



OFFICE OF INSPECTOR GENERAL
EXPORT-IMPORT BANK
OF THE UNITED STATES

**EVALUATION REPORT RELATING TO
ECONOMIC IMPACT PROCEDURES**

OIG-EV-10-03
September 17, 2010



OSVALDO L. GRATACOS
ACTING INSPECTOR GENERAL

EXPORT-IMPORT BANK
OF THE UNITED STATES

September 17, 2010

Fred P. Hochberg
Chairman and President
Export-Import Bank of the United States
811 Vermont Ave. NW
Washington, D.C. 20571

RE: Evaluation Report Relating to Economic Impact Procedures (OIG-EV-10-03)

Dear Chairman Hochberg:

The Export-Import Bank of the United States (Ex-Im Bank or the Bank) Office of Inspector General (OIG) is submitting to you the above referenced evaluation report of Ex-Im Bank's Economic Impact Procedures, as most recently amended in April 2007 (Economic Impact Procedures or EIP's). Ex-Im Bank's Economic Impact Procedures are intended to "layout a reasonable and logical process to analyze the impact of Ex-Im Bank support for a particular transaction" to assure that the Bank does not "approve a transaction that would, on balance, harm the U.S. economy."¹ While the objective of economic impact review can be stated simply, it is difficult in practice to achieve due to limitations in data, time and resources, the need to rely on potentially conflicting data and opinions regarding future relationships of supply, demand, prices and terms of international trade in changing markets, and the conflicting interests of different segments of the economy. The statutory requirements for this process are set forth in Section 2(e) of the Bank's Charter.

The objectives of this evaluation are:

- To independently evaluate Ex-Im Bank's Economic Impact Procedures as well as critiques and suggestions for their improvement delivered by the Government Accountability Office (GAO), members of the Bank's Board of Directors and management, transaction participants, Congress and other U.S. government agencies having a role in the economic impact review process.
- To identify opportunities to improve the efficiency and effectiveness of the Economic Impact Procedures within the constraints of existing statutory requirements, the requirements of transaction proponents, and the resources available to Ex-Im Bank.

Our evaluation has determined that Ex-Im Bank's Economic Impact Procedures can be revised to better implement the intent of Congress as reflected in the Bank's Charter, to improve transparency,

¹ Testimony of James L. Lambright, Chairman and President, Export-Import Bank, March 29, 2006, before the Subcommittee on International Trade and Finance of the Senate Committee on Banking, Housing and Urban Affairs.

and to make them more manageable for U.S. exporters and other participants in the process, including the Board of Directors, Congress, U.S. government agencies that review the Bank's actions in this area and observers in relevant U.S. industries.

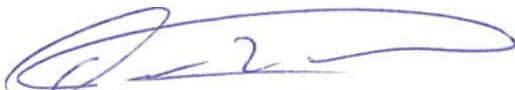
Management's response to this Report, which is attached as Appendix I, states that management intends to consider the suggestions made in this Report in the course of its development of modifications to the Economic Impact Procedures based upon this Report and other sources of comments and suggestions, including ideas developed independently by the Bank's Policy and Planning Group (PPG), the 2007 report prepared by the U.S. Government Accountability Office (GAO), *Export-Import Bank - Improvements Needed in Assessment of Economic Impact* (GAO-07-1071) (2007 GAO Report) and "should coincide with the Bank's impending Congressional reauthorization".

It should be noted that the PPG staff has been pursuing its own evaluation of the Economic Impact Procedures and has been accumulating a set of possible modifications. A complete statement of the modifications under consideration by the PPG staff was not requested by the OIG in the course of preparing this Report in the interest of maintaining the independence of this review. At the same time, it was clear in the OIG's interviews with members of the PPG staff that their comments, which have been incorporated in the findings and recommendations contained in this Report, were informed by their own ongoing review process. Accordingly, the OIG acknowledges the active assistance and support for this Report. The OIG also does not claim sole credit for many of the findings and recommendations in this Report, which were based upon discussions with the PPG staff, the Bank's management and Board and other interview subjects, including representatives of the Reviewing Agencies.

