credit Reform

A SPECIAL STUDY

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CBO STUDY ON REFORM OF BUDGETING FOR THE EXPORT-IMPORT BANK

A special study by the Congressional Budget Office, *Budgeting for Eximbank: A Case Study of Credit Reform*, finds that the federal budget does not accurately measure the cost of new loans, loan guarantees, and insurance provided by Eximbank. The study examines how credit reform would improve budgeting for Eximbank by separating the subsidy cost of the bank's credit assistance from its nonsubsidized cash flows.

Eximbank's loans, guarantees, and insurance cost the government money because the fees it charges do not cover all of its expenses and because the interest rates it charges borrowers are lower than the rates it pays to borrow from the Treasury. The budget's failure to measure accurately the cost of Eximbank's credit programs prevents the Congress and the Administration from comparing their cost with the cost of other programs, and from making and enforcing decisions to limit the cost of the bank's new credit assistance. The present system focuses exclusively on the cash flows resulting from budgetary decisions, rather than on the economic resources used by Eximbank's credit programs.

Credit reform would make subsidy cost the measure of the cost of credit programs in the unified budget. The Congress would be required to appropriate the subsidy cost of new loans and loan guarantees and insurance. The budget would account separately for subsidy cost and for the nonsubsidized cash flows associated with credit assistance. The study shows how these changes would affect the treatment of Eximbank in the unified budget under two versions of credit reform that would have no effect on total budget outlays or the deficit, and under a modification that would change them. Credit reform's potential effects on Congressional consideration of the bank's activity are also discussed.

The study was prepared as a companion volume to the CBO report, *Credit Reform: Comparable Budget Costs for Cash and Credit*. Much of the analysis is applicable to other federal credit programs. To show how analysts can use publicly available data and a model developed by the Office of Management and Budget to estimate credit subsidy cost, the study details how CBO estimated the subsidy cost of Eximbank credit assistance in fiscal year 1990.

Questions about the study should be directed to Robin Seiler of CBO's Budget Process Unit at (202) 226-2835. The Office of Intergovernmental Relations is CBO's Congressional liaison office and can be reached at 226-2600. For additional copies of the paper, please call the Publications Office at 226-2809.

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BUDGETING FOR EXIMBANK:
A CASE STUDY OF CREDIT REFORM

The Congress of the United States
Congressional Budget Office

NOTES

All years are fiscal years, unless otherwise noted.

Details in the text and tables of this report may not add to totals because of rounding.

The Export-Import Bank of the United States is referred to as Eximbank.

PREFACE

This case study of budgeting for the Export-Import Bank (Eximbank) is a companion volume to a Congressional Budget Office (CBO) study, *Credit Reform: Comparable Budget Costs for Cash and Credit*, prepared to satisfy the requirements of Section 212 of the Balanced Budget and Emergency Deficit Control Reaffirmation Act of 1987. Although the study focuses on Eximbank, the analysis is applicable to other federal loan and loan guarantee programs and illustrates both the issues in federal budgeting that have motivated credit reform proposals and how credit reform would affect the budget process.

The study was prepared by Robin Seiler of the Budget Process Unit under the supervision of Marvin Phaup and James L. Blum. Joseph C. Whitehill of the Budget Analysis Division made a significant contribution to the paper. Edith R. Boehler, James C. Cruse, James K. Hess, and Joseph Sorbera of Eximbank provided useful information and comments. Rodney Bent, Julia Doherty, Lisa Witt, Kay McLennan, and Ron Silverman of the Office of Management and Budget, and Danila Girerd, Roy Meyers, and Trevor Alleyne of CBO, also made helpful suggestions.

Sherry Snyder edited the report. Kathryn Quattrone prepared the report for publication, assisted by Robert Whitney.

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SUMMARY

The Export-Import Bank of the United States (Eximbank) provides credit assistance to support the sale abroad of U.S. goods and services. Eximbank makes direct loans to buyers and lenders, supplements some of its loans with grants, and guarantees and insures private export loans. Eximbank's loans, guarantees, and insurance cost the government money because the bank's fees do not cover all of its expenses, which include losses on loans that go into default and the cost of administering its programs, and because the interest rates that Eximbank charges are lower than the rates it pays to borrow from the Treasury.

The cost of Eximbank's loans, loan guarantees, and insurance is not accurately measured in the federal budget. This deficiency prevents the Congress and the Administration from comparing the cost of Eximbank's assistance with that of other programs, and from making and enforcing decisions to limit the cost of the bank's assistance. Budgeting for credit programs is also hampered by the present system's exclusive focus on the cash flows resulting from budgetary decisions, rather than on the economic resources used by federal programs.

Credit reform would remedy these shortcomings of budgeting for Eximbank and other federal agencies that provide credit assistance. This paper is a case study of the current budgetary treatment and control of Eximbank and of how current procedures would change under credit reform.

THE CURRENT BUDGETARY TREATMENT AND CONTROL OF EXIMBANK

Eximbank's activities are recorded in the unified and credit budgets. Eximbank's budget authority measures its obligations financed with appropriations or by borrowing from the Treasury through the Federal Financing Bank (FFB). Eximbank's outlays are equal to its payments to borrowers, lenders, and others less its receipts from them. The credit budget, which supplements the unified budget, includes the limits on new Eximbank loan obligations and guaranteed loan commitments enacted in annual appropriation acts. The *Appendix* to the President's budget includes net income statements and balance sheets for Eximbank that resemble the financial reports of private firms.

The President and the Congress exercise general control over Eximbank through its charter, which sets forth the bank's purposes, authorizes its programs, and allows it to finance its activities with borrowing from the Treasury. Eximbank's annual loan and grant obligations, guaranteed loan commitments, and administrative expenses are limited by appropriation acts. The bank operates within these statutory restrictions and in accord with Administration policies.

Shortcomings of Current Budgetary Measures and Controls

The government's budgetary accounting systems do not measure accurately the cost of new federal loans and guarantees. The unified budget obscures the payments and receipts from new Eximbank loans, guarantees, and insurance by combining them with cash flows from past activity. More fundamentally, however, the cost of new bank credit assistance cannot be measured from cash flows from the assistance in any single year. The credit budget's limits on new Eximbank direct loans and guarantees are always greater than the cost of the assistance, since borrowers are likely to repay much of the principal and interest they owe. Finally, although Eximbank's financial reports recognize the cumulative effects of past bank loans and guarantees, that information cannot be used to measure the cost of new assistance.

Effects on Budgetary Proposals and Decisions

Because of these shortcomings of budgeting for credit assistance, some budgetary proposals and decisions concerning Eximbank have been based on the cash flows resulting from its loans and guarantees, rather than on the cost of the activity. For example, President Reagan's budget for 1987 proposed to replace Eximbank's direct loans with equivalent guarantees of private loans and payments to subsidize the interest rates on those loans. Also, the Omnibus Budget Reconciliation Act of 1986 directed Eximbank to reduce its 1987 outlays by $1.5 billion through the sale of loans to the public. Both proposals sought to create the appearance of a reduction in the cost of Eximbank's activities without in fact achieving one.

THE SUBSIDY COST OF PROVIDING CREDIT ASSISTANCE

Subsidy cost is a measure of the tax-based resources--the current and future claims on taxpayers--used by federal credit assistance. The subsidy cost of a loan or loan guarantee is the most accurate budgetary measure of the cost to taxpayers of providing the assistance.

The subsidy cost of a loan made by Eximbank is the difference between the price the bank pays for the asset and the present value of its future receipts of interest and principal net of administrative expenses. The subsidy cost of its guarantee or insurance of a private export loan is the difference between the fee Eximbank charges the borrower and the present value of its future disbursements to pay guarantee claims and administrative expenses. Measuring the subsidy cost of new Eximbank loans and guarantees requires discounting to their present value the cash flows that will result from the assistance. Discounting is needed to reflect the fact that a sum the bank expects to receive in the future is worth less than an equal amount it has today, since cash in hand can be invested at interest.

According to estimates by the Congressional Budget Office (CBO), the subsidy cost of the direct loans that Eximbank will obligate itself to make in 1990 will average 9.2 percent of loan principal. The estimated subsidy cost of the $713.1 million in new bank direct loan obligations in the February 1989 CBO baseline would therefore total $65.9 million. The subsidy cost of loan guarantees and insurance that Eximbank will commit itself to make will average 0.3 percent of loan principal--$20.4 million on $6.0 billion in new guaranteed loan commitments.

CREDIT REFORM AND BUDGETING FOR EXIMBANK

Credit reform would improve budgeting for Eximbank and other credit programs by requiring the Congress to appropriate the subsidy cost of new assistance, and by accounting for this cost separately from the cash flows associated with making or guaranteeing loans. Subsidy cost appropriations could be supplemented by moving all nonsubsidized cash flows "below the deficit line" and treating them as a means of financing the deficit, where they would not affect federal outlays or the deficit. These accounting changes would reveal the cost to taxpayers of credit assistance, but would not change the operations of credit programs or the subsidies received by borrowers.

Appropriating Subsidy Cost

Under credit reform, the Congress would appropriate to Eximbank the subsidy cost of new loans, loan guarantees, and insurance. The bank would be scored with budget authority equal to the appropriations when it received them, and with outlays equal to the subsidy cost of its assistance as assisted loans were disbursed. Under two versions of credit reform--one proposed by the Reagan Administration and one passed by the Senate in 1987--the addition of subsidy cost outlays to Eximbank's budget would not change total outlays in the unified budget. No change would occur because the subsidy cost outlays would be offset by equal collections credited either to a new account at Eximbank created to finance its new loans and guarantees, or to two new consolidated Treasury accounts created to finance all new credit activity. Total unified budget outlays would change, however, if nonsubsidized cash flows were moved "below the line."

Moving Nonsubsidized Credit Cash Flows "Below the Line"

Nonsubsidized cash flows for credit programs could be removed from the unified budget by classifying them as a means of financing the deficit. In this way, only disbursements for the subsidy cost of credit assistance would be included in calculations of total federal outlays and the deficit. The budget authority and outlays of Eximbank and other credit agencies would then accurately reflect the cost of all loan and guarantee programs, and the current incentives to substitute loan guarantees for direct loans and to sell or allow the prepayment of loan assets would be eliminated.

Effects on Budgeting for Eximbank

Focusing on subsidy cost would enable the Congress to evaluate Eximbank credit assistance and equivalent forms of federal spending on the basis of their relative cost. The Congress could use subsidy cost appropriations and limitations on Eximbank loans and guarantees to express its intent about policies such as targeting loans to particular classes of borrowers.

CHAPTER I

INTRODUCTION

The federal budget records the cash flows of the government that result from budgetary decisions. The cash basis of federal budgetary accounting has the important advantage of helping to control the government's payments and to calculate federal borrowing requirements. A major disadvantage is its inaccurate measurement of the cost of credit transactions, which involve the exchange of cash now for promises to make payments later.

Cash-basis accounting misrepresents the relative costs of different types of credit assistance and other federal spending. The budget initially records the same cost for a $100,000 loan and a $100,000 grant because equal amounts of cash are disbursed, even though the loan will almost certainly generate future income for the government. The budget also records nothing when the government guarantees private loans because no payments are made (unless the borrowers pay the government guarantee fees, in which case government spending goes down). Outlays do not increase even though some of the loans are expected to default and be purchased by the government in the future. Collections from loan sales and prepayments reduce budget outlays just as do collections from sales of real federal assets, even though in the first case the cash received by the government is worth no more, and may be worth less, than the future income it loses.

EFFECTS OF CASH-BASIS ACCOUNTING ON BUDGETING FOR EXIMBANK

By inaccurately measuring the costs of credit transactions, cash-basis accounting creates strong incentives to pursue policies that improve the government's cash flows in the short run, but that do not reduce, or may even increase, program costs in the long run. Two recent proposals affecting the Export-Import Bank of the United States (Eximbank), an agency that helps finance U.S. exports, illustrate the effect of these incentives on budgetary decisions.

President Reagan's budget for 1987 proposed to replace Eximbank lending with 100 percent guarantees of private export loans as well as appropriations to subsidize the interest rates on those loans. The proposed mechanism, called "I-Match" after the matching of loan guarantees and interest subsidies, would have altered the form but not the substance of Eximbank's credit assistance. Borrowers would have obtained private bank loans that were indistinguishable from Eximbank direct loans. The bank's long-term costs would have been unchanged as well, since its future disbursements to lenders--for interest subsidies and to purchase guaranteed loans that defaulted--would have equaled, in present-value terms, its disbursements and repayments on direct loans of equal principal.[1] The change in form would have enabled the budget to show lower federal outlays for several years, without any reduction in the volume of Eximbank's credit assistance or in the subsidies conveyed to borrowers.

The Omnibus Budget Reconciliation Act of 1986 provides another example of how the incentives created by cash-basis accounting have affected budgeting for Eximbank. The act required Eximbank to sell loans in its portfolio in amounts sufficient to reduce its 1987 outlays by $1.5 billion. A notice of the bank's intent to conduct a sale generated $1.9 billion in prepayments, which satisfied the sale requirement. The transactions did not improve the financial condition of Eximbank or the government, nor did they directly affect the subsidies provided by new Eximbank loans.[2] Nonetheless, because the collections lowered Eximbank's outlays by $1.9 billion relative to what they otherwise would have been, the prepayments could have created the inaccurate impression that the cost of Eximbank's programs had been reduced. The main purpose of the sale requirement, and of the prepayment program, was to reduce the bank's outlays and the federal deficit in 1987 without reducing the funding of any federal program.

1. The present value of a claim on a sum of money to be paid in the future is its value in current dollars. The present value of the claim is lower than the nominal, future amount and is calculated by discounting, or reducing, the future amount by an appropriate interest rate.

2. The prepayments indirectly reduced the subsidies conveyed by new Eximbank lending, because the bank decided to stop giving new borrowers the right to prepay their loans at face value at any time.

