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INNOVATION FACT SHEET:

EX-IM BANK

The Export-Import Bank Works For America: Responses to 18 Arguments for Cutting Ex-Im's Authorization

The United States is falling behind in global economic competition, with the result being lost jobs and a rising trade deficit. One reason for this fall is that international trade has become much more competitive. U.S. enterprises are up against formidable competitors, many of them receiving significant support from their governments as they seek to win in the race for economic advantage and the jobs that go with it.

One key factor in this competitive race is export financing. Foreign competitors enjoy substantial and growing support from their countries' export credit agencies (ECAs). Indeed, many of the United States' strongest international trade competitors invest significantly more in export credit assistance as a share of both GDP and exports than the United States does. With the temporary reauthorization of the U.S. Export-Import (Ex-Im) Bank set to expire on May 31, 2012 and as the U.S. Congress looks to reauthorize the Bank for a new five-year term, some free-market or libertarian organizations (e.g., Cato Institute, Club for Growth, Citizens for Limited Government, etc.) have been arguing against reauthorization, making a number of claims about why Ex-Im is not needed. Most of these arguments are not grounded in analysis, but rather are ideological in nature, based on faulty theories and assumptions about markets, globalization, competitiveness and trade. Here is a brief list of the common arguments made by Ex-Im opponents and why they are wrong.

1) "We have always been a nation of free enterprise. It has set us apart from most others and allowed us to lead the world in innovation and entrepreneurialism. But today, those underpinnings of our success are under threat. Government has become a behemoth that is overtaking industries and distorting markets in such a way that competition and self-reliance as we know it are barely recognizable."[1]

America has never been a nation of pure free enterprise. From the very start of the Republic, the founding fathers understood that absent national government leadership America would remain "hewers of wood and drawers of water." Alexander Hamilton, our first Treasury Secretary, issued his "Report on Manufacturers" in 1791 and recommended policies to industrialize our nation so it would not be a natural resource "colony" of Great Britain. From development of canals, the railroad, the Springfield Armory and interchangeable parts, to the creation of the Radio Corp of America (RCA), DARPA and the development of the Internet, the reality is that America has always been a nation where the private sector generated most economic growth, but was supported by smart government policies. If anti-Ex-Im advocates want to argue that today is different, that's fine. But to invoke our nation's tradition to argue against Ex-Im is a fundamental misreading of American history.

2) Clearly, the federal government cutting checks abroad to finance the purchase of American goods is not a core function of government.[2]

If, by core, you mean a Lockean notion of the role of government as limited to defending our nation and enforcing laws, then yes. Ex-Im is not a core function. But neither are national parks, ensuring the safety of the food supply, ensuring universal K-12 education, etc. If you define "core" as meaning a government action to promote economic welfare that the private sector acting alone will underperform at, then clearly Ex-Im financing is a core function.

3) "The reauthorization of the Export-Import Bank is a case study in Washington bureaucrats picking winners and losers and interfering with the free market."[3]

Anytime one wants to criticize government, just throw out the "B" word: bureaucrat. It's Washington bureaucrats that are the problem, implying that all government workers are incompetent or merely get in the way. The reality is that as an independent federal agency, Ex-Im is staffed with professionals who understand banking and export financing.

4) "The real problem is that the Bank's financing helps some companies to the detriment of other firms and taxpayers."[4]

Yes, that is exactly what it does and that is exactly what most economic policy does. In this case, it is because all else being equal, traded sector firms are more important than non-traded sector firms. In other words, the United States has a stake in having a healthy balance of trade. This comes from enterprises in the U.S. in industries in global markets (e.g., automobiles, aviation, biotechnology, mining, agriculture, etc.) being competitive. If these enterprises are not competitive, the U.S.

economy cannot grow at a robust pace. So yes, the Bank does focus on traded sector firms, and rightly so. And those who think taxpayers are hurt when U.S. companies are globally competitive and exports are robust have an odd sense of what is good for taxpayers, whom by the way, are also employees and consumers.

Moreover, the Bank doesn't arbitrarily hand-select winners and losers to finance, rather it follows well established screening criteria and rigorous review procedures when selecting and executing its financing agreements. These include screens to assess whether the financing would be detrimental to existing U.S. industries.