This evaluation is not an audit and it *was* not prepared in accordance with Generally Accepted Government Auditing Standards. For more information on the background and methodology underlying this Report, see Appendix D.

Should you or your staff have any questions or wish to discuss the results of our evaluation, please call me at (202) 565-3908.

Sincerely,



Osvaldo L. Gratacós
Acting Inspector General

Cc: Alice Albright (with attachment)

Attachment: Evaluation Report Relating to Economic Impact Procedures (OIG-EV-10-03)

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Executive Summary

The Export-Import Bank of the United States (Ex-Im Bank or the Bank) Office of Inspector General (OIG) has completed its evaluation of Ex-Im Bank's Economic Impact Procedures, as most recently amended in April 2007 (Economic Impact Procedures or EIP's). This lengthy Report is provided as a source document addressing subjects relating to the economic impact of Ex-Im Bank transactions that have not been addressed publicly, or internally, by the Bank in a comprehensive manner. It is intended to both fill an informational void and to suggest solutions to problems that have proven difficult to resolve, persistent, and generally impenetrable to all but a small number of Bank staff, for the benefit of the full range of interested observers of the Bank's activities, including exporters, foreign buyers, financing sources, Congress, other government agencies, members of the Bank's staff, senior management and Board and the public generally. See Appendix D for additional information on the background of this Report.

Ex-Im Bank's Economic Impact Procedures are intended to "lay out a reasonable and logical process to analyze the impact of Ex-Im Bank support for a particular transaction" to assure that the Bank does not "approve a transaction that would, on balance, harm the U.S. economy."¹ While the objective of economic impact review can be stated simply, it is difficult in practice to achieve due to limitations in data, time and resources, the need to rely on potentially conflicting data and opinions regarding future relationships of supply, demand, prices and terms of international trade in changing markets, and the potentially conflicting interests of different segments of the U.S. economy. The statutory requirements for economic impact review are set forth in Section 2(e) of the Bank's Charter (see Appendices A and C). The 25 transactions subjected to a full economic impact review between 2002 and 2009 that were evaluated in connection with this Report are described in Appendix B.

Summary of Findings and Suggestions for Improvement

The evaluation has determined that Ex-Im Bank's Economic Impact Procedures can be revised to better implement the intent of Congress that the Bank's Board of Directors, not the Bank's officers and staff, decide economic impact cases, to improve transparency and to make the economic impact review process more manageable for U.S. exporters and other participants, including the Board of Directors, Congress, U.S. government agencies that review the Bank's actions in this area and interested observers in relevant U.S. industries. The small number of transactions requiring a full economic impact review that have been submitted to Ex-Im Bank in recent years suggests that the Bank's approach to economic impact analysis has discouraged U.S. exporters of capital equipment from applying for Ex-Im Bank support.

¹ Testimony of James L. Lambright, Chairman and President, Export-Import Bank, March 29, 2006, before the Subcommittee on International Trade and Finance of the Senate Committee on Banking, Housing and Urban Affairs.

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The implementation of the suggestions made in this Report will reduce the uncertainty, delay, and cost associated with transactions requiring economic impact review, advancing the Bank's mission of creating jobs for American workers by expanding U.S. exports.

This evaluation is not an audit and it was not prepared in accordance with Generally Accepted Government Auditing Standards. For more information on the background and methodology underlying this Report, see Appendix D.²

Objectives

The objectives of this evaluation are:

To independently evaluate Ex-Im Bank's Economic Impact Procedures as well as critiques and suggestions for their improvement delivered by members of the Bank's Board of Directors and management, transaction participants, Congress and other U.S. government agencies having a role in the economic impact review process, including the observations and recommendations of the U.S. Government Accountability Office (GAO) in the 2007 report *Export-Import Bank – Improvements Needed in Assessment of Economic Impact* (GAO-07-1071) (2007 GAO Report).

To identify opportunities to improve the efficiency and effectiveness of the Economic Impact Procedures within the constraints of existing statutory requirements, the requirements of transaction proponents and the resources available to Ex-Im Bank.

Expanded Summary of Findings and Suggestions for Improvement

A. Improve Economic Impact Procedures and Reports to Better Support the Board's Congressionally Mandated Role in Deciding Economic Impact Cases.

