1969

Federal financial assistance for overseas trade

Wilford H. Hughes

Follow this and additional works at: https://egrove.olemiss.edu/dl_tr
Part of the Accounting Commons, and the Taxation Commons

Recommended Citation

This Article is brought to you for free and open access by the Deloitte Collection at eGrove. It has been accepted for inclusion in Touche Ross Publications by an authorized administrator of eGrove. For more information, please contact egrove@olemiss.edu.
In these days of worldwide monetary uncertainty, with the seemingly never-ending threat of devaluations and revaluations, one might think international trade would be declining. But, quite the contrary, it is growing at an impressive pace, as more and more American businessmen seek faster earnings growth through overseas expansion. For those braving the rigors of international finance, a quick review of economic assistance offered by the U.S. Government may be of some help.

The Export-Import Bank of the U.S. (Eximbank) and The Agency for International Development (AID) administer the Government's major programs for overseas financing assistance.

- Eximbank, established in 1934 as an independent agency for the sole purpose of boosting U.S. exports, fulfills its goal in three ways: It makes long-term loans for the purchase of U.S. goods and services, guarantees medium-term export credits and underwrites short- and medium-term export insurance issued by the FCIA.
- AID was set up in 1961 to centralize the administration of most of the Government's foreign aid programs. Two such programs guarantee American corporate overseas investments and make long-term development loans to less-developed countries for the purchase of U.S goods and services.
- The Foreign Credit Insurance Association (FCIA), an association of over 70 insurance companies and Eximbank, insures short- and medium-term export credits.

Export Assistance

FCIA insurance helps remove the barrier of credit risk in international trade. How does it work? Suppose, for example, that U.S. Company X arranges the sale of its product to Foreign Company Y. But that upon delivery, Company Y can neither pay for the goods nor arrange for financing. Company X, unwilling to risk extending its customer the credit, is nevertheless anxious to make the sale. So the American manufacturer grants the credit and goes to the FCIA for insurance.

The FCIA offers two types of coverage for a short-term export credit (up to 180 days). One type protects against political risks only, and usually insures 90% of the credit. The other protects against a combination of political and commercial risks (comprehensive coverage), generally covering 95% of the credit. (Export credit insurance will also make it easier for the policy holder to discount his customer's notes.)

To qualify for a short-term policy, an exporter must insure all of his short-term credits but may except:
- Credits to major customers;
- Sales made under an irrevocable letter of credit;
- Credits to the exporting company's branches, subsidiaries or affiliates.

Coverage may also be restricted to certain product lines and divisions.

Premiums vary according to two factors: The length of the credit period and the economic and political stability of the importing country. (Although the im-
porter's credit standing determines whether or not his credit can be insured, it does not affect the premium.) Current rates for comprehensive coverage range from $.09 to $1.42 per $100 of invoice value; the average rate runs about $.48 per $100. Political-risk-only coverage averages about 25% less. (These rates usually cover a period beginning with the date of shipment, but for a small additional premium, goods on consignment and in process may be insured as well.)

FCIA medium-term insurance, similar to the short-term variety, covers a period ranging from 181 days to five years and generally insures 90% of the credit. (But the percentage may range as low as 70% in high-risk countries.) The rates here are considerably higher than those for short-term policies, ranging from $.48 to $6.62 per $100 of credit, political-risk-only coverage again averaging 25% less.

The qualifications for a medium-term export credit insurance policy:
- The importer must make a cash downpayment on delivery of at least 10%.
- The exporter must retain 10% to 30% of the credit risk.

(These percentages are set by Eximbank, based on the credit-standing of the purchaser and the political and economic stability of his country.)

If the exporter's application for medium-term insurance is denied, he may discount his customer's notes with a commercial bank, which may, in turn, qualify for an Eximbank medium-term guarantee. This generally requires that the importer make a cash downpayment of 20% and that the exporter retain 15% of the credit.

Generally, on credits of three years or more, the Eximbank guarantee will cover the amount due after 18 months; on credits of less than three years, 50% of the amount due. For instance, suppose that U.S. Company X sells a machine to Foreign Company Y for $150,000. If Y pays 20% down ($30,000) upon delivery and issues 8 promissory notes of $15,000 each due in semiannual installments beginning six months after shipment, X may discount 85% of the notes ($102,000) with its bank at the time of shipment, thus assuming 15% of the total credit risk. The bank's risk would then be limited to $38,250 (85% of the three installments—$15,000 each—due during the first 18 months). The balance of the risk on the first three installments, $6,750 (15% × $45,000), is borne by X. Eximbank assumes the risk on 85% of the remaining five installments, with X assuming the risk on the other 15%. The total risk: X—$18,000 (12% of sales price), the bank—$38,250 (25.5%), and Eximbank—$63,750 (42.5%).