PROPOSALS FOR CREDIT REFORM

The Reagan Administration, the Senate, Members of the Congress, the General Accounting Office, the Congressional Budget Office, and others have proposed to reform the budgetary treatment and control of federal loans and loan guarantees.[3] These credit reform proposals are designed to correct the measurement of the cost of credit transactions under cash-basis accounting and remove the resulting incentives to substitute loan guarantees for direct loans of equal cost and to sell and prepay loan assets. They would do so by making subsidy cost--the amount of tax-based resources expended on a loan or loan guarantee--the budgetary measure of the cost of new credit assistance. Agencies would be required to receive appropriations equal to the subsidy cost of new credit assistance. Credit reform could also change the treatment of the cash flows arising from federal loans and guarantees.

This paper is a detailed case study of the current budgetary treatment and control of one federal agency--Eximbank--and of the effect that credit reform would have on budgeting for the bank. Much of the discussion is applicable to budgeting for other agencies that operate credit programs.

3. The Administration's credit reform proposal is detailed in Office of Management and Budget, *Federal Credit Reform Act of 1987*, Proposed Legislation and Supporting Materials (March 1987); and in *Budget of the United States Government, Fiscal Year 1990*, pp. 6-21 to 6-27. Title III of the Senate version of H. J. Res. 324, passed July 31, 1987, proposed an alternative package of reforms. The title was dropped in conference. See also General Accounting Office, *Budget Issues: Budgetary Treatment of Federal Credit Programs* (April 1989); and Congressional Budget Office, *Credit Reform: Comparable Budget Costs for Cash and Credit* (December 1989).

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CHAPTER II

EXPORT FINANCE AND EXIMBANK

Most U.S. exports are privately financed. Commercial banks provide the vast majority of private export loans, while specialized financial intermediaries such as forfaiters are also sources of funds. Private insurers and guarantors may reduce the credit risk assumed by these lenders.

The Export-Import Bank supplements private financing by helping to finance exports to high-risk countries, sales by U.S. firms that face competition subsidized by foreign governments, and other exports. Eximbank is required by law to make its credit programs fully competitive with those of other governments. The bank seeks to minimize competition among governmental export credit agencies, in part by reaching international agreements to reduce subsidized export financing. This chapter discusses private financing of U.S. exports and examines how Eximbank pursues its objectives.

PRIVATE FINANCING OF U.S. EXPORTS

Commercial banks provide most private financing for U.S. exports. To fund shipments of noncapital goods, exporters often use one-year bank letters of credit. Exports of capital goods are frequently financed with medium-term (two- to five-year) loans from one or more banks, sometimes in combination with an Eximbank loan or loan guarantee. Unguaranteed bank loans generally carry floating rates of interest tied to the London Interbank Offer (LIBOR) rate, which is a composite of the rates that major banks quote on dollar deposits in London.

To induce banks to finance exports to riskier countries or borrowers, exporters may have to purchase political or commercial risk insurance, usually in the form of policies that cover a number of transactions with importers in several nations. Insurance is available only to experienced exporters. Since the onset of the debt crisis in 1982, private insurance and bank financing for exports to developing countries have declined dramatically. Without the assistance of governmental export credit agencies, the private sector will finance exports to many developing countries only for periods of one year or less, if at all.

Private financing is also provided by specialized firms such as export finance and trading companies, factoring houses, international leasing companies, and forfaiters. A forfaiter is a financial intermediary, usually a subsidiary of a commercial bank, that specializes in export finance.[1] Forfaiters provide short-term, medium-term and, in some cases, long-term (six- to ten-year) financing for exports to buyers in nations that belong to the Organization for Economic Cooperation and Development (OECD) and in some countries in the Soviet bloc, Asia, and the Middle East. They also provide short-term financing for exports to borrowers in some developing countries. Forfaiters compete with commercial banks to finance export sales for which a suitable guarantor is willing to assume the credit risk on the financing.

To finance an export sale, a forfaiter arranges for a highly rated entity--usually a government agency or a major bank--in the importer's country to guarantee unconditionally a series of promissory notes to be issued by the importer. The importer issues the notes to the exporter in exchange for receiving the goods. The exporter sells the notes to the forfaiter, who forfeits all right of recourse to the exporter in return for purchasing them at a discount from face value. Since the guarantor is very creditworthy, the credit risk of the notes is equal to, or only slightly greater than, the risk of lending to the government of the country in which the importer and the guarantor are located.[2] The forfaiter may hold the notes or sell them in the European secondary market for such paper. This type of financing is attractive to exporters because it is available at fixed interest rates, requires minimal documentation, and can be arranged swiftly.

From the point of view of exporters, private export financing has shortcomings. Intermediaries may not be willing to finance some export sales, and may be willing to finance others only on terms that borrowers prefer not to pay. These difficulties arise from political and

1. The word forfaiter is from the French *à forfait*, which in finance refers to the surrender of rights--fundamentally, the right of recourse to the previous holder--when purchasing a debt instrument.

2. Ian Guild and Rhodri Harris, *Forfaiting: An Alternative Approach to Export Finance* (New York: Universe Books, 1986), p. 46.

commercial risks that export loans may pose, lack of information about the creditworthiness of some borrowers, and problems matching loan terms with borrower preferences.[3]

Export loans involve political and commercial risks that private intermediaries may be unwilling to bear. National governments sometimes repudiate debts to foreigners or restrict private borrowers' use of foreign currency holdings to repay their obligations. Exporters or intermediaries that finance exports must assume these political risks. They must also assume two types of commercial risk not presented by domestic trade finance. First, changes in exchange rates or restrictions on the use of foreign currency may leave borrowers unable to repay their obligations. Second, differences in national laws and policies may make it difficult for lenders to take possession of foreign assets financed and pledged as collateral for loans. In some cases, these political and commercial risks may be so great that banks, forfaiters, or insurers would refuse to finance exports at any price.

Another problem may be lack of information, particularly in dealing with developing countries. Lenders and insurers may find it very difficult to obtain enough accurate information about governments, firms, or commercial conditions in some countries to be able to assess the risks of financing export loans to those nations. In addition, since efficient capital markets do not exist in developing countries, firms located there may be unable to finance their purchases domestically.

Finally, the terms of private loans may not match the preferences of borrowers. Private loans normally carry floating interest rates, while importers may prefer to borrow at fixed interest rates. Private loans also usually have maturities of one to five years. Foreign buyers of long-lived capital goods--aircraft or power plants, for example--prefer long-term loans that enable them to match their debt-service payments with the cash flows generated by their investments.

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3. This discussion draws upon David P. Baron, *The Export-Import Bank: An Economic Analysis* (New York: Academic Press, 1983), Chapter 3.

SUBSIDIZED GOVERNMENT INTERVENTION

Eximbank and its competitors supplement private financing of exports through direct loans and by guaranteeing long- and medium-term loans and insuring short-term loans made by private lenders. The interest rates and fees charged by governmental export credit agencies such as Eximbank are lower in general than those charged by private lenders and insurers and do not cover in most cases the agencies' expected losses, borrowing costs, and administrative expenses. As a result, the programs convey subsidies to borrowers.

The most common justification for governmental export credit subsidies is that they are necessary because other countries provide them. Additional arguments, the validity of which is frequently disputed, are that subsidies can reduce domestic unemployment and lower the trade deficit, maintain a country's capacity to produce goods that could not otherwise be produced economically, support firms in depressed regions, or enable producers of export goods and services to compete with subsidized foreign competition. Studies have concluded that if there is unemployment in the domestic economy or if exporter activities benefit other domestic firms, export credit subsidies can be beneficial in some cases. The studies note, however, that since some of the benefits of the subsidies accrue to foreigners, direct subsidization of producers would yield greater benefits to the exporting country.[4] An analysis of the social costs and benefits of subsidized government export credit assistance is beyond the scope of this paper.[5]

THE ORIGINS, ORGANIZATION, AND ROLE OF EXIMBANK

In 1934, President Roosevelt issued executive orders that created two Export-Import Banks of Washington to facilitate trade between the

4. Daniel F. Kohler and Kip T. Fisher, *Subsidization of East-West Trade Through Insurance and Loan Guarantees* (Santa Monica, Calif.: RAND Corporation, January 1983), Chapter V; and Stephen W. Salant, *Export Subsidies as Instruments of Economic and Foreign Policy* (Santa Monica, Calif.: RAND Corporation, June 1984).

5. The costs and benefits of export credit subsidies are analyzed in Baron, *The Export-Import Bank*, Chapter 7; Kohler and Fisher, *Subsidization of East-West Trade*; Salant, *Export Subsidies*; Heywood Fleisig and Catharine Hill, *The Benefits and Costs of Official Export Credit Programs of Industrialized Countries: An Analysis* (Washington, D.C.: World Bank, 1984); and Motoshige Itoh and Kazuharu Kiyono, "Welfare-enhancing Export Subsidies," *Journal of Political Economy*, vol. 95 (February 1987), pp. 115-137.

United States and the Soviet Union and Cuba. The following year the two agencies were consolidated into one, and the scope of its activities was broadened to encompass transactions with other nations. Ten years later, the Export-Import Bank Act of 1945 reorganized the bank, chartering it as a wholly owned government corporation headed by a president and a board of directors. To enable Eximbank to finance its activities, the charter authorized the Treasury to purchase $1 billion of "stock" in the bank.[6] Eximbank continues to operate under the act's authority, which the Congress periodically amends and extends. The Export-Import Bank Act Amendments of 1986 extended the charter act through 1992.

Eximbank's charter currently limits its authority to borrow directly from the Treasury to $6 billion. This is not an effective constraint on the bank's outstanding debt, however, since it can borrow unlimited amounts from the Federal Financing Bank (FFB), an agency of the Treasury. The charter also limits Eximbank's outstanding loans, guarantees, and insurance. The current ceiling of $40 billion has not constrained Eximbank's ability to provide new assistance; at the end of 1988, its outstanding assistance totaled $17.3 billion.

Eximbank's Programs

Eximbank pursues its goals by extending direct loans, guaranteeing and insuring private export loans, and making grants.

Direct Loans. If U.S. exporters are faced with competition from foreign firms that have received loan commitments from the export credit agencies of other governments, Eximbank will lend the foreign buyers of the U.S. exports up to 85 percent of the contract prices of their purchases. Typically, a U.S. exporter obtains a preliminary commitment from Eximbank to finance a transaction and then bids against foreign competitors to win the contract. If the U.S. firm wins, the foreign buyer then applies for the loan. Eximbank also will lend commercial lenders the lesser of the outstanding balance of loans they have made to finance U.S. exports that face officially subsidized foreign competition, or 85 percent of the contract price of such exports. Typically, the

6. For details on the early years of Eximbank, see George D. Holliday, *History of the Export-Import Bank of the United States* (Washington, D.C.: Congressional Research Service, March 27, 1975).

lender makes a loan and then obtains financing from Eximbank. Evidence of foreign competition is not required for direct or intermediary loans to finance exports produced by small businesses when the loan amount is $2.5 million or less and the term is seven years or less. The maturities of loans Eximbank makes to importers and intermediaries vary from two to ten years (and longer, on occasion).

Under an arrangement among OECD members, the interest rates on most export loans made by Eximbank and its competitors may not be lower than certain minimum rates. The rates vary by loan maturity (five years or less, and more than five years) and the per capita income of the borrower's country (rich, intermediate, and poor), and are indexed to the yields on a basket of bonds issued by five OECD governments. The OECD reviews the rates each January and July, and adjusts them to reflect changes in the yields of government bonds.

Loan Guarantees. Eximbank guarantees fixed- or floating-rate loans made by U.S. or foreign lenders to foreign buyers of U.S. exports. Exporters, importers, and lenders may apply to the bank for guarantee commitments. The lenders and borrowers set the interest rates on the loans. Loan maturities and the required minimum cash payment that the buyer must make are the same as those for Eximbank's direct loans. The bank guarantees 100 percent of loan principal against political risk and, in some cases, commercial risk. When Eximbank assumes commercial risk, the exporter or the lender must assume 2 percent of that risk. The guaranteed portion of loan interest differs for fixed- and floating-rate loans, but cannot exceed 0.5 percent above the prevailing yield on U.S. Treasury debt of comparable maturity. Lenders also may apply for Eximbank guarantees of loans of one year or less that provide exporters with working capital. Exporters may apply for preliminary commitments to guarantee working capital and then shop for interested lenders. These guarantees cover 90 percent of loan principal and interest equal to the Treasury rate plus 1 percent.

FCIA Insurance. Acting through the Foreign Credit Insurance Association (FCIA), Eximbank insures U.S. exporters against nonpayment by foreign debtors. Originally, Eximbank assumed the political risk, and a group of private insurance companies the commercial risk, of export loans insured by FCIA. The private firms ceased to underwrite new policies in October 1983, following the rescheduling of the foreign loans of many developing countries, and Eximbank now assumes all risk on FCIA-insured credit. Lenders may apply for coverage of the commercial and political risks of one-year and medium-term export loans, short-term loans to foreign importers of U.S. exports, and letters of credit. Firms financing leased equipment manufactured in the United States and related services may also apply for FCIA lease insurance.

Grants. Grants to reduce the effective interest rates on Eximbank direct loans below the OECD minimum rates--so-called "Tied Aid"--are a fourth form of Eximbank support for the financing of U.S. exports. The Congress appropriated funds for Tied Aid in 1987 through 1989 to aid in negotiations to limit the use of such grants by other governments. Partly in response to the use of these funds, OECD-member countries agreed in March 1987 to tighten the rules governing their heavily subsidized direct loans.

Fees Charged by Eximbank

Eximbank charges fees for its commitments to provide credit assistance. The bank charges a borrower who has a commitment for a long-term direct loan an annual fee of 0.5 percent of the undisbursed loan balance. For loan guarantees, the annual commitment fee is 0.125 percent of the undisbursed balance.

Eximbank also charges fees for assuming credit risk. In May 1987 it updated these fees, which vary with assessed risk, and expanded them to cover all its loans, guarantees, and insurance. Under the new structure, the fee for a particular loan or guarantee depends on three factors: Eximbank's perception of the credit risk of lending to the government of the borrower or guarantor, the type of borrower or guarantor within the country, and the maturity of the loan.