Congress in Section 2(e) (3) of the Ex-Im Bank Charter assigned to the Bank's Board of Directors the responsibility of determining whether "the short- and long-term benefits to industry and employment in the United States [of a transaction proposed for Ex-Im Bank support] are likely to outweigh the short- and long-term injury to United States producers and employment of the same, similar, or competing commodity."

² This Report is largely based on review of economic impact reports relating to the transactions summarized in Appendix B and the relevant statutes, policies and procedures and interviews conducted during 2007, 2008 and 2009 with (i) the Bank's Board of Directors; (ii) the Bank's General Counsel; (iii) members of the Bank's Planning and Policy Group; (iv) officials from the Treasury and Commerce Departments, and the Office of the U.S. Trade Representative, who participate in the economic impact review process; (v) representatives of GAO; and (iv) members of the staffs of the Senate Committees on Finance and Banking, Housing and Urban Affairs.

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This difficult decision was given to the Board of Directors, not the Bank's staff, in recognition of the many challenges of assessing the economic impact of transactions proposed for Ex-Im Bank support where there may be a risk of substantial injury to U.S. manufacturers and employment from increased foreign competition as a result of the transaction.

In each of the small number of economic impact cases decided between 2002 and 2009, the ability of the Board of Directors to carry out their responsibility under Section 2(e)(3) of the Charter has been impaired because the economic impact reports prepared by the Bank's Planning and Policy Group (PPG) staff and submitted to the Board to facilitate their decisional process presented data and analysis supporting the PPG staff's recommendation, but (i) did not address directly several elements of economic impact contemplated by the Charter, (ii) omitted relevant data and analysis beyond that considered necessary to support the PPG staff's recommendation, (iii) did not state the limitations and qualifications of the data, assumptions, estimates, methods and analysis relied upon by the PPG staff and (iv) did not fully address the sensitivity of the staff's conclusions to possible changes in assumptions and estimates that could be reasonably anticipated.³ See Section A of this Report for an expanded coverage of these findings.

Suggestions for Improvement

- A.1. The PPG staff's economic impact reports should present the available quantitative and qualitative information obtained by the PPG staff that is material and relevant to the determination of economic impact in a concise balancing format that addresses each of the elements of economic impact contemplated by the Charter and which will support the Board's decisional process under Section 2(e)(3) of the Charter.
- A.2. Economic impact reports, supplemented by the Bank's publicly available Economic Impact Procedures, should be written to reasonably inform the reader of the limitations and qualifications of the data, assumptions, estimates, methods and analysis relied upon by the PPG staff and the sensitivity of the conclusions expressed by the PPG staff to possible changes in assumptions or estimates that can be reasonably anticipated. The PPG staff should consider guidance provided by the Office of Management and Budget ("OMB") in developing specifications for its analysis and reports to the Board.⁴
- A.3. Reliance on trade flow analysis or any other quantitative methods used by the PPG staff that effectively decide economic impact cases should be made subject to Board approval and subsequent periodic reaffirmation.

³ The most recent two transactions listed in Appendix B, which were decided in 2008 and 2009, were based on economic impact reports in which the PPG staff incorporated on a trial basis some of the suggestions contained in this Report, and to that extent are not subject to the same level of comment as the reports that preceded them.

⁴ See OMB Circular A-4 "Regulatory Analysis" ("OMB Circular A-4").

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B. Develop Improved Criteria to Guide the Board and Staff in Deciding Economic Impact Cases.

The principal criterion applied by the Bank's PPG staff to support their recommendations to the Board in the economic impact cases reviewed for this report has been a quantitative "trade flow" analysis that compares the dollar value of U.S. capital equipment exports (i.e. widget making machinery) attributable to a transaction proposed for Ex-Im Bank support to the discounted dollar value of U.S. production of the products produced with that capital equipment (widgets) that might be "displaced"⁵ by the new foreign production of widgets. In lieu of using the term "widgets" and to maintain consistency with terminology used by the PPG staff, the products produced by exported capital equipment that would compete with U.S. production are referred to in this Report as "Exportable Goods." Heavy reliance on trade flow analysis reflects the PPG staff's efforts over the years to work with management, the Board and Congress to develop a tool that, within the limited data, time, and staff resources available, would serve as an approximate indicator of transactions where adverse economic impact may be an issue.

