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STATEMENT OF

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BEFORE THE

SUBCOMMITTEE ON FOREIGN OPERATIONS

OF THE

HOUSE COMMITTEE ON APPROPRIATIONS

ON THE

FINANCIAL CONDITION OF THE EXPORT-IMPORT BANK

OF THE UNITED STATES,

ITS PROPOSED INTEREST MATCHING PROGRAM, AND

ALTERNATIVE FUNDING PROPOSALS

Mr. Chairman and Members of the Subcommittee:

I want to thank you for the opportunity to offer testimony today concerning the financial condition and reporting practices of the Export-Import Bank of the United States (the Bank). I also will address the Bank's proposed interest matching program, which is intended to replace its direct lending program, and the suggested alternative for appropriating funds to the Bank.

To summarize our views on these matters,

--We are concerned that the Bank's financial statements do not fairly present the full cost of the Bank's operations because the Bank does not recognize the significant losses inherent in its problem loans.

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--We believe that the proposed interest matching program would be more costly to the government than direct loans. We also believe it would be unfortunate if the proposed shift to loan guarantees--without changing the substance of the transactions--had the effect of taking the Bank's lending activity out of the budget.

--As a temporary measure, we believe there is merit in the proposal for a direct appropriation which would also serve as the Bank's annual limitation on direct lending. However, we believe any infusion of capital should be accompanied by a requirement that the Bank recognize loan losses in its financial statements through the establishment of an appropriate loan loss reserve.

THE BANK'S FINANCIAL POSITION

GAO annually audits the Bank's financial statements, and we are currently engaged in an audit of the Bank's fiscal year 1985 financial statements. I will discuss the results of our prior audits and our preliminary analysis of the Bank's 1985 financial data.

The Bank reported net losses in its fiscal years' 1982, 1983, and 1984 financial statements of $160, $247, and $343 million, respectively. In fiscal year 1985, the Bank will record a larger net operating loss, estimated to be about $378 million.

The yearly operating losses reported by the Bank result primarily from three sources: (1) the amount by which interest expense exceeds interest revenue, (2) the amount by which the cost of insurance and guarantee claims exceeds insurance premiums and guarantee fees, and (3) administrative expenses. These operating losses have reduced the Bank's retained earnings from $2.0 billion at September 30, 1982, to $1.4 billion at

September 30, 1984. By far, the largest source of losses reported by the Bank has been the negative interest rate differential. It is expected that the fiscal year 1985 loss will further reduce the Bank's reported retained earnings to about $1.1 billion.

This trend of increasingly larger reported losses is only part of the story. The Bank's accounting practices, which do not recognize loan losses, have resulted in retained earnings which are reported at artificially high amounts. In our view, the value of the Bank's loan portfolio is substantially overstated for the following reasons.

First, delinquent loans at September 30, 1982, were reported at $1.4 billion, or 8.3 percent of total loans receivable. Preliminary data as of September 30, 1985, show delinquent loans will be $2.8 billion, or 16.3 percent of total loans receivable.

Second, the total amount of loans receivable which had delinquent installments prior to a rescheduling has increased from $1.2 billion at September 30, 1982, to $3.4 billion at September 30, 1985. This represents an increase from 7 to 20 percent of total loans receivable. Reschedulings also distort the financial picture in another way since previously recorded but unpaid interest is consolidated into the current debt. Under current Bank accounting practices, this amount is assumed to be fully collectible. The Bank then also records interest on the total amount rescheduled. At September 30, 1984, total interest added to loan principal balances and included in the Bank's retained earnings was $267.6 million, up from $125.8 million at September 30, 1982.

The Bank also has recorded as income interest that has become delinquent. The Bank assumes the delinquent interest will be collected and does not provide for any allowance for loss. That delinquent interest at September 30, 1984, was $278.1 million, up from $149.0 as of September 30, 1982.

Finally, the Bank operates guarantee and insurance programs. Under these programs, when a borrower defaults on an insured loan and the Bank is obligated to pay a claim, the Bank often treats the claim payment as a loan receivable. The net loans purchased, which are included in loans receivable, more than tripled from $288.5 million in 1982, to $984.2 million in 1985.