Eximbank has classified countries into six categories on the basis of its perception of the credit risk of lending to their governments. It is willing to assist the financing of exports to countries in the top five of these categories (A through E, with A presenting the least risk). Within each of the five categories, the premium structure distinguishes three types of borrowers or guarantors: sovereign states (least credit risk); creditworthy, nonsovereign public institutions or banks and highly creditworthy private borrowers (more risk); and other creditworthy private borrowers (most risk). Eximbank charges up-front fees ranging from 0.5 percent of loan principal for a one-year loan to a sovereign borrower in category A, to more than 15 percent of principal for a 10-year loan to a creditworthy private borrower in a country in category E. The fees are paid when loans are disbursed, are the responsibility of the exporters, and may be included in the contract prices and the amounts borrowed.

Eximbank updated and expanded its risk-based fee structure in order to make its loan and guarantee programs more competitive with those of the export credit agencies of other governments. Most of the other agencies have charged variable fees for some time, but the levies do not fully cover the costs of their programs. An analysis by Eximbank indicates that its fees are about average when compared with those of its competitors.[7]

7. Export-Import Bank of the United States, Policy and Planning Division, *1988 Export Credit Agency Fee Study* (June 6, 1988).

CHAPTER III

THE CURRENT BUDGETARY TREATMENT AND CONTROL OF EXIMBANK

The federal budget serves many purposes. The President and the Congress use the budget to measure the cost of alternative federal policies, determine the amount of resources the government will use each year, allocate those resources among competing uses, and decide how much of those resources will be provided by current revenue and how much by federal borrowing. Budget documents make public the proposals and decisions of the Administration and the Congress. The budget also provides a framework for controlling the use of the government's resources. To enable these purposes to be achieved, federal budget documents must provide timely, accurate, and comparable information about the costs of alternative policies.

The three principal resource measures in the budget--outlays, budget authority, and credit authority--do not measure accurately the cost to taxpayers of federal loans and loan guarantees. This shortcoming hampers the achievement of the budget's purposes. This chapter supports these assertions by examining the budgetary treatment and control of Eximbank credit assistance. The chapter also discusses Eximbank's financial performance in the 1980s and the recent deterioration in the bank's reported financial condition.

EXIMBANK IN THE UNIFIED BUDGET

The President's annual budget contains several types of information about Eximbank. The bank's cash flows are recorded in the unified budget, and measures of Eximbank's new credit assistance are presented in the credit budget. In both budgets, the bank appears in function 150--International Affairs. The *Appendix* to the President's budget also reports Eximbank's financial performance and condition in income statements and balance sheets that resemble those of private firms.[1] Finally, in recent years, the President's budget has also included estimates of the subsidy cost of Eximbank's new credit assistance.

The unified budget has two measures of federal spending: outlays and budget authority. For Eximbank and other federal agencies that operate direct loan and loan guarantee programs, outlays measure annual net cash flows--funds disbursed by an agency in each year net of funds received by the agency from assisted borrowers and others. Budget authority measures a lending agency's net borrowings and any appropriations it receives. Outlays and budget authority for Eximbank are recorded in a revolving fund.

Eximbank's disbursements include new loans, purchases of loans guaranteed or insured by the bank that are in default, interest paid on borrowings (primarily from the Federal Financing Bank, or FFB), and administrative expenses. The bank's receipts--known as offsetting collections from the public--include loan repayments and prepayments, the proceeds of sales of loan assets, interest earned on loans, and guarantee fees and insurance premiums. Rather than record offsetting collections as revenues, the unified budget nets them against disbursements to calculate outlays. Eximbank's outlays are positive when disbursements are greater than offsetting collections, as occurred in 1981 through 1984 (see Table 1). In the next four years, the bank's outlays were negative because collections exceeded disbursements.

Several factors caused the dramatic downward trend in the agency's outlays from 1985 through 1987, and the partial recovery in 1988. In 1983, Eximbank and its competitors agreed to abide by OECD-determined interest rates on their direct loans. The agreement tied interest rates on new loans to the rates on a basket of government securities. Because the new rates were higher than those that Eximbank had offered previously, the subsidies provided by new bank lending decreased. By lowering the subsidies on Eximbank loans, the new policy reduced the demand for them significantly in that year. The bank's new loan obligations continued to fall in 1985 and 1986, as the OECD minimum rates fell more slowly than market interest rates.

1. The General Accounting Office audits these statements annually. For 1988, see General Accounting Office, *Financial Audit: Export-Import Bank's 1988 and 1987 Financial Statements* (July 1989). The audits are reprinted in Eximbank's annual reports. See Export-Import Bank of the United States, *1988 Annual Report* (Washington, D.C., 1989), pp. 33-35.

As market rates went down, prospective borrowers who had received preliminary direct loan commitments from the bank in previous years opted to use cheaper, private financing. Outlays in 1985 and 1986 also reflected loan prepayments by some Eximbank borrowers who elected to refinance their debt at the lower prevailing private rates. Finally, outlay figures for 1987 reflected collections of $1.9 billion from borrowers who prepaid their loans at the bank's invitation, pursuant to a

TABLE 1. EXIMBANK IN THE UNIFIED BUDGET
(By fiscal year, in millions of dollars)

	1981	1982	1983	1984	1985	1986	1987	1988
				Budget Authority				
Authority to Borrow[a]	6,908	3,268	0	829	0	0	0	0
Appropriations for Tied Aid	0	0	0	0	0	0	78	8
Total	6,908	3,268	0	829	0	0	78	8
				Outlays[b]				
Disbursements								
Loans	3,512	2,583	2,355	2,342	1,256	686	387	371
Interest to Federal Financing Bank	1,073	1,431	1,608	1,743	1,835	1,773	1,618	1,366
Claims payments, net	14	51	59	159	80	145	257	146
Subtotal	4,599	4,065	4,022	4,244	3,171	2,604	2,262	1,883
Offsetting Collections								
Loan repayments and prepayments	-1,475	-1,731	-2,142	-1,739	-2,286	-2,430	-3,668	-1,862
Loan interest and fees	-988	-1,119	-1,280	-1,218	-1,378	-1,267	-1,069	-809
Guarantee and insurance fees	-34	-16	-34	-42	-13	-33	-49	-46
Subtotal	-2,496	-2,866	-3,456	-2,999	-3,677	-3,730	-4,785	-2,718
All Other Outlays, Net	36	26	-12	178	-122	40	-223	59
Total	2,066	1,173	578	1,068	-384	-1,167	-2,300	-894

SOURCE: Congressional Budget Office from Office of Management and Budget and Eximbank data.

a. The budget authority recorded for Eximbank borrowing from the Federal Financing Bank (FFB) is equal to total Eximbank obligations for loans, guarantee claims, and administrative expenses, net of offsetting collections received from borrowers and exporters, loan cancellations, redemption of debt owed the FFB, and changes in its unobligated balances.

b. Some minor types of disbursements and offsetting collections are shown as "All Other Outlays, Net."

provision of the Omnibus Budget Reconciliation Act of 1986 (OBRA-86) requiring Eximbank to sell enough of its loan portfolio to the public to collect $1.5 billion. Outlays increased (that is, were less negative) in 1988 as collections from prepayments by borrowers fell to $0.6 billion.

Eximbank finances its loan, guarantee, and insurance programs, and its administrative expenses, with funds received from borrowers and exporters and with borrowing from the Treasury and the FFB. In 1981, 1982, and 1984, Eximbank's collections from the public were not sufficient to enable it to liquidate all its obligations for these activities. As shown in Table 1, in those years the unified budget recorded budget authority equal to the net amounts that Eximbank was required to borrow from the FFB to liquidate those obligations.

Eximbank finances Tied Aid with indefinite annual appropriations, which also are counted as budget authority. Table 1 shows budget authority in 1987 and 1988 equal to the amounts Eximbank obligated for Tied Aid in those years--$78 million and $8 million, respectively.

Inadequacy of Budget Authority and Outlays as Measures of Cost

Eximbank's budget authority and outlays are inaccurate measures of the cost to taxpayers of the credit assistance that the bank commits to provide in a given fiscal year. Eximbank's budget authority may be zero, or its outlays negative, for a fiscal year in which it commits to make or guarantee loans on which the government will lose money. This result is possible for two reasons. First, because the two unified budget measures reflect the net cash flows arising from both new and old Eximbank credit assistance, the practice of netting all current-period disbursements and receipts obscures the flows arising from, and borrowing required to finance, new assistance. Second, Eximbank credit assistance involves payments over more than one budget period. The cash flows from or borrowing required by a new loan or guarantee in any year are not equal to the loss the government has sustained on the transaction. Therefore, even if Eximbank's budget authority and outlays excluded cash flows from and borrowing required by past assistance, the revised figures would not measure the cost of new assistance provided by the bank.[2]

Effects of Cash-Basis Accounting on Budgeting for Eximbank

The unified budget leads elected officials to base budgetary decisions on the cash flows resulting from, rather than the cost to taxpayers of, credit programs. President Reagan's I-Match proposal, described in Chapter I, illustrates how cash-basis accounting can distort decisions about how to accomplish policy goals and about the overall level of federal spending. Substituting a combination of Eximbank guarantees and interest-rate subsidies for its direct loans would not have reduced the government's cost of providing export credit assistance, but would have lowered Eximbank and total federal outlays and the deficit in the first year. The unified budget's focus on cash flows, rather than on resource cost, creates an incentive to substitute loan guarantees for direct loans. I-Match was a response to this incentive and to a desire to hold down the unified budget deficit without lowering the amount of credit assistance provided by Eximbank.

The requirement of OBRA-86 that Eximbank reduce its 1987 outlays by $1.5 billion by selling loans to the public also illustrates how the unified budget's treatment of credit programs distorts decisions about aggregate federal spending. Only in a very few cases and under special circumstances will the sale or prepayment of federal loans in competitive markets improve the government's financial condition. A loan sale will make the government better off, for example, if the government has adverse information about a loan portfolio that it does not share with private investors, who as a result pay more for the portfolio than it is worth; or if investors believe that private firms will service the loans more effectively, in which case they pay more for the loans than they are worth to the government. A prepayment program can improve the government's financial condition only if borrowers are willing to prepay amounts that exceed the market values of their

2. The shortcomings of current budgetary measures of federal credit assistance are also discussed in Congressional Budget Office, *New Approaches to the Budgetary Treatment of Federal Credit Assistance* (March 1984); Barry P. Bosworth, Andrew S. Carron, and Elisabeth H. Rhyne, *The Economics of Federal Credit Programs* (Washington, D.C.: Brookings Institution, 1987), Chapter 7; and Congressional Budget Office, *Credit Reform: Comparable Budget Costs for Cash and Credit* (December 1989), Chapter I.

loans.[3] Loan sales and prepayments also absorb private savings just as does the Treasury debt they displace. Nonetheless, the cash basis of the unified budget gives agencies such as Eximbank an incentive to sell loans or solicit prepayments in order to reduce their outlays and the deficit.

EXIMBANK IN THE CREDIT BUDGET

To improve control of credit programs, the President's budget submission for 1981 introduced the credit budget, which measures all new direct loan obligations and new guaranteed loan commitments. The Balanced Budget Act of 1985 required the Congress to set aggregate ceilings on credit authority in Congressional budget resolutions and established procedures for enforcing those levels. The annual limits on Eximbank's credit authority, enacted in the Foreign Assistance Appropriation Acts since 1982, are included in the credit budget and in the credit authority totals in the budget resolutions.

The credit authority provided to Eximbank differed from its actual obligations and commitments in each of the years between 1981 and 1988 (see Table 2). The adoption of OECD-set minimum loan rates, and the lag between changes in the market interest rates and in the OECD rates, caused the bank's actual direct loan obligations to be much lower than the enacted limits in 1983 through 1986. Actual loan obligations exceeded the enacted limit in 1988 because Eximbank was allowed to obligate unused direct loan authority carried over from 1987. Eximbank's authority to guarantee loans has consistently exceeded the demand for its guarantee and insurance commitments.

Although the limits imposed by the Congress can control the volume of new federal credit assistance by limiting the new credit authority provided to Eximbank and many other agencies, these ceilings cannot directly control the cost to taxpayers of credit programs. This cost is determined not only by the volume of assisted loans, but also by

3. Prepayments may also save money by reducing agency administrative expenses. Loan sales may initially yield nonmonetary benefits for the government, such as making agency personnel familiar with private-sector practices of loan valuation. Eximbank's 1987 prepayment program yielded no nonmonetary benefits.

TABLE 2. EXIMBANK IN THE CREDIT BUDGET
(By fiscal year, in millions of dollars)

	1981	1982	1983	1984	1985	1986	1987	1988
				Direct Loan Obligations				
Appropriation Limit	5,461	4,400	4,400	3,865	3,865	1,059	680	690
Actual	5,431	3,516	845	1,467	660	578	677	693[a]
				Guaranteed Loan Commitments				
Appropriation Limit	8,059	9,220	9,000	10,000	10,000	11,484	11,355	10,000
Actual	7,416	5,832	8,524	7,149	7,849	5,508	6,754	5,739

SOURCE: Congressional Budget Office from Office of Management and Budget data.

a. In 1988, Eximbank was allowed to obligate $3 million of unused direct loan authority carried over from 1987.

their terms and by the behavior of borrowers. Consequently, the Congress cannot use the credit budget to measure or control directly the cost of new federal credit assistance. The I-Match program was proposed and the Eximbank loan prepayment program adopted after the credit budget had been added to the Congressional budget process, which indicates that the credit budget has eliminated neither the incentives created by cash-basis accounting nor the effect these incentives have on budgetary decisions.

FINANCIAL REPORTING FOR EXIMBANK

Each year the *Appendix* to the President's budget includes statements of Eximbank's net operating income and financial condition. These reports resemble the financial statements of private firms.

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Net Operating Income

During most of the period from 1981 through 1988, Eximbank's total net operating income declined dramatically, falling from $12 million in 1981 to a loss of $476 million in 1987. The bank's direct loan program was responsible for most of its losses during that period. Table 3 shows the reported net operating income of Eximbank's direct loan and loan guarantee and insurance programs for 1981 through 1988.