Reliance on quantitative trade flow analysis to guide the PPG staff's recommendation for approval or disapproval of economic impact cases by the Board of Directors is responsible for much of the criticism of the economic impact process by the Board of Directors and the Reviewing Agencies.⁶ Trade flow analysis, as it has been applied during the period addressed in this Report, appears to be inconsistent with the requirements of the Bank's Charter. Among the weaknesses of trade flow analysis are that (a) it does not speak directly to several of the determinations required to be made by the staff and Board under Section 2(e) of the Charter, (b) in some cases it excludes or conflicts with material, relevant market data that is persuasive as to the likelihood, or unlikelihood, of substantial injury to U.S. producers and employment, (c) it has not been empirically validated by the PPG staff or approved by the Board as a controlling decisional tool and (d) the PPG staff's efforts to revise the method to better correlate with conflicting data have been viewed as result-driven by members of the Board and the Reviewing Agencies.

5 Trade flow analysis assumes that the new foreign production of widgets that might reach the U.S. market will capture 100% of the head-to-head sales competition, resulting in that quantity and dollar value of lost sales by U.S. producers, an assumption the PPG staff describes as resulting in the most "conservative" possible estimation of the adverse impact of the new foreign production on U.S. producers. The PPG staff acknowledges that in real markets it is more likely that only a portion of possible sales will be lost as a result of increased foreign production, with the market possibly experiencing lower prices as supply increases. These effects are difficult or difficult to predict with any certainty. The methodology of trade flow analysis is described in greater detail in Appendix F.

6 The Bank's Economic Impact Procedures provide for the Departments of State, Treasury and Commerce and the Office of the United States Trade Representative (the "Reviewing Agencies") to receive a draft copy of the staff's economic impact reports, with the opportunity to comment to the staff and the Board. The Secretary of Commerce and the U.S. Trade Representative serve as ex officio members of the Bank's Board of Directors. Section 2(e)(7) of the Bank's Charter, enacted in the Bank's 2006 reauthorization, requires that summary notice of transactions receiving detailed economic impact review be published in the Federal Register and requires that the Bank seek comments from the Department of Commerce, the Office of Management and Budget, the Committee on Banking, Housing and Urban Affairs of the Senate and the Committee on Financial Services of the House of Representatives.

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The Bank has cited reliance upon trade flow analysis to support the inclusion on the Bank's list of "sensitive sectors" with respect to which "the provision of financing support by the Bank is deemed unlikely by the President of the Bank due to the significant potential for a determination that such financing support would result in an adverse economic impact on the United States" as required by Section 2(e)(5) of the Bank's Charter. Without any proof of substantial injury to any U.S. industry, the Bank has advised U.S. capital equipment manufacturers that the Bank is unlikely to support financing for "Products associated with projects where a significant portion of the output directly produced by the project is destined for the U.S. market and will compete directly with U.S. production." This may prevent some U.S. manufacturers of capital equipment from seeking Ex-Im Bank support for exports to the Western Hemisphere and much of the Pacific Rim. If trade flow analysis is no longer given decisive effect, this provision would appear to be overbroad, and may have contributed to the decrease in capital equipment export transactions requiring economic impact review in recent years despite a significant decrease in the availability of private sector export credit financing. See Section B of this Report for an expanded coverage of these findings.