5) The Ex-Im Bank at best recreates, and at worst misallocates, private financial behavior.[5]

If the private market wisdom is the standard by which allocation decisions are judged, exactly how did major private sector banks buy up worthless mortgages just months before the collapse of the real estate bubble when it was clear that the default rate on these mortgages would be extremely high? This was misallocation of societal resources on a massive scale. Moreover, the fallout of their actions was not just on their shareholders, it was on the global economy. Government had to step in after market dynamics nearly led to a second Depression. The idea that the markets always get it right and government does not is clearly not valid.

6) Our Congressional Scorecard for the 112th Congress provides a comprehensive rating of how well or how poorly each Member of Congress supports pro-growth, free-market policies, and will be distributed to our members and to the public.[6]

While shutting down Ex-Im may be a "free-market policy" it is not a "pro-growth policy" since it will lead to fewer exports, a lower value of the dollar (meaning lower purchasing power for U.S. consumers) and lower-wage jobs. This is in part because jobs in exporting industries pay more than other jobs in non-exporting industries. Free market and pro-growth are not always synonymous (see #4.)

And in fact, when the term "free market" is bandied about without acknowledging that global markets aren't idyllically "free," bur rather that they are readily characterized by the intentionally distortive mercantilist policies of foreign governments (not to mention the legitimate policies countries undertake to support their enterprises) then not only is a blindly "free market policy" not a "pro-growth policy," it is a sure-fire recipe for the U.S. losing exports, market share, and employment in key traded sector industries.

7) The Ex-Im Bank was a New Deal program founded in the mid-1930s to assist with the export of American goods. Among other things, it provides loans using funds backed by the full faith and credit of the American people. This means Joe and Jane Taxpayer are responsible for the Bank's activities.[7]

It also means that Joe and Jane taxpayer are beneficiaries of the Bank's activities. The $34.4 billion in exports backed by the Bank and the 227,000 jobs, many of them high-wage, that come from these exports benefit Joe and Jane Taxpayer directly if they happen to work at one of the 3,300 firms getting Ex-Im financing, or at those firms' suppliers, or a business in the community where the Ex-Im beneficiary firm or supplier is located. They benefit indirectly by having a larger economy. More and higher wage jobs mean higher total U.S. tax revenues and lower government costs (e.g., unemployment insurance). Moreover, the Ex-Im Bank has returned $3.4 billion to the U.S. Treasury above and beyond the cost of its operations over the past five years and has achieved a loan default rate of less than 1.5 percent. So Joe and Jane taxpayer have benefited from Ex-Im activities.

8) The Ex-Im Bank provides taxpayer-subsidized loans to U.S. exporters under the auspices of increasing exports, but according to *Wall Street Journal*, Ex-Im's contribution to increasing exports is "negligible."[8]

There is no silver bullet to restoring U.S. competitiveness and expanding exports. It will require an array of policies—tax reform, trade enforcement, investments in education and R&D, and export financing — each of which will play a unique and complementary role. To hold Ex-Im to the standard of whether it alone plays a large role in expanding exports is unfair. Moreover, it's disingenuous to argue for cutting Ex-Im authorization levels while at the same time complaining that its impact is too low. If they want a larger impact, they should support expanding Ex-Im authorization levels.

9) The Bank makes contradictory claims about the nature of its activities. While maintaining that it does not displace private-sector activity, the Bank argues that it takes a conservative approach to lending and finance. But if the bank's transactions were "sure bets," then the private sector would—and should—be expected to step in. If, on the other hand, the private sector wouldn't finance a transaction, it is a signal that taxpayers should not be exposed to the risk, either. [9]

This is exactly the risk portfolio the Bank should take. It clearly does not want to fund extremely low-risk activity since private lenders should and do fund this. And it clearly does not want to fund extremely high-risk activities where the expected net return is negative. But there is a middle ground that is appropriate for the Bank to fund those kinds of investments that lead to a high social return to the entire economy that is greater than the rate of private return. In other words, overall U.S. economic welfare is maximized if the Bank funds those activities that have high total societal returns relative to risk but have lower private rates of returns such that private banks may not want to fund them.

10) And if banks decide against providing some of these companies with loans, shouldn't that tell us something?[10]

It likely tells us that they don't care (nor should they) with externalities and the national interest. If one assumes that private interest always equals public interest then this point is valid. But economists have long shown that the private and social rates of return (social rate of return equals the private rate plus the spillovers) are not the same and that smart government policies can maximize the latter.