Eximbank's direct loan program has lost money in part because the interest rates paid by the bank during the 1980s have exceeded those it has earned on its portfolio. In late 1979 and early 1980, the interest rates on Treasury debt and on the borrowings of other nations increased sharply. Eximbank did not raise its lending rates as much as its borrowing rates rose. As a result, the new loans it made began to carry deep interest-rate subsidies. In 1981, for example, Eximbank committed itself to lend $5.4 billion at rates between 8.75 percent and 9.75 percent, and financed the lending by borrowing at rates as high as 15.7 percent. The difference, or spread, between the overall interest rates that Eximbank paid on its borrowings and earned on its loan portfolio rose rapidly, peaking at 3.5 percent of its liabilities during 1983. The negative spread remained constant at about 3.4 percent through the middle of 1987 and then fell to 3.2 percent during 1988. (The spread fell slowly during the period because Eximbank made few new loans and borrowers prepaid much of the higher-rate assets in the

TABLE 3. EXIMBANK'S NET OPERATING INCOME
(By fiscal year, in millions of dollars)

Program	1981	1982	1983	1984	1985	1986	1987	1988
Direct Loan	-17	-166	-261	-240	-323	-342	-508	-494
Guarantee and Insurance	29	-6	13	-103	-50	-1	32	97
Total	12	-160	-248	-343	-378	-343	-476	-398

SOURCE: Congressional Budget Office from Office of Management and Budget data.

TABLE 4. FINANCIAL CONDITION OF EXIMBANK
(By fiscal year, in millions of dollars)

	1981	1982	1983	1984	1985	1986	1987	1988
Assets								
Loans receivable	13,765	16,665	16,983	17,504	15,876	14,351	11,213	9,905
Other	326	620	785	909	1,834	1,889	2,792[a]	2,209[a]
Liabilities								
Borrowing from the FFB	10,067	13,954	14,676	15,690	15,409	14,268	12,463	10,958
Other	836	291	300	273	195	209	248[a]	247[a]
Government Equity	3,187	3,309	2,792	2,450	2,106	1,762	1,293[a]	910[a]

SOURCE: Congressional Budget Office from Office of Management and Budget data.

NOTE: FFB = Federal Financing Bank.

a. Includes Foreign Credit Insurance Association.

bank's portfolio as it paid off its higher-rate debt.) Failure to receive payments on an increasing proportion of the loans in the bank's portfolio has also contributed to losses on its direct loan program.

Financial Condition and Capital Position

Eximbank's operating losses have significantly worsened its financial condition. Table 4 summarizes this trend. The government's equity in Eximbank fell from an all-time high of $3.2 billion at the end of 1981 to $0.9 billion by the end of 1988--less than Eximbank's initial $1 billion Treasury capitalization. Eximbank expects to continue to lose money beyond 1998, since many of its loans are not likely to yield any returns, and the interest it earns on current loans will continue to be less than the cost of carrying its outstanding debt.[4] Proposals have been made to appropriate additional funds, or take other measures, to increase the bank's equity.

4. Projections of Eximbank's future financial condition are found in Office of Management and Budget, *Appendix, Budget of the United States Government, Fiscal Year 1990*, p. I-Z18; and *U.S. Export-Import Bank: On Recapitalization and Other Issues*, Hearing before the Subcommittee on International Finance, Trade, and Monetary Policy of the House Committee on Banking, Finance, and Urban Affairs, 100:2 (February 25, 1988), p. 83.

In the private sector, equity capital--the excess of assets over debt claims--is a measure of a firm's ability to sustain losses and still meet its obligations. The greater the cushion against losses that equity provides, the more debt a firm can issue to expand its operations, and the lower the interest rates investors will require on the firm's securities.

The government's equity in Eximbank, in contrast, is solely a measure of the cumulative effect of its earnings and losses on the $1 billion in funds initially appropriated to it. The bank's reported capital indicates neither its ability to sustain losses and fulfill its obligations nor its ability to borrow. As a federal agency, all of Eximbank's obligations are backed by the full faith and credit of the U.S. government. The bank has unlimited authority to borrow from the FFB, and the interest rates the FFB charges do not depend on Eximbank's financial condition but on the rates the Treasury pays to borrow. Eximbank would be able to continue to borrow even if its equity became negative. In that case, it would have to increase steadily its borrowings from and interest payments to the FFB, but it would still be able to provide new export credit assistance.[5]

The Irrelevance of Financial Reporting for Budgeting

Information on the financial performance and condition of agencies such as Eximbank is irrelevant for federal budgeting. Budgeting requires information about the cost to taxpayers of alternative future Eximbank policies. Financial statements provide accounting recognition of payments arising from decisions made in the past. Hence, financial reports would be useful for budgeting for Eximbank only if the data could be used to estimate the cost of its policies. However, the bank's operating income in any year cannot provide even a rough guide to the cost of assistance provided in any period in the past, since that

5. Eximbank is in this situation already. The General Accounting Office has estimated that, measured according to generally accepted accounting principles, Eximbank's equity at the end of 1988 was between negative $3.8 billion and negative $6.3 billion. See the letter of Comptroller General Bowsher in General Accounting Office, *Financial Audit*, p. 4; and Eximbank, *1988 Annual Report*, p. 33. In January 1990, Eximbank announced the establishment of a $4.8 billion loss reserve for its loans and guarantees. This action reduced the bank's equity to a negative $4.0 billion, effective September 30, 1989.

measure lumps together payments resulting from decisions reached in many different years.[6]

CONCLUSION

The unified budget records Eximbank's cash flows and its net borrowings and appropriations. The credit budget records the bank's loan obligations and guaranteed loan commitments. The President's annual budget submissions include statements of the bank's operating income and financial condition that recognize in accounting terms the cost of assistance provided in the past. None of these data, however, reveals the cost to taxpayers of new Eximbank credit assistance. Improvement of budgeting for federal credit activities and elimination of the incentives created by cash-basis accounting will require integrating a measure of this cost into budget documents and the budget process.

6. The differences between and different objectives of budgeting and financial reporting for the federal government are discussed in detail in Congressional Budget Office, "Budgeting and Financial Reporting for Sovereign Governments: Objections to Capital Budgeting" (CBO Staff Memorandum, October 3, 1988).

CHAPTER IV

THE SUBSIDY COST OF EXIMBANK CREDIT ASSISTANCE

The President's annual budget submission includes estimates of the subsidy cost of federal loan and loan guarantee programs. Under credit reform, subsidy cost would be used to measure and control the cost of Eximbank credit assistance. This chapter defines subsidy cost, explains its advantages over current measures of the cost of credit programs in the unified and credit budgets, and develops estimates of the subsidy cost of Eximbank credit assistance in 1990.

SUBSIDY COST: THE TAX-BASED RESOURCES USED BY CREDIT ASSISTANCE

Federal loans involve the exchange of cash for notes issued by borrowers. Federal guarantees involve the exchange of government contingent liabilities for cash. If the cash or financial asset the government receives is worth less than the cash it gives up or the contingent liability it acquires, then it loses money on the exchange.

On a direct loan, the government incurs a loss if the amount of the loan minus any fee paid by the borrower when the loan is disbursed is greater than the present value of the borrower's interest and principal payments net of the government's cost of servicing the loan. Suppose, for example, that a sovereign borrower in country risk category C receives a $1 million, nine-year loan from Eximbank and pays an up-front fee of about $34,000. Suppose further that the present value of Eximbank's cost of servicing the loan and of the borrower's payments is $846,000. In that case, Eximbank has lost about $120,000 ($1 million minus $34,000 minus $846,000) on the loan. Similarly, on a federal guarantee or on federal insurance of a private loan, the government loses money if any initial fee, or the present value of any future fees, paid by the borrower is less than the present value of administrative expenses and defaults net of amounts recovered. Current and future taxpayers must absorb such losses.

The subsidy cost of a federal loan or loan guarantee is the amount of tax-based resources used by the exchange through which the credit assistance is provided.[1] Tax-based resources are used when the exchange occurs, even though outlays in the unified budget may not be affected until years later. As a measure of the cost of credit programs, subsidy cost is superior to budget authority and outlays. The latter two reflect the net borrowing required by and the cash flows arising from credit assistance provided in the past and the present, whereas subsidy cost reflects decisions made in the budget period only. Subsidy cost also measures in current dollars the cost of current-period decisions to provide credit assistance, which makes it easier to compare the costs of credit and other types of federal spending.

ESTIMATING THE SUBSIDY COST OF EXIMBANK CREDIT ASSISTANCE

Analysts can use two types of information to estimate the subsidy cost of federal credit assistance: data on the cash flows on loans made or guaranteed by the government in the past, or actual or estimated market yields on private loans with maturities and credit risk comparable with those of federally assisted loans. Frequently, data on the characteristics and historical performance of federally assisted loans are not complete enough to be used to estimate the expected cash flows or subsidy cost of future assistance.

The numerous reschedulings of Eximbank-assisted loans to developing countries present a further obstacle to using historical data on Eximbank's credit programs. As a condition for resuming export credit assistance to developing countries following the debt crisis of the early 1980s, Eximbank and other export credit agencies have uniformly required countries that have rescheduled their debt to governmental and multilateral creditors to agree that future reschedulings will only apply to debt incurred before specific cutoff dates. Such agreements reduce the incentive to repay the rescheduled loans because they effectively subordinate those debts to loans assisted by export credit

1. More detailed discussions of subsidy cost may be found in Barry P. Bosworth, Andrew S. Carron, and Elisabeth H. Rhyne, *The Economics of Federal Credit Programs* (Washington, D.C.: Brookings Institution, 1987), pp. 30-33 and Chapter 7; and Congressional Budget Office, *Credit Reform: Comparable Budget Costs for Cash and Credit* (December 1989), Chapter IV.

agencies that have been or will be made after the cutoff dates for reschedulings.[2] Consequently, using historical data would probably result in overestimating the subsidy cost of assisting new medium- and long-term loans to borrowers in these same countries.

The deficiencies of the historical data on federal loans and guarantees provide one reason why the Office of Management and Budget (OMB) and others have used market yields on private loans to estimate the subsidy cost of federal credit assistance. OMB has developed a model to project the cash flows required by the average contract terms on each type of federally assisted loan, and to discount these flows to their present value.[3] The model uses estimated market yields on comparable private loans to discount the contract cash flows on the federally assisted loans. The present value so calculated is an estimate of the subsidy cost of the federal assistance. Previous studies of Eximbank have used estimates of market yields on comparable private export loans, and similar discounting procedures, to estimate the subsidies provided by bank assistance.[4]

The remainder of this chapter develops CBO's estimates of private market yields on export loans that are comparable with those assisted by Eximbank, and of the subsidy cost of new Eximbank credit assistance in 1990. The estimates were made using OMB's method and a version of OMB's model. CBO has developed its own estimates, rather than rely on those published by OMB, in order to show in detail how analysts can use publicly available data and the OMB subsidy cost model to produce conceptually sound, empirically justifiable estimates of the subsidy cost of federal credit programs, even when historical data are incomplete.

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2. K. Burke Dillon and Luis Duran-Downing, with Miranda Xafa, *Officially Supported Export Credits: Developments and Prospects* (Washington, D.C.: International Monetary Fund, February 1988), pp. 3-5.

3. The model is explained in Office of Management and Budget, *Measuring the Subsidy Element of Federal Financing* (October 17, 1984).

4. See, for example, David P. Baron, *The Export-Import Bank: An Economic Analysis* (New York: Academic Press, 1983), Chapter 6; and Daniel F. Kohler, *Economic Cost and Benefits of Subsidizing Western Credits to the East* (Santa Monica, Calif.: RAND Corporation, July 1984), Chapter II.

ESTIMATING MARKET YIELDS ON PRIVATE EXPORT LOANS

CBO used data on forfaited loans to estimate the market yields on some export loans to sovereign borrowers--national governments or their agencies. Market yields on other sovereign loans were estimated from data on commercial bank intermediation costs, sovereign debt ratings, and the spreads between the yields on private debt with comparable ratings and Treasury debt. Market yields on export loans to private borrowers were estimated by adding risk premiums to the estimated yields on sovereign loans. The remainder of this section details how CBO estimated these yields. The estimates are summarized in Table 5 (see page 30).

Using Forfaited Loans as Proxies for Export Loans to Some Sovereign Borrowers

Forfaiters finance export loans that are comparable in maturity and risk with some loans financed with Eximbank assistance. CBO has designated loans financed by forfaiters as proxies for some Eximbank-assisted loans and has used indicative yields that forfaiters quote for purchasing the former to estimate approximate market yields on the latter. CBO estimates that the market yields on medium-term loans to sovereign borrowers in countries in Eximbank risk categories A, B, and C average approximately 1.45, 2.05, and 3.5 percentage points more, respectively, than the yields on Treasury securities of comparable maturity. For short-term loans to borrowers in countries in those risk categories, the spreads between the yields on forfaited loans and on Treasuries are estimated to be about 0.05 to 0.1 percentage points lower; for long-term loans to borrowers in countries in categories A and B, spreads are estimated to be 0.15 to 0.2 percentage points higher. On one-year loans to finance exports to countries in risk categories D and E, market yields are estimated to average approximately 4.7 and 5.9 percentage points more, respectively, than yields on comparable-maturity Treasuries.[5]

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5. CBO's estimates are based on indicative rates quoted for August and September 1988 by Midland Bank Aval, Ltd, and for September and October 1988 by Finanz AG Zurich, and on conversations with Midland Bank Aval staff.

Estimating Yields on Hypothetical Commercial Bank Export Loans to Other Sovereign Borrowers

No information is available on the yields that commercial banks would or do require on export loans to developing countries that forfaiters will not finance. To overcome this lack of data, CBO has estimated yields that commercial banks would charge to make hypothetical medium-term export loans to sovereign borrowers in countries in risk categories D and E, and long-term loans to borrowers in risk categories C, D, and E, which are comparable with loans assisted by Eximbank. The yields incorporate estimates of the costs to banks of performing intermediation functions, absorbing expected default losses, and bearing the risk that losses may be greater than expected.