Suggestions for Improvement

- B.1. While the data supporting trade flow analysis and the conclusions that may be drawn from that data and analysis have relevance to the Board's consideration and determination of economic impact cases, trade flow analysis should not be the sole or primary criterion for deciding economic impact cases addressed in the PPG staff's economic impact reports, and it should not be determinative of the PPG staff's recommendation, or the Board's decision, in economic impact cases.
- B.2. The PPG staff should develop additional criteria for analysis of economic impact that are consistent with the Bank's Charter and Congressional intent to assist the Board in deciding economic impact cases. These criteria should focus on the sort of macroeconomic trends that were characteristic of the U.S. industries that were cited as experiencing substantial economic injury at the hands of foreign competitors in Congressional hearings preceding the enactment of the current economic impact requirements expressed in Section 2(e) of the Bank's Charter.
- B.3. It is suggested that the Bank's Economic Impact Procedures provide for a periodic backward-looking empirical review to determine whether it appears that transactions approved have in fact caused or contributed to any substantial injury to U.S. producers of an Exportable Good or related employment under the criteria relied upon by the PPG staff and the Board, and whether any projected benefits to the U.S. economy and employment of approving, or disapproving, specific transactions were in fact realized.
- B.4. It is suggested that in view of the suggestions above at A.1., 2., and 3. and B.1. and 2., the PPG staff should reevaluate the "sensitive commercial sectors list" promulgated by the Bank pursuant to Section 2(e)(5) of the Charter. In particular, it is suggested that the Bank further

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refine or omit reference to “Products associated with projects where a significant portion of the output directly produced by the project is destined for the U.S. market and will compete directly with U.S. production,” which is based on “likely net negative trade flow implication.” It is also suggested that the Board be consulted before the sensitive sector list is published to confirm that they are in general accord with it in order to avoid the Bank’s President effectively misrepresenting, and thereby usurping, the Board’s final authority to decide economic impact cases.

C. The Bank should improve the transparency of its Economic Impact Procedures and its economic impact determinations.

The results of economic impact reviews are expressed in relatively brief written reports prepared by the Bank’s PPG staff and in minutes of meetings of the Board of Directors, none of which are publicly disclosed or thereafter easily accessible by the Bank’s Board and management. The PPG staff’s internal procedures for producing economic impact reports rely to a significant extent on the PPG staff’s experience and practice in producing prior economic impact reports and are not thoroughly documented. As a result, transaction proponents and opponents, the Reviewing Agencies, Bank management, the Board of Directors, Congress and the public have a very limited ability to understand the Bank’s economic impact determinations, to predict the outcomes of individual cases or to evaluate the consistency and quality of procedure and results between cases over time. See Section C of this Report for an expanded coverage of these findings.

Suggestions for Improvement

The Bank should advance the transparency of its economic impact policy and determinations by:

- C.1. Revising the Economic Impact Procedures to include more information about the PPG staff’s methodology and publishing the expanded description on the Bank’s website.
- C.2. Revising the Bank’s internal procedures to more fully and accurately describe the PPG staff’s methodology in preparing economic impact reports.
- C.3. Making economic impact reports publicly available after redacting them, or delaying their release, to protect sensitive business confidential information of the transaction proponents.

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D. The Bank should improve the efficiency and responsiveness of the Economic Impact Procedures by simplifying the process and reallocating resources.

Other U.S. government agencies that evaluate the impact on the U.S. economy of specified transactions or developments apply a number of strategies to advance the goals of achieving transparency, reasonably accurate determinations and responsiveness to the interests of the public, transaction participants and other stakeholders that have not been fully evaluated or applied in the context of Ex-Im Bank's Economic Impact Procedures. See Section D of this Report for an expanded coverage of these findings.

Suggestions for Improvement

The Bank should increase the efficiency and responsiveness of the Bank's Economic Impact Procedures by:

- D.1. Developing and making public a methodology to identify at an early stage transactions where there appears to be little risk of adverse economic impact in order to allow expedited handling of those cases.
- D.2. Requesting exporters of capital equipment to provide relevant data that is reasonably available to them, without undue burden, during the application process to support an accelerated review by the PPG staff.
- D.3. Inviting (but not requiring) proponents of transactions subject to formal economic impact review to submit white paper analyses addressing economic impact concerns that might be raised by the transaction.
- D.4. Providing earlier notice to Congress and the Reviewing Agencies of the initiation of a substantive economic impact review, after an initial screening review but before the PPG staff has prepared a complete economic impact report.
- D.5. Implementing a policy that the Reviewing Agencies will have a specified limited time period after they receive a draft economic impact report in which to submit their comments.
- D.6. Hiring, or contracting for the services of, a trained economist with a background in macroeconomic market analysis of the sort required by economic impact review to assist in implementing the improvements suggested in this Report.