That is what Ex-Im financing does. From a private interest perspective, financing for a retail store and financing for a high value-added, traded sector firm competing in global markets are the same. From a national interest perspective they are not the same.

As Harvard economist F.M. Scherer explains with respect to this view that the market acting alone maximizes economic output, it "assumes perfect competition, constant returns to scale, and the absence of externalities. All three assumptions have been questioned, often convincingly, by new growth theorists."[11]

11) But even if some U.S. exporters may be harmed by foreign subsidies, it does not follow that the harm to the overall economy is sufficient to warrant federal intervention on their behalf.[12]

But this is only true if you believe that consumer welfare is the only thing that matters and that the trade deficit is not a problem. In fact, the loss of U.S traded sector competitiveness, especially the decline of U.S. manufacturing output by 11 percent in the last decade, is a real problem for the U.S. economy going forward.[13] The idea that the U.S. economy can be healthy with only grocery stores, electric utilities, professional sports, and insurance companies is fundamentally misguided. Unless the United States also has a healthy traded sector it won't be able to create higher-wage jobs at a robust rate and it won't be able to maintain global terms of trade (e.g., a stronger dollar) that is in the national interest.

12) While the administration argues that we need to increase funding for Ex-Im to match increased export credit activity by countries such as China, allowing Beijing to set the terms and pace of export credit policy in the United States is foolhardy at best.[14]

We may not like the fact that Beijing is setting the terms and pace of export financing policy but it does. This would have been akin to saying during the Cold War, "to let Moscow set the terms and pace of military spending in the United States is foolhardy at best." Moreover, as #13 explains, it's not like China is the only country that aggressively uses export financing. (Although China does go further than most countries by often condition their dispersal of foreign aid to countries to those countries purchasing Chinese exports, with China's Eximbank providing the export credit financing for those transaction).

As such, the United States really has only three choices: 1) Unilateral disarmament; 2) Expansion on Ex-Im financing to try to level the playing field; or 3) Globally binding treaties limiting export financing. The first option would result in an even greater loss of U.S. traded sector (and manufacturing) capacity than has already been the case. The third might be the ideal policy, but it won't happen anytime soon and the odds of it happening if the United States unilaterally disarms first are close to zero. The second is the only viable policy choice now.

13) In any case, the idea that the United States suffers from a prohibitively tilted playing field is questionable.[15]

A key argument for the Ex-Im Bank is that firms in the United States face an un-level playing field when it comes to trade. It's hard to see how anti-Bank advocates can make this claim when the U.S. corporate tax rate is the highest in the world, other nations manipulate their currency, have more closed markets and provide much higher subsidies. Even when looking only at export financing, the United States badly trails many nations, including Brazil, Canada, China, Germany, and India in new medium- and long-term official export credit volumes as a share of GDP. In fact, in 2010, Brazil's and China's export-import banks provided ten times more financing to their exporters as a share of GDP than the U.S. Ex-Im Bank provided to its. France and India both provided at least seven times more export assistance as a share of GDP than the United States did in 2010.[16] In 2011, Germany invested almost as much in export credit financing, about $29 billion, as the United States did, $32.7 billion, despite the fact their economy is one-quarter the size of America's.

14) With freer trade, resources flow from less competitive uses to more competitive and efficient uses, creating opportunity and bolstering long-run economic growth and job creation.[17]

This is basically a reflection of what is known as classical Ricardian trade theory which assumes that a nation's comparative advantage is static (e.g., some countries are good at wine, others at textiles). In this case, market forces alone dictate the industrial composition of a nation and these forces maximize economic welfare. But "new trade theory" holds that nations can develop competitive advantage (e.g., become good at textiles as well as wine) through economic policies and that market forces alone may not maximize economic welfare vis-à-vis trade. Adherents of Ricardian trade theory in today's marketplace subscribe to the Michael Boskin theory of economic advantage: "potato chips, computer chips, what's the difference?" One key difference is that computer chip jobs pay much more because they are higher value added. The Unites States has a stake in having high valued-added industries and, absent policies to win in global competition, America will be left with low value-added industries. Ex-Im Bank plays a key role in supporting the growth through exports of these high-value added industries.