Commercial Bank Intermediation Costs. Federal Reserve data indicate that, between calendar years 1980 and 1987, the operating expenses of large banks resulting from their commercial and other lending (excluding real estate) averaged 1.6 percent of loans outstanding.[6] CBO estimates that the cost of assessing the risk of lending to countries in categories C, D, and E increases the banks' average operating expenses to 2.4 percent of outstanding loans.[7] Federal Reserve data also indicate that in 1987 the operating expenses of large banks associated with issuing certificates of deposit under $100,000 averaged 0.3 percent.[8] The latter amount is a proxy for the average annual cost to banks of raising funds to finance export loans. These figures suggest that the intermediation costs of large commercial banks for export loans will average 2.7 percent of loan principal over

6. Federal Reserve Banks, *Functional Cost Analyses, 1980-1986 Average Banks* (1981-1987), p. 40; and *1987 National Average Report: Commercial Banks* (1988), p. 40.

7. The 0.8 percentage-point increase is equal to the average difference--in calendar years 1980, 1981, and 1983--between large banks' operating costs of international lending and the operating costs of their commercial and other domestic lending. The difference in calendar year 1982, negative 0.6 percent, seemed implausible and was excluded from the calculation. See Federal Reserve Banks, *Functional Cost Analyses* (1980-1983), pp. 40 and 45. Data on bank costs associated with international lending since calendar year 1983 are not available.

8. The latest figure, rather than an average of data from several years, is used because this cost has risen steadily in the 1980s.

TABLE 5. ESTIMATES OF COMPARABLE PRIVATE MARKET YIELDS FOR LOANS ASSISTED BY EXIMBANK IN FISCAL YEAR 1990, BY LOAN MATURITY AND COUNTRY RISK CATEGORY (In percent)

	(1) Treasury Yield	(2) Forfaiter Spread[a]	(3) Bank Intermediation Cost[b]	(4) Sovereign Risk Premium[c]	(1)+(2)+(3)+(4)=(5) Sovereign Yield	(6) Private Risk Premium[d]	(5)+(6)=(7) Private Yield
			Short-Term Loans (One year)				
A	7.50	1.40	n.a.	n.a.	8.90	0.55	9.45
B	7.50	2.00	n.a.	n.a.	9.50	0.85	10.35
C	7.50	3.40	n.a.	n.a.	10.90	1.20	12.10
D	7.50	4.70	n.a.	n.a.	12.20	1.80	14.00
E	7.50	5.90	n.a.	n.a.	13.40	2.70	16.10
			Medium-Term Loans (Two to five years)				
A	8.55	1.45	n.a.	n.a.	10.00	0.55	10.55
B	8.55	2.05	n.a.	n.a.	10.60	0.85	11.45
C	8.55	3.50	n.a.	n.a.	12.05	1.20	13.25
D	8.55	n.a.	2.70	3.20	14.45	1.80	16.25
E	8.55	n.a.	2.70	5.55	16.80	2.70	19.50
			Long-Term Loans (Six to ten years)				
A	9.00	1.60	n.a.	n.a.	10.60	0.55	11.15
B	9.00	2.25	n.a.	n.a.	11.25	0.85	12.10
C	9.00	n.a.	2.70	2.55	14.25	1.20	15.45
D	9.00	n.a.	2.70	3.35	15.05	1.80	16.85
E	9.00	n.a.	2.70	5.70	17.40	2.70	20.10

SOURCE: Congressional Budget Office estimates based on data from Midland Bank Aval, Finance AG Zurich, the Federal Reserve Banks, Salomon Brothers, and the Office of Management and Budget. Estimates of Treasury yields are from CBO, *The Economic and Budget Outlook: Fiscal Years 1990-1994* (January 1989).

NOTES: The letters A through E designate country risk categories established by Eximbank, with A denoting the lowest risk.

n.a. = not applicable.

a. The estimated average difference between the yield on an export loan charged by a forfaiter--a financial intermediary that specializes in export finance--and the yield on a comparable-maturity Treasury security.

b. The estimated average cost of commercial bank operating expenses associated with export loans not purchased by forfaiters.

c. The estimated average cost of the expected defaults and risk of loans to sovereign borrowers.

d. Office of Management and Budget estimates of the average additional cost of the expected defaults and risk of loans to private borrowers.

the life of the loans. CBO assumes that the yields that all banks charge on export loans compensate them for these costs.[9]

Default Losses and Risk-Bearing. The credit risk associated with export loans to riskier sovereign borrowers can be assessed by assigning average credit ratings to loans to countries in each of Eximbank's five risk categories: Aaa and Aa for category A, A and Baa for category B, Ba for category C, B1 for category D, and B2 and Caa for category E. These ratings are broadly consistent with the credit ratings of the publicly traded sovereign debt of 25 nations published by Moody's Investors Service.[10]

The average spreads between the yields on widely traded debt of private firms with different credit ratings and the yields on Treasury securities provide estimates of the average market prices of the expected defaults and of the risk of unanticipated default losses on loans to borrowers of comparable creditworthiness. Using Salomon Brothers' data, CBO has estimated the spreads over Treasuries for debt issued by financial firms with different credit ratings for calendar years 1986, 1987, and 1988.[11] The average spreads over Treasury yields in those years range from 2.3 to 7.5 percentage points for one- to ten-year debt issued by financial firms with ratings of Ba, B, and Caa. These estimates, and CBO's assumptions regarding the average credit ratings of Eximbank loans to sovereign borrowers in different risk categories, imply that the spreads between the yields on Treasury debt and export loans range from 3.2 to 5.6 percentage points for medium-

9. The yields that forfaiters charge to finance export loans to the least risky borrowers, noted above, suggest that their intermediation costs for such loans are very low--perhaps equivalent to 1 percent of loan yield. Since commercial banks often compete directly with forfaiters to finance such loans, it seems likely that the large banks' intermediation costs for such loans are also quite low. No data exist to reconcile this possibility with the estimated average intermediation cost of 2.7 percent based on Federal Reserve data.

10. Moody's ratings of sovereign debt as of September 12, 1989, are presented in Moody's Investors Service, *Moody's Credit Opinions* (New York: September 1989), pp. 419-450. In ascending order of risk, the rating categories are: Aaa, Aa, A, Baa, Ba, B, Caa, Ca, and C. Risk is further distinguished within each category by the numbers 1, 2, and 3, so that Aa2 is a lower risk than Aa3, which is lower than A1, and so on. Definitions of the categories are found on pp. 28-31 of that publication.

11. CBO's estimates are based on data on Treasury yields and the yields of investment-grade debt issued by financial intermediaries published in Salomon Brothers, *Analytical Record of Yields and Yield Spreads: Monthly Update* (New York: January-December 1986, 1987, and 1988); data on non-investment-grade corporate debt published in Salomon Brothers, *High-Yield Market Update* (New York: December 1986 and December 1988); and data provided by Salomon Brothers' staff.

term export loans to sovereign borrowers in Eximbank risk categories D and E, and from 2.6 to 5.7 percentage points for long-term loans to sovereign borrowers in categories C through E.

Risk Premiums on Export Loans to Private Borrowers

To make export loans to private borrowers, commercial banks must be compensated for assuming the additional credit risk associated with lending to them. The Office of Management and Budget has estimated that banks require yields on loans to foreign, private borrowers that exceed the yields on loans to sovereign entities by 0.6 to 2.7 percentage points, with the spreads depending on the country risk category of the private borrower.[12] In the absence of any other data or estimates, CBO used OMB's figures.

Market Yields on Private Export Loans in 1990

On the basis of the assumptions detailed above, CBO has estimated the market yields in 1990 of export loans comparable with those that Eximbank will assist. Yields on export loans to sovereign borrowers are estimated to range from 8.9 percent for short-term loans to countries in risk category A to 17.4 percent for long-term loans to countries in risk category E. Yields on export credits to private borrowers are estimated to range from 9.4 percent for short-term loans to borrowers in countries in category A to 20.1 percent for long-term loans to their counterparts in category E. Table 5 displays the full range of yields estimated by CBO.

The limited number of countries for which forfaiters quote rates, the roughness of the credit ratings assigned to higher-risk sovereign borrowers in Eximbank categories C, D, and E, and the number of variables estimated make the estimates of yields in Table 5 quite uncertain. At best, they are approximations of the market prices that private firms that finance exports would charge for investing in loans comparable with those financed with Eximbank assistance. Adoption

12. Memorandum of Rodney G. Bent, International Affairs Division, Office of Management and Budget, January 5, 1988, Attachment D.

of credit reform would stimulate efforts to refine these and other estimates of comparable private market yields.

THE SUBSIDY COST OF EXIMBANK CREDIT ASSISTANCE IN FISCAL YEAR 1990

The subsidy cost of the credit assistance that Eximbank will commit to provide in 1990 is equal to the present value of the future bank disbursements and collections expected to result from its loan obligations and guarantee commitments. CBO used a version of the OMB subsidy cost model to calculate this present value.

CBO's Estimates

CBO divided Eximbank's credit programs into five broad types: medium-term loans, long-term loans, short-term insurance, medium-term guarantees, and long-term guarantees. The contract cash flows of loans of each type were projected from Eximbank's assumptions about the proportion of assisted loans that will be made to sovereign and private borrowers, the rates at which the loans will be disbursed, and the loan contract terms; and from CBO estimates of the yields that commercial banks require on letters of credit and loans insured by the FCIA and on loans guaranteed by Eximbank. CBO used the market yields for private export loans estimated above and shown in Table 5 to discount the projected cash flows for each type of loan.

The subsidy cost of new direct loans that Eximbank will obligate itself to make in 1990 will average an estimated 9.2 percent of loan principal. Thus, the $713.1 million in new Eximbank direct loan obligations in the CBO baseline for 1990 will have an estimated subsidy cost of $65.9 million. The subsidy cost of long-term loans is estimated to be higher (12.4 percent), and that of medium-term loans to be lower (4.5 percent), than the average. The subsidy cost of new guarantees that Eximbank will commit to make in that year is estimated to average 0.3 percent of loan principal--for an estimated subsidy cost of $20.4 million on the $6.0 billion in new Eximbank guaranteed loan commitments in the CBO baseline. The average subsidy cost of new guar-

TABLE 6. ESTIMATED SUBSIDY COST OF EXIMBANK CREDIT ASSISTANCE IN FISCAL YEAR 1990

Type of Assistance	Loan Principal in CBO Baseline (Millions of dollars)	Subsidy Cost: Millions of Dollars	Subsidy Cost: Percentage of Loan Principal
Loan Obligations			
Long-Term Loans	427.9	53.0	12.4
Medium-Term Loans	285.2	12.9	4.5
Total	713.1	65.9	9.2[a]
Guaranteed Loan Commitments			
Long-Term Guarantees	364.3	11.5	3.2
Medium-Term Guarantees	312.3	4.3	1.4
Short-Term Insurance	5,361.2	4.6	0.1
Total	6,037.8	20.4	0.3[b]

SOURCE: Congressional Budget Office estimates based on CBO baseline, estimated comparable market yields, and Eximbank assumptions regarding terms of its assisted loans and the risk of assisted borrowers.

a. The weighted-average subsidy cost of all long- and medium-term loans.

b. The weighted-average subsidy cost of all long- and medium-term guarantees and short-term insurance.

antees of long-term and medium-term loans is estimated to be higher (3.2 percent and 1.4 percent, respectively), and that of new Eximbank insurance of short-term loans lower (0.1 percent), than the average. Table 6 shows CBO's estimates for both direct loan obligations and guaranteed loan commitments.

Comparison of CBO and Reagan Administration Estimates

The Reagan Administration estimated that the subsidy cost of new Eximbank guaranteed loan commitments would be 1.3 percent in 1990.[13] This estimate is higher than the CBO estimate shown in

13. Office of Management and Budget, *Appendix, Budget of the United States Government, Fiscal Year 1990*, p. I-Z16; and "Special Analysis F: Federal Credit Programs," *Special Analyses, Budget of the United States Government, Fiscal Year 1990*, p. F-43.

Table 6 for two reasons. The Administration assumed that loans guaranteed by the bank would have shorter maturities, which reduced the subsidy cost of the assistance. This effect was partially offset by assuming higher yields on loans to private borrowers guaranteed by Eximbank. OMB also has estimated that, if Eximbank's direct loan programs were continued and its lending policies were unchanged in 1990, the subsidy cost of new Eximbank direct loan obligations would be 3.3 percent in that year. This estimate is lower than those shown in Table 6 mainly because CBO assumes higher market yields on private loans that are comparable with those assisted by Eximbank and lower OECD minimum interest rates on loans made by the bank, and because OMB assumes smaller spreads between the yields on private loans to riskier sovereign borrowers and Treasury yields.

CHAPTER V

CREDIT REFORM AND BUDGETING FOR EXIMBANK

Credit reform would establish subsidy cost as the measure of the cost of credit programs in the unified budget. The Congress would be required to appropriate the subsidy cost of new loans and guarantees. The budget would account separately for subsidy cost and for the nonsubsidized cash flows associated with credit assistance. These accounting changes would alter the way in which the Congress controls loans and loan guarantees, but would not affect assisted borrowers in any way.

This chapter examines two approaches to credit reform--one proposed by the Administration and one passed by the Senate in 1987--and shows how they would affect the presentation of Eximbank in the unified budget.[1] Credit reform would reveal policy issues now obscured by cash-basis accounting and would also change the allocation of Eximbank's spending among Congressional committees. The chapter describes these changes and identifies some of their potential effects on Congressional decisions about bank assistance. A final section assesses how, under credit reform, unanticipated changes in economic activity could affect Eximbank's programs.

SUBSIDY COST APPROPRIATIONS

Both the Administration's and the Senate-passed versions of credit reform would require the Congress to appropriate the estimated subsidy cost of all new direct loans and loan guarantees and insurance. For discretionary credit programs, such as those of Eximbank, subsidy cost appropriations would be provided in annual appropriation acts. For

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1. The Administration's version (the Federal Credit Reform Act of 1988) was proposed and then revised by the Reagan Administration and has been endorsed by the Bush Administration. The Senate version was passed by the Senate on July 31, 1987 (Title III of H.J. Res. 324, Joint Resolution Increasing the Statutory Limit on the Public Debt), but was dropped in the House and Senate conference. For further discussion of the Administration's and the Senate-passed versions of credit reform and implementation issues, see Congressional Budget Office, *Credit Reform: Comparable Budget Costs for Cash and Credit* (December 1989), Chapters III, V, and VI.

credit entitlements, such as the Department of Veterans Affairs' (VA) home mortgage guarantees, the money would be permanently appropriated. In both cases, the appropriations would be credited to new agency budget accounts and would partially finance the assistance. Agencies would obligate subsidy cost appropriations at the time they incurred the associated loan obligations or guaranteed loan commitments. If an agency had not received, or had exhausted, its subsidy cost appropriations for a fiscal year, it could not legally provide credit assistance to borrowers.