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Background – Ex-Im Bank Mission and Programs

Ex-Im Bank provides support for U.S. exporters and export-related employment by offering guarantees, credit insurance and direct loans to augment the availability of financing for foreign purchasers of goods and services originating in the United States. Ex-Im Bank is directed by its Charter not to compete with the private sector in providing export credit, and to make its support available for transactions where the private sector is unable or unwilling to provide credit or where necessary to “level the playing field” for U.S. exporters competing with foreign producers offering financing through their governmental programs. The Bank may not support transactions unless it is determined that there is a reasonable likelihood of repayment. Ex-Im Bank approved 2,891 authorizations in support of U.S. export sales in its 2009 fiscal year, representing \$21.0 billion in loans, guarantees, and export-credit insurance.

The terms of Ex-Im Bank support vary by program.

- In guarantee transactions, a U.S. or foreign lender provides a loan to the foreign buyer seeking to purchase goods or services acquired from a U.S. exporter. The foreign buyer uses the loan proceeds and its own cash to pay for the exported U.S. goods or services. Ex-Im Bank guarantees the repayment of the loan by the foreign purchaser/borrower in exchange for a fee. If the foreign borrower defaults before the loan is paid in full, Ex-Im Bank reimburses the lender for the amount of the loan and then seeks to collect the debt through legal proceedings in the U.S. or the borrower’s home country.
- In insurance transactions a lender, generally the exporter selling the U.S. made goods to a foreign buyer, provides payment terms to the foreign buyer and obtains a credit insurance policy from Ex-Im Bank in exchange for an insurance premium. If the foreign buyer defaults, Ex-Im Bank insurance reimburses the exporter and Ex-Im Bank attempts to collect the debt from the foreign buyer.
- In direct loan transactions, Ex-Im Bank makes a loan directly to a foreign buyer, who uses the proceeds to pay for the U.S.-sourced goods or services. Ex-Im Bank is compensated by the fees and interest received on the direct loan and pursues its rights as a creditor directly if the foreign buyer defaults.
- Ex-Im Bank also provides guarantees to U.S. lenders that provide working capital financing to U.S. exporters to support the inventory and receivables of the exporter that are attributable to export sales. Any losses incurred by the working capital lender are reimbursed by the Bank.

References in this Report to “support” of export transactions by Ex-Im Bank mean any of the forms of financial support described above.

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Ex-Im Bank's Charter has since 1968 required that "in authorizing any loan or guarantee, the Board of Directors shall take into account any serious adverse effect of such loan or guarantee on the competitive position of United States industry . . ."⁷ The concept underlying this simple statement – that the Board should consider any adverse economic impact of the transactions supported by the Bank on the U.S. economy – has since been significantly expanded to encompass a complex set of considerations and procedures that are all focused on the determination of adverse economic impact. Section 2(e) of the Charter now prohibits the Bank from supporting export sale transactions that are likely to result in substantial injury to U.S. producers of competing goods unless the Bank's Board of Directors determines that, on balance, there is a net benefit to the U.S. economy from the transaction. The issues associated with this requirement are the subject of this Report.

Inherent Challenges in the Economic Impact Review Process

The thoughtful implementation of the suggestions set forth in this Report by the Bank's staff will significantly improve the statutory soundness, transparency, efficiency and responsiveness of the Economic Impact Procedures. The suggested changes address many, but not all, of the criticisms of economic impact review that were provided by the Bank's staff, management, Board of Directors and the Reviewing Agencies during the preparation of this Report. The suggested changes are not a panacea, and even if fully and expertly implemented will not result in economic impact review becoming simple, straightforward and conflict free.

Many of the causes of continuing complexity and potential dissatisfaction with the Bank's Economic Impact Procedures are unavoidable. Economic impact reviews after adoption of all of the suggestions contained in this Report will still require the Bank's PPG staff and Board to address conflicting interests, and pick potential "winners and losers," under conditions of limited time and resources and incomplete and imperfect information. It is particularly important in such cases that the process used by the Bank be as transparent, efficient, procedurally fair and reasonable as is possible under the circumstances so that its results will be accepted as a valid exercise of governmental power in accordance with the law, even if some of the affected parties may disagree with the result.

