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The Export–Import Bank: A Government Outfit Mired in Mismanagement

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Advocates of the Export–Import Bank (Ex–Im) are lobbying Congress for reauthorization by claiming that its taxpayer-subsidized financing is a safe—and lucrative—investment. But even a mountain of rhetoric cannot bury the facts: The bank is beset by mismanagement, dysfunction, and risk, all of which have been documented for years by Ex–Im's own inspector general and the Government Accountability Office (GAO). The problems are the inevitable result of government assuming a function far beyond its proper purview and one that rightly belongs to private business alone.

The bank's current authorization is set to expire on September 30. Ex–Im provides loans and loan guarantees as well as capital and credit insurance for U.S. exports. The financing is backed by the "full faith and credit" of the U.S. government, which means taxpayers are on the hook for losses that bank reserves fail to cover.

Allowing the authorization to expire should be an easy call for lawmakers. There is no shortage of private investment: 98 percent of the $2.2 trillion in annual U.S. exports are financed without help from Ex–Im. And despite promises to clean up their act, bank officials persist in underestimating costs, misstating losses, and failing to maintain adequate capital reserves. But even if the bank functioned perfectly, there is no justification for the government to act as financier to favored interests.

Phony Profits and Real Losses. Bank chairman and president Fred Hochberg boasts that the bank has sent billions of dollars in surplus funds to the U.S. Treasury. Congressional appropriators have undoubtedly been pleased to get their hands on the extra revenue. But supplementing government spending does not ensure that the other $140 billion worth of taxpayer subsidies doled out to corporations and foreign governments is necessarily secure. After all, stockholders of Fannie Mae and Freddie Mac collected many a dividend before racking up $164 billion in losses—prompting a taxpayer bailout approaching $200 billion.

Ex–Im has incurred losses, too, accumulating a deficit of $5.3 billion in the 1980s.[1] The losses largely resulted from the bank paying higher interest for the money it borrowed to finance new deals than it was earning from the borrowers it previously financed. Bank officials compounded the problem by overstating revenue—i.e., reporting delinquent interest payments as income (to be collected in the future). By late 1984, problem loans tripled as a percentage of the bank's retained earnings.[2]

Interest rates have hovered near historic lows in recent years, but changes in unemployment or inflation could prompt increases. The cost of this potential problem would be made worse by the bank's recent record levels of lending. Annual authorizations grew by nearly 150 percent between 2008 and 2012, while the overall portfolio increased 65 percent.[3]

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Imprudent Accounting. Ex–Im's books understate the risk on many of the loans borne by taxpayers. That is because the bank calculates its future revenue from loan repayments based on interest rates tied to Treasury securities.[4] But unlike private banks, which follow much stricter accounting rules, Ex–Im does not adjust the amount of anticipated revenue for changes in the market that could actually reduce future repayments.

This practice, which artificially increases the appearance of "profit," is no small matter. As noted by the Congressional Budget Office, "That appearance creates a budgetary incentive to expand the programs beyond the scale that would be chosen if the budget reflected their costs at market value."[5] It also means that the bank's accounting methods could lead Congress to act in ways lawmakers might not otherwise if they knew the actual state of Ex–Im finances. Lawmakers ought to avoid such a miscalculation in coming weeks.

Risky Analysis. Financing exports entails multiple risks, including changes in interest rates, currency fluctuations, political unrest, and international conflicts. With hundreds of millions of taxpayer dollars at stake, one might reasonably assume that Ex–Im applies rigorous risk analysis to its lending. But according to the inspector general, "Ex–Im Bank lacks a systematic approach to identify, measure, price and reserve for its portfolio risk."[6]

Private investors, on the whole, are far more diligent. With their own money at stake, they carefully calibrate their investments to account for ever-changing risks. Government, on the other hand, spends far more recklessly because the consequences of doing so fall upon taxpayers.

Among other problems noted by the inspector general, bank personnel fail to document applicants' eligibility and application requirements and disregard mandatory checks on applicants' character and financial integrity.[7] Government regulators would impose harsh punishment on private lenders that dared to act so carelessly.

