UNITED STATES GENERAL ACOUNTING OFFICE

WASHINGTON, D.C. 20548

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STATEMENT FOR THE RECORD

BY

INTERNATIONAL DIVISION

U.S. GENERAL ACCOUNTING OFFICE

SUBMITTED TO THE

SUBCOMMITTEE ON INTERNATIONAL TRADE, INVESTMENT

AND MONETARY POLICY

HOUSE COMMITTEE ON BANKING, FINANCE AND URBAN AFFAIRS

ON THE

FINANCIAL CONDITION OF THE U.S. EXPORT-IMPORT BANK

Mr. Chairman and Members of the Subcommittee:

We are pleased to provide you with information concerning the financial condition of the Export-Import Bank. We annually audit the Bank's financial statements pursuant to 31 U.S.C. 9105 and recently completed our fiscal year 1982 audit and our report will be issued soon. This statement will discuss the results of our fiscal year 1982 audit as well as issues discussed in our most recent report.[1]

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1 "Examination of Export-Import Bank's Fiscal Year 1981 Financial Operations and Related Issues" (GAO/ID-83-12, Nov. 18, 1982).

RESULTS OF OUR FINANCIAL AUDIT AND THE DETERIORATION OF EXIMBANK'S RESERVES

We are qualifying our opinion on the fiscal year 1982 financial statements because we were unable to express an opinion on the adequacy of Eximbank's reserve for contingencies and defaults. Due to a net loss in fiscal year 1982 ($159.8 million) the reserve decreased, and the risk that it will incur further reductions from possible future losses increased due to

--increased loan purchases, outstanding purchase agreements, and principal and interest delinquencies,

--the uncertain nature of future foreign economic and political conditions, and

--the Bank's average borrowing rates continuing to be higher than its lending rates.

The amount reserved for contingencies and defaults has been the basis of our qualified opinions on Eximbank's financial statements since fiscal year 1975.

In our 1975 report,[2] we said that additions to the reserve were not keeping pace with the growth of Eximbank's outstanding commitments. This has continued to be the case. Between fiscal years 1975 and 1982, the reserves increased from $1.6 billion to $2.0 billion or by 25 percent. In contrast, outstanding commitments increased from $13.1 billion to $22.9 billion or by 75 percent. Outstanding commitments consist of loans, guarantees, and insurance. Eximbank's outstanding commitments are now more than 11 times larger than the amount of the reserve.

We are particularly concerned that the amount of principal and interest delinquencies, loans purchased, and outstanding loan purchase agreements has increased over recent years and now exceeds the amount of Eximbank's reserves.

The entire principal balance of a loan is considered delinquent when any installment of principal or interest is past due 90 days or more. The outstanding principal amount of delinquent loans included in loans receivable increased by 90 percent from $735.9 million at the end of fiscal year 1980 to $1.4 billion at the end of fiscal year 1982. These amounts included $494 million and $643 million of installments past due 90 days or more, respectively. Of the past due amounts, $305.7 million results from an acceleration of the repayments schedule for loans made to or guaranteed by the Government of Iran. Also, total earned but uncollected interest on delinquent loans included in Eximbanks reserves increased by 34 percent from $165 million as of the end of fiscal year 1980 to $221 million at the end of fiscal year 1982.

Loan purchases occur when a borrower defaults on a loan and Eximbank is obligated to pay a claim under a guarantee or insurance agreement with a commercial bank. The claim payment is treated as a loans receivable when, in the opinion of Eximbank's Board of Directors, the prospect of repayment and other factors justify such treatment. The net loan purchases pursuant to Eximbank guarantee and insurance agreements included in loans receivable increased from $191.3 million to $288.5 million, or by 51 percent, between fiscal years 1980 and 1982. Still outstanding at the end of fiscal year 1982 were $390.1 million in prospective additional loan purchases relating to the above guarantee and insurance agreements.

The schedule below compares the reserve to possible losses arising from loan delinquencies, purchased loans, and outstanding purchase agreements for the past 3 fiscal years.

	Fiscal year		
	1980	1981	1982
	-----(in millions)----		
Retained income reserve			
Per financial statements	$2,187	$2,200	$2,040
Less uncollected interest and fees	165	173	221
Adjusted reserves, net of uncollected interest and fees	$2,022	$2,027	$1,819
Delinquent, purchased loans and outstanding loan agreements			
Delinquent loans	$ 736	$ 888	$1,400
Purchased loans	191	245	289
Outstanding purchase agreements	213	270	390
Total	$1,140	$1,403	$2,079
Difference between net reserves and known possible losses	579	214	(260)

The schedule shows that although Eximbank's reserve was adequate to cover possible losses arising from current loan delinquencies as well as defaults to private creditors that had been identified for fiscal years 1980 and 1981, the reserve was inadequate to cover such known possible losses in fiscal year

1982. This was mainly due to the 58 percent increase in delinquent loans and the reduction of the reserve due to Eximbank's net loss in fiscal year 1982. If possible future losses occur, it will further impair Eximbank's ability to absorb such losses from its reserves.

It cannot be predicted whether the delinquent, purchased, and prospective purchased loans discussed above will eventually be paid or become losses. However, if losses from these items do occur to the extent that Eximbank is unable to meet such losses from its reserves, it would have to borrow to cover the shortage. As a result, Eximbank would suffer an additional financial burden from the interest cost for these borrowings.

Associated with the widening gap between additions to the reserve and outstanding commitments, is another trend which has serious implications for the Bank's financial condition. This is not being able to maintain an adequate interest rate spread between current lending and borrowing. In our report of June 24, 1981,[3] we concluded that with a negative spread of 2 percent or more between lending and borrowing costs, losses will commence in fiscal year 1982 and Eximbank's reserve will be depleted by the end of the decade.