The inherent sources of difficulty associated with the Bank's Economic Impact Procedures cited by the individuals interviewed in support of this Report include:

- The Charter uses concepts such as "substantial injury to United States producers," "excess supply on world markets" (referred to in this Report as "oversupply" in order to maintain consistency with PPG staff terminology), "short- and long-term benefits to industry and employment in the United States" and "short- and long-term injury to United States producers and employment of

⁷ Ex-Im Bank Charter Section 2(b)(1)(B). The legislative history of economic impact requirements in the Bank's Charter is described in detail in Appendix C.

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the same, similar, or competing commodity” that do not have commonly accepted meanings or criteria for evaluation among business people, academics, professional economists or other possible sources of data and expert and non-expert opinion.

- The Charter requires the Bank’s staff to consider the available, but frequently limited, historical and projected market data to determine if a transaction supported by the Bank today will exceed 1% of U.S. production of a particular Exportable Good⁸ at a projected future date. Future conditions of supply, demand and price in international markets are not possible to predict with a high degree of confidence in most cases. The difficulty of the task is compounded by the necessity to accommodate commercial scheduling requirements.
- Where substantial injury to U.S. producers is presumed to exist because the amount of new or expanded production of the Exportable Good proposed to be supported by the Bank will exceed 1% of U.S. production of the Exportable Good,⁹ the Charter requires the Board to balance “the short- and long-term benefits to industry and employment in the United States” from approving Bank support for a transaction against the likely “short- and long-term injury to United States producers and employment of the same, similar, or competing commodity” at a projected future date. Reliable historical and projected information to support this analysis is frequently not available, and there is an “apples and oranges” aspect of non-comparability when evaluating the effect on two different U.S. industries of approving or rejecting a given transaction.
- The determinations required to be made by the Bank’s staff and by the Board are not susceptible to the application of commonly accepted quantitative methods to readily available and reliable data. Because U.S. and international market structures and dynamics are frequently unique to specific industries, Board decisions in specific cases may not result in records that can be compared for consistency and precedential effect with decisions regarding other transactions impacting other industries.
- The Bank’s PPG staff, management and Board have varying degrees of knowledge and experience to support their economic impact decisions. None of the individuals interviewed during the preparation of this Report claimed professional training or subject matter expertise that is closely focused on the EIP process.
- Competition is a painful, but necessary, characteristic of a healthy U.S. and world economy. Capitalism has been described as “creative destruction” – marginal competitors suffer losses and are driven from existence by more efficient producers on a regular basis. It is a broad, consistent and long-standing policy of the U.S. government to support fair but active competition, domestically and internationally, because of the benefits to the U.S. economy and population. It is also a long-standing policy of individual manufacturers and trade associations to seek to avoid or limit the impact of competitive pressures where they can. U.S. government assistance of any sort to a foreign purchaser of capital equipment that might increase the extent of foreign competition experienced by other U.S. businesses can be of significant concern to the affected

8 See definition of this term on page 3.

9 See Section 2(e)(4) of the Bank’s Charter (Appendix A) and discussion appearing in Section A of this Report.

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U.S. businesses, even if (i) the resulting injury to their business is not “substantial” at the level contemplated by Congress as expressed in Section 2(e) of the Charter, (ii) the same international competitive pressure will exist regardless of any action by Ex-Im Bank and (iii) the proposed transaction will produce a significant net benefit to another sector of the U.S. economy and related employment.

- Ex-Im Bank’s rejection of a transaction because of an adverse economic impact determination provides no assurance that U.S. producers of the specific Exportable Good and related employment will be protected from substantial injury from new foreign production. Rejection of the transaction usually means that the U.S. exporter of capital equipment that requested Ex-Im Bank support for the transaction will lose an export sale. In many cases, the new foreign production of the Exportable Good, and any corresponding loss of U.S. domestic and export sales of the Exportable Good, will still occur because a foreign exporter of competing capital equipment will be standing ready to provide the necessary equipment to the foreign manufacturer. Rejecting Ex-Im Bank financing for a proposed export of U.S. capital goods on economic impact grounds, or because the economic impact process is too cumbersome, expensive and unpredictable, has been described as resulting in “a double hit” for the U.S. economy – foreign competition increases in the Exportable Good industry and a U.S. export sale is lost in the U.S. capital equipment industry.