In the fiscal year in which an agency received a subsidy cost appropriation, its new credit subsidy account would be scored with an equal amount of budget authority. When loans supported by the appropriation were disbursed, the agency's new subsidy account would be scored with outlays equal to the subsidy cost associated with the loans.

Subsidy cost appropriations would improve budgeting for credit assistance in three ways. First, the portion of federal spending whose cost could be compared in terms of budget authority would be expanded considerably.[2] Second, the Congress would allocate and control the tax-based resources expended through new loans and guarantees by limiting the appropriations provided to cover their subsidy cost. Allocation decisions for credit programs could be more fully integrated with budgetary decisions for other types of spending. Third, federal direct loans and loan guarantees with the same subsidy cost would require equal subsidy cost appropriations, regardless of their different effects on the government's cash flows in any period. Thus, subsidy cost appropriations would reduce the incentive provided by cash-basis accounting to substitute loan guarantees for direct loans, as the Reagan Administration's I-Match proposal would have done for Eximbank. The incentive would not be eliminated, however, since direct loans would still increase total budget outlays, at least in the first year, much more than would guarantees of equal subsidy cost. Elimination

2. Budget authority is now an accurate measure of the tax-based resources devoted to some transfer payments and to discretionary spending that occurs in the year appropriations are made, including one-time grants, which are the equivalent of credit assistance of equal-dollar subsidy cost. However, if a discretionary appropriation is not disbursed in the year it is made, the budget authority scored for the appropriation overstates the tax-based resources used by the action, since funds disbursed in later years have a lower present value than their nominal, future amounts. Further, for discretionary and entitlement programs funded from trust funds, budget authority measures income dedicated to the funds rather than the financial resources consumed by the programs.

of this incentive would require moving nonsubsidized credit cash flows "below the deficit line" and treating them as a means of financing the deficit, as discussed below.

TREATMENT OF CREDIT CASH FLOWS, PAST LOSSES, AND ADMINISTRATIVE EXPENSES

Requiring subsidy cost appropriations and crediting them to new subsidy accounts would separate the subsidy cost of new loans and guarantees from their nonsubsidized cash flows. The latter would be credited and charged to new revolving funds known as financing accounts (see Figure 1).

The Administration's and the Senate-passed versions of credit reform differ principally with respect to whether the unified budget would show the new financing accounts in the agencies that provided new credit assistance or in the Department of the Treasury. They also differ over whether to credit the cash flows associated with liquidating old loans and guarantees to the new financing accounts. Either version could be modified by treating the financing or the liquidating cash flows as a means of financing the deficit.

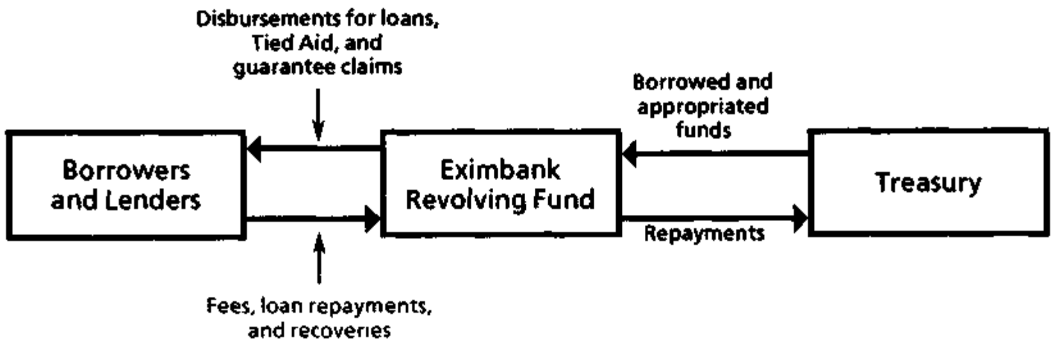
Cash Flows from New Credit Assistance

Under the Administration's version of credit reform, the cash flows of new federal loans and new federal loan guarantees and insurance would be consolidated in two Treasury accounts--a direct loan financing account and a loan guarantee financing account. The net disbursements of the two accounts would be financed with borrowing from the Treasury. Each account's budget authority and outlays would appear in a new budget function for credit financing activities.

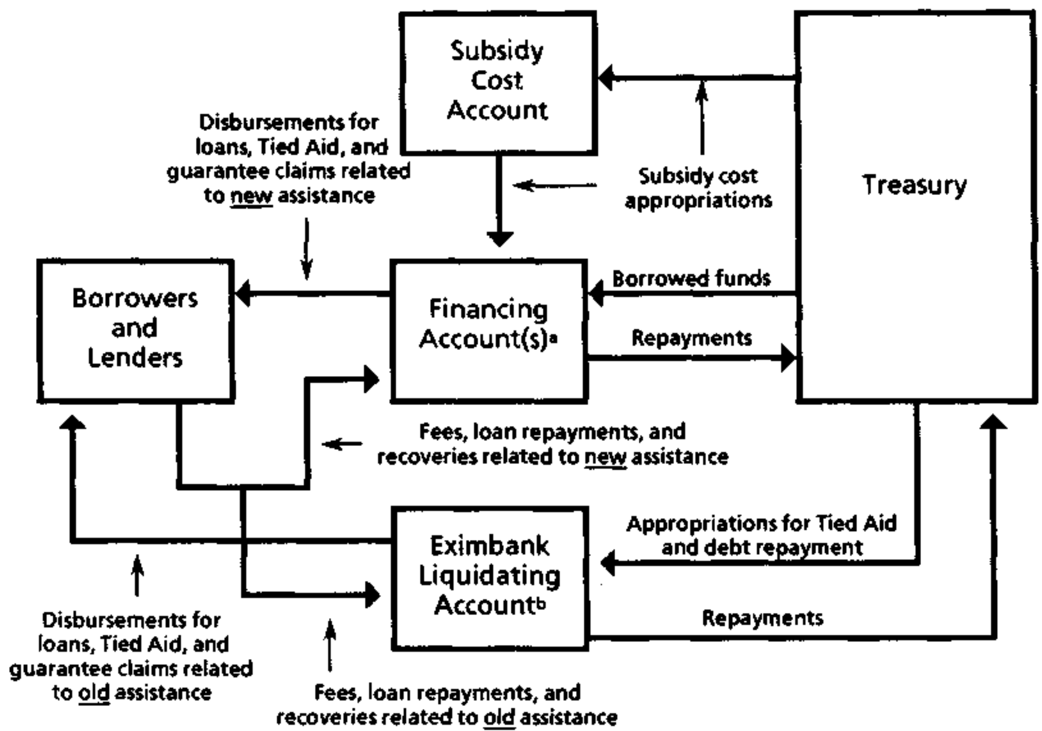
The new Treasury loan and guarantee financing accounts would be charged with all disbursements and credited with all collections associated with new federal loans, and new federal guarantees and insurance, respectively. The accounts would also be credited with offsetting collections equal to the outlays scored to the new agency sub-

Figure 1.
Eximbank Cash Flows: Current and Under Credit Reform

Current Treatment



New Treatment Under Credit Reform



SOURCE: Congressional Budget Office.

NOTE: Financing and outlays for administrative expenses are not shown.

a. The Administration's credit reform proposal would consolidate the cash flows from financing new Eximbank assistance in two Treasury financing accounts; the Senate-passed version would separate them in an Eximbank financing account.

b. The Administration plan would credit all cash flows from liquidating old Eximbank assistance and its grants to its existing revolving fund, which would become a liquidating account; the Senate-passed plan would credit those cash flows to the new Eximbank financing account.

sidy cost accounts. The outlays in the subsidy accounts and the collections in the financing accounts would offset each other and, therefore, would not affect total federal outlays or the deficit.

Under the Senate-passed plan, all cash flows arising from new Eximbank credit assistance would be credited to one new financing account at the bank. This account would be credited with offsetting collections equal to the outlays of the new Eximbank subsidy account as assisted export loans were disbursed, so that the subsidy cost outlays would not change total bank outlays or the unified budget deficit. Net disbursements from Eximbank's financing account would be funded with authority to borrow from the Treasury. The new Eximbank financing account would appear, together with the financing accounts of all other agencies with credit programs, in a new budget function.

The Senate-passed plan exempts all amounts recorded in this function from points of order under the Congressional Budget Act that might be raised against two types of legislation: bills that would breach spending ceilings allocated to Congressional committees by a budget resolution, and measures that would exceed the maximum deficit amount for a fiscal year. Amounts in the new budget function would also be exempt from reconciliation and from the sequestration procedures under the Balanced Budget Act.

Cash Flows to Liquidate Old Assets and Liabilities

Credit reform would not affect the ability of Eximbank and other agencies to make disbursements and receive collections associated with credit assistance provided in the past. At the end of 1988, Eximbank reported assets in excess of $12.1 billion and guaranteed and insured loans of more than $5.7 billion. Eximbank also had outstanding several billion dollars of obligated or committed but undisbursed loans, guarantees, and insurance.

The Administration's version of credit reform would credit Eximbank's existing revolving fund with all the future cash flows associated with the liquidation of these claims, as well as flows related to any future borrowing by Eximbank from the Federal Financing Bank. Thus, the bank's revolving fund would become a liquidating account. Under the Senate-passed version, Eximbank's liquidating cash flows would be credited to the new financing account.

Moving Credit Cash Flows "Below the Deficit Line"

Cash-basis accounting provides an incentive to reduce the reported level of aggregate federal spending by directing agencies to sell or arrange the prepayment of outstanding loans, or to substitute loan guarantees for direct loans. Neither credit reform proposal would eliminate this incentive as long as the nonsubsidized cash flows associated with credit assistance extended in any year--that is, the transactions of the new financing accounts and, under the Administration's plan, the liquidating accounts--were included in the unified budget totals. One way to remove the incentive would be to classifiy those flows as a means of financing the deficit.[3] Under current budget concepts, some federal cash flows and changes in the stocks of the government's financial assets are treated not as outlays or receipts but as a "means of financing [the deficit] other than borrowing from the public."[4] These transactions are "below the deficit line" in that they are not included in cal-culating total federal outlays, revenues, or the deficit.

If credit reform was implemented with this modification, budget authority for Eximbank would decline substantially, since it would no longer be recorded for the bank's net borrowing from the FFB. Instead, Eximbank's budget authority would consist solely of appropriations to it for Tied Aid, for the subsidy cost of its export credit assistance, and for administrative expenses. The bank's outlays would consist of disbursements of Tied Aid and, when it or private lenders disbursed assisted loans, disbursements of the subsidy cost associated with the assistance provided, and payments of administrative expenses. (Details of the treatment of the bank's administrative expenses are provided below.) All other cash flows associated with Eximbank activity--disbursements of loan principal, disbursements to purchase guaranteed loans in default, and receipts of fees and payments of loan principal and interest--would be treated as a means of financing that affected the amount of debt the Treasury would have to issue to finance

3. Statement of James L. Blum, Congressional Budget Office, before the Committee on the Budget, U.S. Senate, March 4, 1987; and statement of Edward M. Gramlich, Congressional Budget Office, before the Committee on Small Business, U.S. House of Representatives, March 10, 1987.

4. Office of Management and Budget, *Budget of the United States Government, Fiscal Year 1990*, Summary Table 4, Federal Government Financing and Debt, pp. 10-11. At present, the means of financing other than borrowing from the public are changes in Treasury operating cash balances, checks outstanding, and deposit fund balances; seigniorage on coins; and proceeds from the sale of loan assets with recourse to the government.

the deficit, but not the deficit itself. In years in which Eximbank's outlays would be lower under the current budgetary treatment than its subsidy cost outlays and its disbursements for Tied Aid and administrative expenses under credit reform, the proposed modification would increase both its outlays and the federal deficit.

Recognition of Losses on Past Credit Assistance

Several revolving funds that finance credit activity have reported increasingly negative capital positions. Although Eximbank's reported capital was a positive $0.9 billion at the end of 1988, its recent decision to establish a $4.8 billion loss reserve reduced its equity to a negative $4.0 billion at the end of 1989.[5] This suggests that the Congress will eventually have to appropriate several billion dollars to enable Eximbank to repay all its debt to the FFB. From a budgetary perspective, such appropriations would have the advantage of recognizing in the budget the losses incurred by Eximbank on subsidized credit assistance it had provided before the implementation of credit reform. They would prevent Eximbank from having to incur, and its budget from showing, continuously increasing interest payments to the FFB. Appropriations to liquidate the bank's debt would not affect the deficit, however, because they would be intragovernmental transactions.

Eximbank's Administrative Expenses

Subsidy cost appropriations based on estimates developed from private market yields--such as the estimates made by the Reagan Administration and CBO--implicitly include the present value of the administrative expenses associated with providing new credit assistance. Consequently, under credit reform, subsidy cost appropriations to Eximbank could be used to fund that portion of its administrative expenses.

The Administration's and the Senate-passed versions of credit reform differ on how to fund Eximbank's administrative expenses associated with old credit assistance--loans, guarantees, and insurance that it committed to provide before the implementation of credit

5. Export-Import Bank, "Eximbank Establishes Loan and Guarantee Loss Reserves" (January 4, 1990), p. 2.

reform. Under the Administration's version, Eximbank could use amounts collected by its liquidating account, and, when they were too low, sums it collected for the Treasury financing accounts. Under the Senate-passed version, which would consolidate all of Eximbank's nonsubsidized cash flows in its financing account, the bank could use sums collected by this account.

Under both versions of credit reform, the Congress could continue to enact annual limits on all of Eximbank's administrative expenses, including those for activities unrelated to providing credit assistance--marketing the bank's services, for example. In each year, the difference between the limit enacted and the collections available to finance Eximbank's administrative expenses would be scored as an appropriation. Because the means-of-financing modification would remove from the unified budget all nonsubsidized cash flows associated with Eximbank credit assistance, the full amount of annual limits on its administrative expenses would be scored as appropriations.