The above spread is far from being realized. The average cost of the Bank's debts exceeded the rate earned on all outstanding loans by 2.9 percent at the end of fiscal year 1981,

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[3]"To be Self-Sufficient or Competitive? Eximbank Needs Congressional Guidance" (ID-81-48, June 6, 1981).

and by 3.4 percent at the end of fiscal year 1982. The effect of this increasing negative spread has been to significantly reduce Eximbank's profitability. Its net income of $12.1 million for fiscal year 1981 was about $100 million less than the previous year, and as previously stated the Bank suffered a loss of $159.8 million for fiscal year 1982. Its net loss for the first 5 months of fiscal year 1983 is $112 million. It should be noted that $50 million of the fiscal year 1982 loss resulted from losses from the default on Eximbank loans and guarantees by Laker Airways Limited, when Laker declared bankruptcy in February 1982.

In our November 1982 report, we said that Eximbank took steps to reduce its spread between borrowing and lending by raising its direct lending rate for non-aircraft transactions from 8.75 percent to 10.75 percent in July 1981, and again to 12 percent in November 1981. However, between September 1981 and March 1982, interest paid by Eximbank on funds from the Federal Financing Bank, its borrowing source for medium- and long-term needs fluctuated between 14 and 15.7 percent. As a result, a negative difference of 2 to 4.8 percent existed during this period. We concluded that although the above increases in Eximbank lending rates have reduced the negative spread to a more favorable level, the spread has not been reduced sufficiently to preclude projected losses, and the possible depletion of the reserve by the end of the decade.

The widening gap between the reserve and the Bank's outstanding commitments also has been affected by a costly arrangement with PEFCO, a Government-sponsored commercial corporation which raises funds for export financing in the private market using unconditional Eximbank guarantees. Eximbank's relationship with PEFCO is not new, but in September 1980 the Bank entered into a unique agreement with PEFCO to guarantee $1,099 million in loans for which it will incur substantial increased costs. Eximbank guarantees normally do not require it to make a financial outlay unless a borrower defaults. The September arrangement is unique because Eximbank has agreed to reimburse PEFCO for the difference between the latter's interest charges and the rates at which the loans were committed. By doing this, Eximbank is in effect subsidizing the interest spread between PEFCO's cost of funds and the interest rate charged the borrower.

The increased cost to be incurred by Eximbank under the PEFCO agreement can be viewed as the difference in the interest rate charged by PEFCO for its portion of loans under the agreement and the interest rate at which these loans were guaranteed to the borrowers by Eximbank. This cost cannot be determined until the loans are disbursed.

Our June 1981 report estimated that Eximbank will incur increased costs of $313.2 million under the agreement, on the basis of the then-current cost of borrowing by PEFCO of 13.75 percent. We calculated that Eximbank would subsidize an average interest differential of 4.75 percent. This is the difference between PEFCO's cost of funds (13.75 percent) and the 9-percent average interest rate for the loans made to the borrowers.

In our November 1982 report, we reported that as of May 1982, $210 million had been disbursed under the agreement, and the actual increased cost to Eximbank to subsidize the interest differential for these disbursements was $89.4 million. Whether the total increased costs to Eximbank under this agreement will reach or exceed our prior estimate of $313.2 million will depend on the trend in interest rates during the time the remaining $890 million under the agreement are disbursed. Regardless, we believe that the PEFCO agreement is costly and that such agreements should be avoided in the future.

DILEMMA BETWEEN BANK'S SELF-SUPPORTING AND COMPETITIVENESS OBJECTIVES CONTINUES

Although we believe that Eximbank's reserve is subject to further reductions, we are also mindful that the Bank continues to be faced with a familiar, but nevertheless difficult, dilemma. The Bank is admonished by law to meet the competition, and it has attempted to do so while operating on a self-supporting basis. From 1934 through 1966, it was able to charge more for loans than they cost. Earnings were partly paid to Treasury in the form of dividends of $1.05 billion while the Bank amassed a reserve of $2.2 billion. Although the Bank generally has had a negative spread between the average interest rate on its loan portfolio and the average rate on outstanding debt since 1966, it managed to continue to show a profit through 1981 because of interest earned on loans financed by its reserve (currently $2.0 billion) and $1 billion of initial capital on which it pays no interest. However, due to the continued concessionary lending in the face of historically high interest rates, the Bank has shown decreasing profits in recent years and, as noted earlier, experienced its first loss in fiscal year 1982. Future losses are predicted and the need for increased borrowing or approriated funds seems probable if the Bank's current financial condition continues to deteriorate.

In our April 1980[4] and June 1981 reports on Eximbank's competitiveness, we suggested several alternatives regarding possible congressional involvement in determining future Bank lending. We will not repeat them here, other than to say in essence that, when circumstances make the Bank's basic objectives simultaneously unattainable, the Congress should either direct Eximbank to emphasize

--its statutory mandate to be competitive over its longstanding and congressionally accepted policy of being self-sustaining, or

--this implied mandate to be self-sustaining over its statutory requirement to be competitive.

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4 "Financial and Other Constraints Prevent Eximbank from Consistently Offering Competitive Financing for U.S. Exports (ID-80-16, April 30, 1980).

We believe Eximbank's current financial dilemma has intensified to the point where the Congress needs to clarify its intent. If the mandate to meet the competition is emphasized over self-sufficiency, some form of subsidy for the Bank's lending activity with public funds could be necessary. If the Congress does not intend that meeting the competition be given predominance in the current situation, then it should affirm that fact by indicating what it believes is acceptable lending policy. In any event, it is now clear that increased congressional involvement is needed in determining Eximbank's export financing policies.