15) Export promotion programs cannot affect the trade balance[18]

This is a recitation of conventional neoclassical trade theory which is based on idealized conditions that don't exist in the real world. The most important violation of the theory is that the U.S. dollar is the global reserve currency and hence does not fluctuate fully in response to market forces. It is also based on the theory that the trade balance is based on macroeconomic factors, particularly savings rates. But as American University economist Robert Blecker states, "This identity does not prove causality, and is consistent with other causal stories about the trade deficit."[59] In other words, what the conventional story fails to recognize is that savings is a function of national competitiveness. If, for example, the Chinese stopped manipulating their currency, the U.S. trade deficit would fall and the Chinese would buy less of our government debt. The result would be a rise in both U.S. exports and interest rates. And both would spur more savings. Higher interest rates would lead more Americans to save. More exports (and relatively fewer imports) would boost U.S. corporate savings. And more jobs and higher wages through exports (exporting firms pay 9.1 percent more than jobs in firms that export less) would boost individual savings and reduce the budget deficit.

16) So pervasive are the benefits of trade liberalization for the country doing the liberalization that countries would be smart to lower their protectionist barriers on their own, irrespective of what other countries do.[19]

This argument is made to claim that the United States doesn't need to do anything, including support exports. But this is only true if America lives in a fantasy world where Americans are only consumers. As long as 130 million Americans are also workers, this is false. For unilateral disarmament of programs like Ex-Im would hurt businesses and workers in the United States. The fact that the United States accrued a $7 trillion trade deficit in the last decade (and a $4.5 trillion trade deficit in manufactured products from 2000-2011) while losing one-third of its manufacturing workforce calls into question the "pervasive benefits of unilateral trade liberalization," irrespective of what others do. Autor et al. find that the losses in economic efficiency from trade-induced increases in the usage of public benefits are, in the medium run, about one to two-thirds as large as U.S. gains from trade with China. In other words, as much as two-thirds of the consumer welfare gains from lower-price imports are wiped out through the use of public benefits (e.g. unemployment compensation, trade adjustment assistance, etc.) alone[20], not to mention how much better off households, communities, the industrial commons, and the innovation potential of the economy would be were many of the jobs and much of the production from displaced manufacturing still in the United States

17) By providing credit at less than its full risk-adjusted premium, Ex-Im loans may indeed stimulate foreign demand, but the greater demand for dollars needed to buy U.S. exports bids up the dollar's value in the exchange markets.[21]

There are two things wrong with this argument. The first is that as the global reserve currency, the price of the dollar is not fully flexible in global currency markets. If it were, its value would be much lower and the United States would not be running as large a trade deficit. The second is that it is in the national interest to have as high a value of the dollar as possible while at the same time not running a trade surplus. In other words, a strong dollar in the presence of trade deficits is bad for the nation, if for no other reason that the nation is building up debt that the next generation must pay. Conversely a weak dollar with a trade surplus means that consumers and businesses are paying too much for imports. The "goldilocks" solution is a strong dollar and no trade deficit. Ex-Im financing helps the nation get closer to this.

18) "Government export finance assistance programs may largely shift production among sectors within the economy rather than raise the overall level of employment in the economy."[22]

First of all, sectors matter (See #3 and #10.) Second, timing matters. As Keynes famously stated, "in the long run we are all dead." That statement is true but it has long given economists an easy out on weighing in on the short and medium term realities. In the world of reality, loss of export competitiveness does have macroeconomic employment impacts at least for the short and medium-term. It should be no surprise that in a decade when the United States lost one-third of its manufacturing jobs (the 2000s) that there was no net new job growth. The two are related. In fact, of 10 countries examined by the Bureau of Labor Statistics, there was a 0.57 correlation between change in manufacturing employment and overall growth of jobs. Moreover, even if Ex-Im financing helped companies export and this had no effect on the overall number of jobs (which is wrong), it does have an effect on the composition of jobs, leading to more higher-value-added, higher-wage jobs.

Conclusion

Having a strong export economy is critical to the performance of the U.S. economy. Competition from foreign export credit agencies is not abating—*in fact it is increasing.* The stakes to our nation's economic future are too high to let this critical debate over Ex-Im be determined on the basis of ideology about the proper role of government. It is clearly the proper role of government to help U.S. businesses win the fight they are in for global competitive advantage. As such, Congress should reauthorize the U.S. Export-Import Bank.

Endnotes:

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