It is not now practicable, and may never be, to separate administrative expenses from the other components of estimated credit subsidy cost--interest subsidies and default losses. Moreover, Eximbank and other agencies do not account separately for administrative expenses associated with providing new credit assistance, providing credit assistance committed in the past, and performing other functions. To address these difficulties, GAO has suggested that credit reform could be implemented without including administrative expenses in the estimates of credit subsidy cost.[6] Under GAO's approach, analysts would have to reduce subsidy cost estimates developed from private market yields. All of Eximbank's administrative expenses would be financed with sums that it collected from borrowers (under the Administration's and the Senate-passed versions of credit reform) or with appropriations (under the means-of-financing modification).

6. General Accounting Office, *Budget Issues: Budgetary Treatment of Federal Credit Programs* (April 1989), pp. 18-19.

EXIMBANK'S TREATMENT IN THE UNIFIED BUDGET UNDER CREDIT REFORM

Implementing credit reform would change the treatment of Eximbank in the unified budget. Under the Administration's and the Senate-passed versions, budget authority would increase, relative to the CBO baseline, but total unified budget outlays would not change. Under the means-of-financing modification, budget authority would decline, while outlays would increase (that is, become less negative). Table 7 shows how the bank's spending would be treated in the unified budget if credit reform took effect in 1990. The figures in the table and in the text below are from the February 1989 CBO baseline, and are used for illustrative purposes only.

Eximbank's new budgetary treatment would reflect the separation of the subsidy cost of Eximbank's credit assistance, and the cost of its Tied Aid and administrative expenses, from the bank's nonsubsidized cash flows. These changes would affect how Eximbank's activities are accounted for in the unified budget, but would not affect the bank's relationships with borrowers and lenders. The remainder of this section discusses the accounting changes in detail.

Under both versions of credit reform and the means-of-financing modification, Eximbank would receive a subsidy cost appropriation in 1990 of $86.3 million. The appropriation would be scored as budget authority and would result in $12.4 million in outlays, the subsidy cost associated with loans the bank committed to assist in 1990 that were disbursed in that year. The new spending would appear in Eximbank's new subsidy account in function 150--International Affairs.

Administration's Version

Under the Administration's version, Eximbank's existing revolving fund would become a liquidating account. In 1990, budget authority for this account would be $114.5 million, CBO's estimate of the bank's Tied Aid appropriation. The account's outlays would be a negative $636.9 million--the sum of the cash flows associated with liquidating Eximbank's old credit assistance (negative $665.1 million) and its

TABLE 7. UNIFIED BUDGET TREATMENT OF EXIMBANK'S SPENDING IN FISCAL YEAR 1990, BY AGENCY AND BUDGET FUNCTION (In millions of dollars)

	Current Treatment		Administration's Version		Senate-Passed Version		Means-of-Financing Modification	
	Budget Authority	Outlays	Budget Authority	Outlays	Budget Authority	Outlays	Budget Authority	Outlays
			By Agency					
			Eximbank					
Existing Revolving Fund[a]	437.2	-573.4	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Subsidy Account	n.a.	n.a.	86.3	12.4	86.3	12.4	86.3	12.4[b]
Financing Account	n.a.	n.a.	n.a.	n.a.	424.8	-585.8	n.a.	n.a.
Liquidating Account[a]	n.a.	n.a.	114.5	-636.9	n.a.	n.a.	n.a.	n.a.
Tied Aid and Administrative Expenses Account	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	136.4[c]	28.2[c]
Subtotal	437.2	-573.4	200.8	-624.5	511.1	-573.4	222.7	40.6
			Treasury					
Direct Loan Financing Account[d]	n.a.	n.a.	691.7	96.3	n.a.	n.a.	n.a.	n.a.
Loan Guarantee Financing Account[d]	n.a.	n.a.	0	-45.2	n.a.	n.a.	n.a.	n.a.
Subtotal	n.a.	n.a.	691.7	51.1	n.a.	n.a.	n.a.	n.a.
Total	437.2	-573.4	892.5	-573.4	511.1	-573.4	222.7	40.6

SOURCE: Congressional Budget Office's February 1989 baseline and subsidy cost estimates in Table 6.

NOTE: n.a. = not applicable.

a. Under the Administration's version, Eximbank's existing revolving fund would become a liquidating account. The two accounts are shown separately, for clarity.

b. Under the means-of-financing modification, the subsidy account's outlays do not include the subsidy cost of credit assistance that CBO estimates Eximbank will provide in 1990, but which the bank committed to provide in previous years, because no appropriations to cover those costs were made, and no data exist to estimate them now. This temporary transition problem could be avoided by phasing in implementation of credit reform with the means-of-financing modification.

c. The subsidy cost appropriations shown in the table were estimated on the basis of private market yields and, therefore, would cover Eximbank's administrative expenses associated with providing new credit assistance. However, the budget authority and outlays for appropriations to the bank for

(Continued)

TABLE 7. Continued

	Current Treatment		Administration's Version		Senate-Passed Version		Means-of-Financing Modification	
	Budget Authority	Outlays	Budget Authority	Outlays	Budget Authority	Outlays	Budget Authority	Outlays
By Budget Function								
International Affairs (Function 150)								
Existing Revolving Fund[a]	437.2	-573.4	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Subsidy Account	n.a.	n.a.	86.3	12.4	86.3	12.4	86.3	12.4[b]
Financing Account	n.a.	n.a.	n.a.	n.a.	114.5	28.2	n.a.	n.a.
Liquidating Account[a]	n.a.	n.a.	114.5	-636.9	n.a.	n.a.	n.a.	n.a.
Tied Aid and Administrative Expenses Account	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	136.4[c]	28.2[c]
Subtotal	437.2	-573.4	200.8	-624.5	200.8	40.6	222.7	40.6
Credit Financing Activities								
Eximbank								
Financing Account	n.a.	n.a.	n.a.	n.a.	310.3	-614.0	n.a.	n.a.
Liquidating Account[a]	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Treasury								
Direct Loan Financing Account[d]	n.a.	n.a.	691.7	96.3	n.a.	n.a.	n.a.	n.a.
Loan Guarantee Financing Account[d]	n.a.	n.a.	0	-45.2	n.a.	n.a.	n.a.	n.a.
Subtotal	n.a.	n.a.	691.7	51.1	310.3	-614.0	n.a.	n.a.
Total	437.2	-573.4	892.5	-573.4	511.1	-573.4	222.7	40.6

c. Continued

Tied Aid and administrative expenses, shown under the means-of-financing modification, were not reduced to eliminate the duplication between the two appropriations, because no data exist that would provide a basis for doing so. Eliminating the duplication would reduce Eximbank's budget authority and outlays under the means-of-financing modification. The amount of the reductions would increase as more and more of the cost of administering the bank's credit programs was covered by subsidy cost appropriations.

d. The table shows only the portion of budget authority and outlays of the Treasury financing accounts attributable to Eximbank credit assistance.

disbursements for administrative expenses ($21.9 million) and Tied Aid ($6.3 million). The liquidating account would appear in function 150.

The Administration's version would create two new financing accounts in the Treasury--one for direct loans and one for loan guarantees. Both accounts would appear in the new budget function for credit financing activities. The direct loan financing account would include $691.7 million in budget authority and $96.3 million in outlays associated with Eximbank's lending in 1990. The budget authority would reflect the bank's new direct loan obligations ($713.1 million) and interest payments to the Treasury ($4.2 million), net of subsidy cost appropriations made to Eximbank and transferred to the account ($7.8 million) and fees, interest income, and loan repayments received from assisted borrowers ($17.7 million). The outlays would equal new loan disbursements ($117.6 million) and interest payments, net of transferred subsidy cost appropriations and collections from borrowers.

The loan guarantee financing account would be scored with outlays of negative $45.2 million in 1990 from new Eximbank guaranteed loan commitments. The figure would reflect disbursements for guarantee claims ($3.4 million) and purchases of assets ($13.9 million), net of fees collected from borrowers ($56.5 million), transferred subsidy cost appropriations ($4.5 million), and earnings on cash balances held at the Treasury ($1.5 million). The account would not be scored with any budget authority, since it would not need to borrow from the Treasury to finance its obligations associated with Eximbank guaranteed loan commitments in that year.

Senate-Passed Version

Under the Senate-passed version of credit reform, all of Eximbank's nonsubsidized cash flows would appear in a new bank financing account. The account would incur the same obligations as the bank's existing revolving fund, would receive the same collections from borrowers, and would be credited with collections equal to the subsidy cost account's outlays. Budget authority and outlays for the account in 1990 would total $424.8 million and a negative $585.8 million, respectively. Because the Eximbank financing account would receive $12.4 million from the subsidy cost account, these figures are $12.4 million less than the budget authority and outlays of the bank's existing revolving fund, under the current budgetary treatment of credit activity.

The budget authority and outlays in Eximbank's new financing account would include $114.5 million in budget authority for Tied Aid, and $28.2 million in outlays for Tied Aid and administrative expenses. These activities are costly to taxpayers and, therefore, would continue to appear in function 150, where they could be controlled in the budget process. The remaining spending in the financing account, associated with the bank's nonsubsidized credit cash flows, would appear in the new budget function for credit financing activities.

Means-of-Financing Modification

Under the means-of-financing modification, a new Eximbank account would be created to record appropriations to the bank for Tied Aid and for its administrative expenses. The account would receive $136.4 million in budget authority and $28.2 million in outlays in 1990. To enable these expenditures to be controlled in the budget process, the account, like the new subsidy account, would appear in function 150.

Administrative Expenses. The subsidy cost appropriations to Eximbank shown in Table 7 were estimated on the basis of private market yields and, therefore, would cover the bank's administrative expenses associated with providing new credit assistance. Once all old assisted loans were repaid or written off, subsidy cost appropriations would finance all of Eximbank's administrative expenses associated with providing credit assistance. During the transition period, however, the annual limits on Eximbank's administrative expenses would have to be reduced in order to eliminate the duplication between the two sources of funding. CBO did not reduce the appropriations for Tied Aid and administrative expenses shown under the means-of-financing modification in Table 7, however, because no data exist that would provide a basis for doing so. Eliminating the duplication would reduce Eximbank's budget authority and outlays under the means-of-financing modification. The amounts of the reductions would increase as more and more of the cost of administering the bank's credit programs was covered by subsidy cost appropriations.

Subsidy Cost Outlays from Old Commitments. The subsidy account's outlays would not include the subsidy cost of credit assistance that Eximbank had committed to provide in previous years and that CBO estimates the bank would provide in 1990. These costs would be unrecognized in the budget because no appropriations were made to cover them, and no data exist to estimate them now. The subsidy account's outlays would continue to understate the subsidies provided by Eximbank credit assistance until all loans that the bank had committed to assist before credit reform had been disbursed, or the borrowers had canceled their commitments. This temporary transition problem could be avoided by first implementing credit reform without the means-of-financing modification, and then moving nonsubsidized credit cash flows "below the deficit line" after all previous commitments to provide credit assistance had been honored or canceled.

Effect on the Deficit. Below-the-line treatment would increase Eximbank's outlays and the unified budget deficit by $614 million in 1990. The rise in outlays would be offset by an equal increase in the cash flows used to finance the deficit, so that no additional federal borrowing would be required and aggregate savings and investment would remain the same. The accounting change would not affect the level of subsidies provided by Eximbank, but would merely recognize the subsidies that the bank would provide anyway, at the time commitments were made.

Comparison of the Three Approaches

Under the Administration's version of credit reform, Eximbank's budget and budget function 150 would show all budget authority and outlays associated with assistance that the bank provided before credit reform, but only budget authority and outlays associated with the subsidy cost of its credit assistance, and Tied Aid, provided after credit reform. Under the Senate-passed version, Eximbank's budget would include all budget authority and outlays associated with its activity. However, only the subsidy cost of new bank credit assistance and the cost of Tied Aid would be included in function 150. Under both versions, Eximbank's budget authority would not measure the cost of all its administrative expenses, since some of them would be financed with nonsubsidized cash flows. Under the means-of-financing modification, the unified budget would include budget authority and outlays associated with the subsidy cost of new Eximbank credit assistance, Tied Aid, and the bank's administrative expenses. The spending would all appear in function 150.

EFFECTS OF CREDIT REFORM ON CONGRESSIONAL CONSIDERATION OF EXIMBANK'S PROGRAMS

Credit reform would reveal policy choices that cash-basis accounting currently obscures, and would change the allocation of Eximbank's spending among Congressional committees. Both changes could affect Congressional decisions about the bank.

Policy Choices Revealed by Credit Reform

The subsidy cost of individual federal loans and loan guarantees varies enormously. This variation reflects differences in the principal amounts, maturities, and interest rates of assisted loans, and in the credit risk of borrowers. It is subsidy cost, rather than the principal amounts of assisted loans, that determines the economic effects of federal loans and guarantees.[7] The lower the subsidy cost of a federal loan or guarantee, the more likely it is that the assisted loan will substitute for a loan that the borrower could have obtained from a private lender without federal assistance. The greater the probability of substitution, the more likely it is that the activity financed would have occurred without government assistance. Conversely, the higher the subsidy cost of credit assistance, the greater the probability that it will change the allocation of credit and the production of goods and services in the United States.

Because cash-basis accounting ignores the subsidy cost of loans and guarantees, elected officials currently have no way to appraise credit programs on the basis of their relative cost to the government and their potential consequences for U.S. economic activity. Using subsidy cost appropriations to measure and control the cost of credit programs would enable such choices to be articulated and made. Exim-

7. See, for example, William G. Gale, "Economic Effects of Federal Credit Programs" (Department of Economics, University of California at Los Angeles Working Papers, Number 483, June 1988).

bank provides two examples of policy choices that credit reform would illuminate: whether and how Eximbank loans should be targeted, and whether the subsidy cost of the bank's loans should be increased when domestic interest rates rise.