If the credit had been for two years, there would have been 4 semiannual installment notes of $30,000 each (rather than 8 at $15,000), and the bank would have had to assume 85% of the risk on $60,000, or 50% of the credit. Here the total risk, again $120,000, would be borne as follows: X—$18,000 (12%); the bank—$51,000 (34%); and Eximbank—$51,000 (34%).

Normally, Eximbank is guided by the following relationship between contract price and repayment period:
- Up to $25,000 . . . . 3 years
- $25,000 to $150,000 . . . . 4 years
- over $150,000 . . . . 5 years

However, a longer term of payment may be allowed if other exporting countries in competition with U.S. exporters normally allow a particular export a longer term, or if the size of a purchase is unusually large.

If FCIA insurance is denied on what is called a "reasonable basis," and bank financing is also unavailable, there are two remaining alternatives. Eximbank may finance the credit directly, or issue a "comprehensive guarantee" on the amount financed by a commercial bank, which would then relieve the bank from all risk.

**Long-Term Financial Assistance**

Eximbank and AID both make long-term loans to overseas organizations—both public and private—for the purchase of U.S. goods and services. Eximbank project loans have ranged in size from as little as a few thousand dollars to as much as $115 million and run anywhere from 5 years to 20 years. The interest rate is currently 6%.

AID development loans are most frequently made for long-term projects, rather than for specific investments, and are usually granted to foreign governments or development banks which then reloan the funds (at interest rates which are lower than the prevailing local rates) to local enterprise.

Terms of payment for a government are based on the state of economic development and the nature of the enterprise involved; the longest term is currently 40 years. The interest rate takes the form of a minimal service charge of 1% for the first ten years, a higher rate of 3% thereafter.

Loans to development banks are generally for a 20-year term at somewhat lower than local rates.
Investment Guarantees

AID offers basically two types of protection for U.S. equity and loan investments overseas: Specific risk guarantees and extended risk guarantees. Specific risk coverage is for political risk only and is limited to new debt and/or equity investments. Thus, the acquisition of an existing enterprise is not considered a “new” investment and does not qualify for a guarantee, but additions to an existing enterprise do qualify. Equity investments are guaranteed for a maximum of 20 years; loans, for the term of the loan. There is no apparent limit on the amount that may be covered—guarantees ranging from $1,000 to $184 million have been issued. Guarantees on debt investments may cover interest costs; equity guarantees may cover up to twice the amount invested, insuring investment earnings as well.

Extended risk guarantees (comparable to the comprehensive coverage of export credit insurance) cover 50% of an equity investment, 75% of a debt investment. (A specific risk guarantee may be obtained to cover the remaining amount.)

A U.S. parent company, unable to get a guarantee for a loan to its foreign subsidiary, may apply for a so-called “guaranteed guarantee.” If the subsidiary defaults on the loan, and the U.S. parent has to make payment, AID allows this payment to be treated as a capital contribution to its subsidiary, and the “capital contribution” is then treated as an equity investment.

Other Aid Programs

Under its investment survey program, AID will finance feasibility studies for potential investors. If the investor rejects the project under consideration, AID will finance up to 50% of the study’s cost.

Under the so-called Cooley Amendment (of the Agricultural Trade Development and Assistance Act), certain foreign currency received by the U.S. Government in payment for the sale of agricultural commodities abroad is allocated to AID. AID may then loan these funds to U.S. firms and their overseas subsidiaries for reinvestment in the country from which they originated.

Recent Developments Affecting Eximbank and AID

For applications for export assistance which fail to qualify through usual channels, Eximbank’s Export Expansion Facility (EEF) was set up in July 1968 for those cases which “offer sufficient likelihood of repayment. . . .” The EEF fund ($500 million of Eximbank’s total $13.5 billion) is available to each of Eximbank’s traditional programs; no special applications are required. Although EEF risk standards are more liberal, terms of repayment, interest rates and premiums are no higher than those under other Eximbank programs.

Last year Congress cut back AID appropriations by about $1½ billion, affecting all programs except the Cooley loans:
- Development loan appropriations were reduced by more than half;
- The funds for specific risk and extended risk guarantees was only slightly increased;
- The investment survey program received no new allocation, leaving only $1½ million available for new surveys.