The bank does assign a risk rating to each transaction. However, it does not assess the relationships between all the various risks in its portfolio. For example, aircraft transactions account for nearly half of the balance sheet exposure, but each new airline transaction is assigned a risk rate in a vacuum—failing to account for the bank's inordinate investment in that single sector of the economy.[8] The lack of thorough analysis is particularly problematic for taxpayers because Ex–Im financing is heavily concentrated in two geographic regions (Asia and Latin America) and three economic sectors (airlines, oil and gas, and power). Ex–Im also does not analyze the risk of the "sub-portfolios" mandated by Congress—which include small business, sub-Saharan Africa, and renewable energy—although their performance likely differs from the overall portfolio. But politics drives the composition of the portfolio, so accurate risk assessment does not matter much.

Without accurate risk assessments, the bank cannot determine the appropriate level of capital reserves that are prudent. A future shortfall could provoke a bailout.

1. U.S. General Accounting Office, *Export-Import Bank's 1989 and 1988 Financial Statements*, June 1990, http://gao.gov/assets/220/212761.pdf (accessed April 28, 2014).
2. Frederick D. Wolf, U.S. General Accounting Office, statement before the Subcommittee on International Finance and Monetary Policy, Committee on Banking, Housing and Urban Affairs, U.S. Senate, February 7, 1986, http://archive.gao.gov/f0102/129040.pdf (accessed April 28, 2014).
3. Mathew J. Scirè, U.S. Government Accountability Office, "Recent Growth Underscores Need for Improved Risk Management and Reporting," testimony before the Subcommittee on Monetary Policy and Trade, Committee on Financial Services, U.S. House of Representatives, June 13, 2013, http://www.gao.gov/assets/660/655201.pdf (accessed April 28, 2014).
4. This "accrual" method of accounting is in keeping with the Federal Credit Reform Act of 1990.
5. Congressional Budget Office, "Fair-Value Accounting for Federal Credit Programs," March 2012, http://www.cbo.gov/sites/default/files/cbofiles/attachments/03-05-FairValue_Brief.pdf (accessed April 28, 2014).
6. Export–Import Bank, Office of Inspector General, "Report on Portfolio Risk and Loss Reserve Allocation Policies," September 28, 2012, http://exim.gov/oig/upload/Final-20Report-20Complete-20Portfolio-20Risk-20120928-1.pdf (accessed April 28, 2014).
7. Export–Import Bank, Office of Inspector General, "Export-Import Bank's Management of Direct Loans and Related Challenges," September 26, 2013, http://www.exim.gov/oig/upload/OIG-Final-Report-Audit-of-Ex–Im-Bank-s-Management-of-Direct-Loans-and-Related-Challenges-09-26-13-2.pdf (accessed April 28, 2014).
8. Export–Import Bank Inspector General, "Report on Portfolio Risk and Loss Reserve Allocation Policies."

Impaired Default Assumptions. Ex–Im's true financial condition is also obscured by its narrow definition of default, which is applied only to unpaid past-due loans and claims paid to bank-insured transactions. It does not pertain to a variety of other loan violations that are designated as defaults by private banks—such as loans that are restructured under less favorable terms to promote repayment.

Bank officials no longer report on "impaired assets" each quarter, thereby eliminating an early warning signal of potential losses.[9] The bank also does not maintain time-sequenced data necessary to compare the current portfolio to past loan performance. The GAO characterizes the bank's technology as "antiquated and inflexible," with some components more than 30 years old.[10]

A Government Creature. The closer the expiration deadline nears, the more insistent will advocates' claims become that Ex–Im is necessary and a sound "investment" for taxpayers. The facts say otherwise, as documented for years by Ex–Im's inspector general and the GAO.

In reality, the bank is little more than a conduit for corporate welfare beset by unreliable risk management, inefficiency, and cronyism. As a government creature interfering in business, it can hardly be otherwise.

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9. Ibid.

10. Export–Import Bank Inspector General, "Export-Import Bank's Management of Direct Loans and Related Challenges."