We consider loans that are currently delinquent, under reschedulings, or recorded as loan purchases to be "problem" debt because they exhibit characteristics suggesting that a significant portion will ultimately prove to be uncollectible. The total problem debt, as of September 30, 1982, was $2.1 billion, or 12.7 percent of total loans; by 1984, that problem debt had more than doubled to $4.7 billion, or 26.3 percent of total loans. These amounts will again increase for fiscal year 1985.

Our attached analysis of the Bank's financial condition indicates that the amount of problem loans is increasing while the Bank's retained earnings are dwindling. At September 30, 1982, problem loans were roughly equal to the Bank's retained earnings. However, by September 30, 1984, problem loans, as a percent of the Bank's retained earnings, had risen to 322 percent. Preliminary estimates indicate problem loans will exceed 400 percent of the Bank's retained earnings as of September 30, 1985.

It is important for me to point out that we are not criticizing the Bank's rescheduling practices; these are policy decisions between the Congress and the Bank. We are concerned, however, that the results of these policies are not appropriately accounted for and fully disclosed in the Bank's financial statements.

Fair presentation of loans receivable requires a recognition in the accounts of the diminished value of loans through a charge against current year's income and a corresponding increase in an allowance for loan losses. The Bank has not recognized that its loans are impaired--even when the foreign governments repudiate the debts. The result, in our opinion, is a loan balance which is not fully collectible and, accordingly, is overstated.

The Bank reported retained earnings of $1.4 billion as of September 30, 1984. If an allowance for estimated loan losses had been provided, we estimate the Bank's retained earnings would decrease by $1.0 to $1.5 billion. This would result in a retained earnings of between $400 million and a deficit of $100 million, as of September 30, 1984. Admittedly, our approach involves judgment, but determining an allowance for losses, a common practice of financial institutions, is rarely subject to precise measurement.

One significant result of not recognizing loan losses is the potential impact on congressional oversight. As shown on the statements, the Bank's financial position does not appear as severe as it is in reality, and the Congress may be led to make policy decisions that it would not otherwise make were the Bank's true financial condition fairly presented.

THE BANK'S PROPOSAL FOR AN INTEREST MATCHING PROGRAM

The Bank proposes to restructure its subsidized loan program to finance the loans with agency guaranteed borrowing rather than by Treasury borrowing. In its fiscal year 1987 budget request the Bank is requesting authority to provide interest subsidies on $1.8 billion of guaranteed export loans to counter foreign government-supported export credit subsidies. Lenders would be selected competitively but would be guaranteed payment of interest and principal. Since the interest rate arranged for an export loan may be below the market rate at which the commercial lender would normally make such a commitment, the Bank will pay the commercial lender the differences between the rate committed on the loan and the market rate. The Bank estimates that the present value of the subsidy associated with the $1.8 billion over the life of the credit would be about $100 million.

One possible effect of this proposal is to take Bank transactions off budget for the purpose of calculating the federal budget deficit. The impact on the economy of a government loan guarantee is similar to that of a direct government loan. The Congressional Budget Office (CBO) has noted that the substance of the transaction will not change, only its form. CBO has thus decided that the budgetary scorekeeping of the transactions should not change. We agree that it would be unfortunate for form to triumph over substance, particularly in the Gramm-Rudman-Hollings era, when the way we decide to count things can cause real differences in the results.

Also, the proposal would incur increased cost to the government; that is, it would be more expensive for the government to provide a loan guarantee coupled with a subsidy to reduce interest rates than to provide a comparable direct loan with an equivalent interest rate. The reason is that the cost to commercial lenders of borrowing with a government guarantee is higher than the cost to the U.S. Treasury of borrowing on comparable terms. The cost differential would probably range between 25 to 75 basis points. Therefore, any subsidized loan guarantee would have to include the cost of this differential in its direct cost. Hence, the added cost in the first year on the first $1 billion in subsidized loan guarantees used in place of direct loans could be $2.5 million to $7.5 million. If such a program were continued at a constant level for several years, the annual cost would get substantially larger--by the fifth year, the additional annual costs could be $12.5 million to $37.5 million if the loans all have a term of at least 5 years. On a present value basis, these costs would range from $10.8 million to $32.3 million.