Targeting of Eximbank's Direct Loans. Eximbank currently targets its direct loans to support export sales facing subsidized foreign competition--that is, competition from foreign exporters who have received loan commitments from the export credit agencies of other governments. The subsidies provided by Eximbank's direct loans are greater on average than those provided by its guarantees and insurance of similar-maturity private loans, as shown in Chapter IV. Some U.S. exports faced with subsidized foreign competition probably would not occur without the additional subsidies provided by direct loans. The bank targets the assistance to those exports in order to maximize the probability that the composition of U.S. economic activity will be changed.

At the same time, Eximbank does not explicitly target its direct loans to borrowers in countries in any income category. The arrangement among OECD members on the interest rates that Eximbank and the other governmental export credit agencies may charge allows them to lend at lower rates to borrowers in poorer countries. A lower rate carries a higher subsidy cost, even when the borrower is thought to be a fairly good credit risk--as is, for example, the government of India. Eximbank's targeting policies reflect Administration guidelines rather than decisions made by the Congress.

Under credit reform, the Congress could legislate its intent about Eximbank's targeting policies by placing limits on the bank's credit authority and making subsidy cost appropriations. Suppose, for example, that the Congress wanted to keep Eximbank's direct loans at current levels, retain the policy of making loans only to finance exports faced with foreign competition, and, as part of a development policy, direct the bank to target a certain percentage of its lending toward exports to the poorest countries eligible for assistance. It could do this by raising the subsidy cost appropriation to Eximbank and expressing its intent that the bank pursue the new targeting policy. By combining different subsidy cost appropriations, limits on direct loan or loan guarantee authority, and legislative language, the Congress could support other policies.

Domestic Interest Rates and the Subsidy Cost of Eximbank Loans. When interest rates rise in the United States, the subsidy cost of Eximbank direct loans also increases. Under credit reform, if the Congress did not increase subsidy cost appropriations to Eximbank to offset the higher cost of new lending, the bank's loan volume would fall. This effect would be consistent with the tendency of higher U.S. interest rates to raise the relative value of the dollar and dampen demand for U.S. exports. If the Congress desired to maintain Eximbank's lending volume, it could provide higher subsidy cost appropriations to the bank.

Changes in the Amounts of Eximbank Spending Assumed in Allocations to Congressional Committees

Each year the Congressional budget process allocates specific amounts of budget authority, outlays, and credit authority to Congressional committees. These allocations are based on nonbinding assumptions about the amounts of spending and credit authority that the Congress could provide to individual agencies. Beginning with the 1985 budget resolution, the amounts of budget authority for Eximbank assumed in the Appropriations Committee allocations have been equal to the ceilings set on its new direct loan obligations. Similarly, CBO has scored the Foreign Operations Appropriation Acts with budget authority set equal to the loan limits that the legislation imposed on Eximbank.

These practices have had two effects on Congressional budgeting for Eximbank. First, because Eximbank's direct loan obligations have exceeded its budget authority in recent years, negative offsetting entries, which are not allocated to the Appropriations Committees or any other committees, have been inserted in the budget resolution assumptions in order to bring total budget authority for the bank back to the total amount assumed. Second, the information that the Budget Committees make available to the Appropriations Committees, which details the assumptions behind the allocations that the Appropriations Committees receive, has overstated the cost of Eximbank's credit assistance in the unified budget. Overstatement occurs because the direct loan authority provided to the bank exceeds the subsidy cost of its new loan obligations and guaranteed loan commitments. This overstatement may have disadvantaged Eximbank in the competition for budget or credit authority within the appropriation process.

Credit reform would alter the allocation of Eximbank's spending to Congressional committees. Table 8 shows how the Administration's and the Senate-passed versions could affect the amounts of budget authority and outlays for Eximbank assumed in the allocations in 1990. The figures assume that the allocations include the loan and guarantee levels in the February 1989 CBO baseline for the bank plus appropriations equal to the subsidy cost estimates developed in Chapter IV.

TABLE 8. HOW CREDIT REFORM WOULD CHANGE THE AMOUNTS FOR EXIMBANK ASSUMED IN ALLOCATIONS TO CONGRESSIONAL COMMITTEES FOR FISCAL YEAR 1990 (In millions of dollars)

	Amounts Assumed in Hypothetical Allocations			
	Under Current Treatment		Under Credit Reform	
	Budget Authority	Outlays	Budget Authority	Outlays
Administration's Version				
Appropriations Committees	723.5	-573.4	200.8	-624.5
Not Allocated to Committees	-286.3	0.0	691.7	51.1
Total	437.2	-573.4	892.5	-573.4
Senate-Passed Version				
Appropriations Committees	723.5	-573.4	200.8	40.6
Not Allocated to Committees	-286.3	0.0	310.3	-614.0
Total	437.2	-573.4	511.1	-573.4

SOURCE: Congressional Budget Office.

NOTE: The amounts assumed reflect the February 1989 CBO baseline estimates for Eximbank and the amounts in Table 7. The amounts assumed under current treatment are consistent with recent practice; the amounts assumed under credit reform reflect the changes in the budgetary treatment of Eximbank.

Both versions of credit reform would reduce the amount of budget authority for Eximbank assumed in the allocations to the House and Senate Appropriations Committees from $723.5 million to $200.8 million. The latter amount would include funds for Tied Aid ($114.6 million) and credit subsidy cost ($86.3 million). Under the Administration's version, outlays for Eximbank assumed in the allocations to those committees would decrease from a negative $573.4 million to a negative $624.5 million. The new figure would include disbursements for credit subsidy cost ($12.4 million) and the outlays of the new bank liquidating account (negative $636.9 million). Under the Senate-passed version, bank outlays assumed in the same allocations would increase to $40.6 million. That amount would include disbursements for Tied Aid ($6.3 million), credit subsidy cost, and administrative expenses ($21.9 million)

The revised amount of budget authority assumed in the allocations to the Appropriations Committees would accurately measure the cost of the CBO baseline levels of Eximbank's credit and grant programs. Whether this reduction in budget authority would affect the amounts of budget or credit authority given to the bank in the appropriation process would depend in part on how credit reform affected budget authority and outlays for other credit programs, particularly those within the jurisdiction of the Foreign Operations Subcommittees of the House and Senate Appropriations Committees.

Under the Administration's version of credit reform, two new financing accounts in the Treasury would borrow to finance new Eximbank loans, guarantees, and insurance. As shown in Table 8, the $691.7 million in budget authority and $51.1 million in outlays associated with the borrowing and the nonsubsidized cash flows from the accounts would not be allocated to any Congressional committee. Under the Senate-passed version, $310.3 million in budget authority and a negative $614.0 million in budget authority would not be allocated. These amounts would correspond to the borrowing and the nonsubsidized cash flows of the bank's new liquidating account.

EFFECTS OF UNANTICIPATED ECONOMIC CONDITIONS UNDER CREDIT REFORM

Unanticipated economic conditions might arise after the Congress had provided subsidy cost appropriations to Eximbank, but they would not be likely to disrupt the bank's loan guarantee and insurance programs. The subsidy cost of a loan guarantee depends principally on the borrower's credit risk, which changes slowly as overall economic conditions change. An unanticipated increase in interest rates probably would not raise the risks of guaranteed borrowers enough to increase significantly the subsidy cost of the loan guarantee authority provided to Eximbank in that year. At the same time, worsening economic conditions would occur slowly enough for the agency and the Congress to adjust for the trend by increasing subsidy cost appropriations.

The most likely effect of an unanticipated rise in interest rates would be to constrain Eximbank's direct lending. Since the OECD minimum lending rates are adjusted more slowly than the FFB adjusts Eximbank's cost of borrowing, an unanticipated rise in interest rates would increase the average subsidy cost of Eximbank's direct loans. The bank then might not be able to obligate all the direct loans authorized by the Congress without reducing the average subsidy cost of the transactions or receiving a supplemental subsidy cost appropriation. Lowering the average subsidy cost of direct loans would reduce their potential economic impact. If exporters were led to view Eximbank as an unreliable source of assistance, the bank might be less able to compete with other governmental export credit agencies that are less constrained in making subsidized export loans.

GLOSSARY

Above the Line/Below the Line: In the federal budget, this distinction indicates whether a payment or collection affects the deficit. Above-the-line cash flows affect the measured deficit; below-the-line cash flows do not, but are regarded instead as a means of financing the deficit. Under current federal accounting practice, both loan disbursements and collections are recorded above the line. An excess of repayments over disbursements reduces the deficit. In contrast, federal borrowing and repayments of federal debt are currently recorded below the line and do not affect the deficit.

Administration's Credit Reform Proposal: A proposal for legislative action from the Reagan Administration to the Congress that would have carried out a plan for credit reform. The proposal was also endorsed by the Bush Administration.

Appropriation Limitation: A statutory restriction in an appropriation act, which establishes the maximum or minimum amount that may be obligated or expended for a specified purpose.

Budget Authority: Authority provided by law to enter into obligations that will result in immediate or future outlays of government funds. For a lending agency such as Eximbank, budget authority measures the agency's net borrowings and any appropriations it receives.

Budget Documents: Materials submitted conveying the President's budget proposal to the Congress, including the Budget, Budget Appendix, Special Analyses, Historical Tables, The United States Budget in Brief, Major Policy Initiatives, and Management of the United States Government.

Cash Flows: Cash receipts and payments.

Credit Authority: Authority to incur direct loan obligations or incur primary guaranteed loan commitments.

Direct Loan: A disbursement of funds that is contracted to be repaid with or without interest. Two other types of transactions are also considered direct loans: (1) the purchase by the government of a private loan in the secondary market; and (2) a sale of agency assets on credit terms of more than 90 days.

Discount Rate: The interest rate used in determining the present value of future payments.

Discounting: The calculation of the present value of an amount to be paid in the future.

Discount from Face Value: The difference between face value and market value when market value is less than face value.

Face Value (of a Loan): Generally represents the amount of money borrowed to be repaid at a future date.

Financing Accounts: A new type of budget account to be created under credit reform. These accounts would receive subsidy payments from subsidy accounts and finance new direct loans and guarantees by borrowing the nonsubsidy portion from the Treasury. These borrowings would be repaid with fees and the proceeds of loan repayments.

Forfaiter: A private financial intermediary, usually a subsidiary of a commercial bank, that finances exports. The forfaiter (1) arranges for a highly rated entity in an importer's country to unconditionally guarantee notes issued by the importer to the exporter, and (2) purchases the notes from the exporter while forfeiting all right of recourse to the exporter in return for buying them at a discount from face value.

Guaranteed Loan Commitment: A legal or binding agreement by the federal government to guarantee, in whole or in part, the principal and/or interest on nonfederal loans when issued.

Intermediation Costs: The costs associated with financial intermediation--the process of raising funds from small investors and loaning the money in large amounts to those who want to purchase commodities.

Liquidating Accounts: A new type of budget account to be created under credit reform. These accounts would be credited and charged with the liquidation of credit assistance that an agency provided, and funds that the agency borrowed from the Treasury, before credit reform. The accounts would replace existing agency revolving funds.

Loan Guarantee: An agreement by which the government agrees to pay, in whole or in part, the loan principal and interest to a lender or holder of a debt security in the event of default by the borrower.

Maturity: The length of time between the disbursement of a loan and the date on which the last payment on the debt is due.

Means of Financing: Ways in which a budget deficit is financed or a budget surplus is used. A budget deficit may be financed by Treasury (or agency) borrowing, by reducing Treasury cash balances, by the sale of gold, by seigniorage on coins, by allowing certain unpaid liabilities to increase, or by certain equivalent transactions. Conversely, a budget surplus may be used to repay borrowing or to build up cash balances.

Nonsubsidized Cash Flows: Cash flows arising from the nonsubsidized component of a federal loan or guarantee. In a loan or guarantee, *all* cash flows except for the subsidy are nonsubsidized.

Obligations: Amounts of orders placed, contracts awarded, services received, loans committed to be made, and similar transactions during a budget period that will require payments or will otherwise have to be liquidated in the same or a later period.

Offsetting Collections from the Public: Collections from the public that are the result of business-type charges and, thus, are included in outlays rather than recorded as federal receipts.

Outlays: Payments to liquidate obligations that usually take the form of checks, cash, or electronic funds transfers. Negative outlays for a government activity occur when their offsetting collections exceed their outlays.

Present Value: The current value of a claim on an amount or series of amounts of money to be paid in the future. A sum of money to be received in the future has a lower present value than the nominal, future amount, because cash in hand can be invested at interest.

Private Borrower: A borrower that is a private firm or individual. For the market yield and subsidy cost estimates in this paper, all borrowers assisted by Eximbank are assumed to be either sovereign or private.

Revolving Fund: An expenditure account authorized to be credited with collections, primarily from the public, that are generated by and earmarked to finance a continuing cycle of operations.

Senate-Passed Credit Reform Proposal: For this paper, refers to Title III of H.J. Res. 324, Joint Resolution Increasing the Statutory Limit on the Public Debt, passed by the Senate on July 31, 1987. The title was dropped in conference.

Sovereign Borrower: A borrower that is a national government or one of its agencies.

Subsidy: A payment, benefit, or service underwritten by the federal government for which there is no current charge. Also refers to the provision of loans, goods, and services to the public at prices lower than market value, such as interest subsidies.

Subsidy Accounts: A new type of budget account to be created under credit reform. These accounts would receive appropriations and make subsidy payments to the financing accounts.

Subsidy Cost: The loss to the government on a federal credit transaction. In a direct loan, the government exchanges cash for a loan of lesser present value. In a loan guarantee, the government obligates itself to pay an expected sum whose present value exceeds any fee collected.

Tax-Based Resources: Payments by current and future taxpayers that the government uses or will use to finance its activities.

Treasury Securities: Debt instruments of various maturities sold by the Treasury, including Treasury bills (3 to 12 months), Treasury notes (1 to 10 years), Treasury bonds (more than 10 years).

SOURCES: Congressional Budget Office, based on General Accounting Office, *A Glossary of Terms Used in the Federal Budget Process* (March 1981); Congressional Budget and Impoundment Control Act of 1974, as amended; James L. Farrell, Jr., *Guide to Portfolio Management* (New York: McGraw-Hill, 1983); and Office of Management and Budget, *Budget of the United States Government, Fiscal Year 1989*, Parts 6b and 6e.