ALTERNATIVE APPROPRIATIONS PROCEDURES

You also asked that we address alternative methods for appropriating funds to the Bank. We understand that a suggestion has been made to provide a direct appropriation to the Bank which would also serve as the Bank's annual limitation on direct lending.

As we have already observed, if the Bank's financial statements properly reflected the quality of its loan portfolio by establishing an appropriate loan loss reserve, the Bank's total capital and retained earnings would be substantially less than is currently reported.

Under these circumstances, an appropriation to restore the Bank's capital may well be appropriate. However, the amount of the capital infusion needed is not necessarily the same as the level of direct lending which may be appropriate for any given fiscal year. If an appropriation of that size were provided every year, it would soon produce a level of capitalization well in excess of the Bank's needs.

Accordingly, if Congress choses to link the two items in a single number this year, we suggest that you make it clear that this is a temporary measure and that it should not be viewed as a long-term precedent. In addition, we urge that any infusion of capital be accompanied by clear direction to the Bank that its financial statements should reflect an appropriate loan loss reserve. Once the Bank's capitalization has been properly stated on its financial statements and restored to an appropriate level, we suggest that the Congress consider an annual appropriation to restore any further depletion that will have been reflected in the audited statements.

GAO ANALYSIS OF THE FINANCIAL CONDITION OF THE EXPORT-IMPORT BANK OF THE UNITED STATES
(ALL AMOUNTS IN MILLIONS)

		(4) (UNAUDITED) FY 85	FY 84	FY 83	FY 82
LOANS RECEIVABLE		$16,860	$17,504	$16,883	$16,565
PROBLEM LOANS	(1)				
DELINQUENT LOANS		$2,753	$2,707	$1,904	$1,377
% OF TOTAL LOANS		16.3%	15.5%	11.3%	8.3%
RESCHEDULINGS		$3,370	$1,546	$1,194	$1,178
% OF TOTAL LOANS		20.0%	8.8%	7.1%	7.1%
LOANS PURCHASED		$984	$757	$397	$289
% OF TOTAL LOANS		5.8%	4.3%	2.3%	1.7%
TOTAL PROBLEM LOANS	(2)	(5)	$4,663	$2,654	$2,098
GROWTH (FY82 BASE)		(5)	222%	126%	100%
REVENUES:					
INTEREST REVENUE		$1,478	$1,458	$1,342	$1,272
FEES, PREMIUMS & MISC		$85	$99	$82	$124
EXPENSES:					
INTEREST EXPENSE		$1,828	$1,746	$1,624	$1,479
NET LOAN WRITE-OFFS	(3)	$5	($20)	$5	$32
NET CLAIMS PAID	(3)	$78	$139	$14	$25
ADMIN AND OTHER		$30	$35	$27	$20
NET LOSS		($378)	($343)	($247)	($160)
CAPITAL		$1,000	$1,000	$1,000	$1,000
RETAINED EARNINGS		$1,072	$1,450	$1,792	$2,040
CAPITAL AND RETAINED EARNINGS		$2,072	$2,450	$2,792	$3,040
UNREALIZED INTEREST INCOME					
RESCHEDULED		$394	$268	$199	$126
DELINQUENT		$315	$278	$186	$149
CAPITAL AND REALIZED EARNINGS		$1,363	$1,904	$2,407	$2,765
TOTAL PROBLEM LOANS		(5)	$4,663	$2,654	$2,098
AS A % OF RETAINED EARNINGS		(5)	322%	148%	103%
AS A % OF CAP & RETAINED EARN		(5)	190%	95%	69%
AS A % OF CAP & REALIZED EARN		(5)	245%	110%	76%

NOTES:

1- LOANS THAT EXHIBIT CHARACTERISTICS THAT LEAD TO DELINQUENCY AND ULTIMATE UNCOLLECTIBILITY
2- EXCLUDING DOUBLE-COUNTING AMONG CATEGORIES
3- INCLUDES "LAKER AIRWAYS" LOSS OF $50M IN FY82 AND $35M GAIN IN FY84
4- PRELIMINARY FY85 DATA; UNAUDITED
5- AMOUNT AND PERCENTS CURRENTLY UNAVAILABLE; WILL INCREASE OVER FY84