It is important to note that the determination of economic impact in individual cases by the Bank’s PPG staff and Board of Directors is not an evidentiary proceeding. Transaction proponents and opponents do not present evidence or briefs, they do not appear or argue before the PPG staff or the Board and no appeal rights are provided. Some transaction proponents and opponents have insisted on obtaining a meeting with the Bank’s staff or a Board member to discuss pending economic impact reviews, but those actions are not part of the ordinary process for consideration of transactions. Introducing the procedural requirements of an administrative proceeding would likely increase the cost to the transaction proponents and introduce further delays, making Ex-Im Bank support less, rather than more, efficient, effective and appealing for U.S. exporters.

The current procedures used by the PPG staff are designed to rely upon information about the economic impact of the proposed transaction developed by the PPG staff and obtained in some cases from the Reviewing Agencies, Congress and parties making note of the Federal Register announcement of the transaction. This information is then evaluated by the PPG staff and the Board of Directors as they make their respective judgments of the economic impact implications of a proposed transaction and determine to approve or decline Ex-Im Bank support. The substantial time and effort that would be required for formal hearings, and appeals, would likely exceed the time and resources available for completion of most commercial transactions. Excessive delays in the process, whether resulting from requirements of PPG staff and Board review or organized opposition, effectively decide economic impact cases against the U.S. exporter of capital equipment.

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This Report does not suggest changes in the Charter that would directly address these challenges, which would require legislative action that was determined to be outside the scope of this Report. The findings and suggestions presented are focused on opportunities for positive change in the Economic Impact Procedures that are believed to be consistent with existing provisions of the Charter, and to address the challenges presented by the Charter as described above in a consistent and constructive manner.

Acknowledgement of PPG Staff and GAO Contributions

It should be noted that the PPG staff has been pursuing its own evaluation of the Economic Impact Procedures and has been accumulating a set of possible modifications independently and in response to the 2007 GAO Report. A complete statement of the modifications under consideration by the PPG staff was not requested in the course of preparing this Report in the interest of maintaining the independence of this review. At the same time, it was clear from interviews of members of the PPG staff that their comments, which have been incorporated in the findings and suggestions contained in this Report, were informed by their own ongoing review process. Accordingly, the active assistance and support for this Report, and for positive change in the Economic Impact Procedures, of the PPG staff must be acknowledged. Many of the findings and suggestions in this Report are based upon discussions with the PPG staff, the Bank's management and Board and other interview subjects, including representatives of the Reviewing Agencies. The contribution to this Report of the 2007 GAO Report is also acknowledged.

For additional information regarding the background of this Report, please see Appendix D – Methodology and Background of this Report.

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Section A

Improve Economic Impact Procedures and Reports to Better Support the Board's Congressionally Mandated Role in Deciding Economic Impact Cases

Conclusion

The PPG staff's economic impact reports should support the Board's decisional process under Section 2(e) (1) and (3) of the Charter by presenting the available quantitative and qualitative information obtained by the PPG staff that is material and relevant to the determination of economic impact in a concise balancing format that addresses each of the elements of economic impact specified by the Charter. Economic impact reports, supplemented by the Bank's publicly available Economic Impact Procedures, should be written to reasonably inform the reader of the limitations and qualifications of the data, assumptions, estimates, methods and analysis relied upon by the PPG staff and the sensitivity of the conclusions expressed by the PPG staff to possible changes in assumptions or estimates that can be reasonably anticipated. Reliance on trade flow analysis or any other quantitative methods to effectively decide economic impact cases should be made subject to Board approval and subsequent periodic reaffirmation thereafter.

Findings

Conflicting Congressional Views of Economic Impact

Ex-Im Bank's Economic Impact Procedures are intended to "lay out a reasonable and logical process to analyze the impact of Ex-Im Bank support for a particular transaction" to assure that that the Bank does not "approve a transaction that would, on balance, harm the U.S. economy."¹⁰ The statutory requirements for this process are set forth in Section 2(e) of the Bank's Charter (see Appendices A and C) and have been implemented by the Bank's PPG staff through the publicly disclosed Economic Impact Procedures (see Appendix E) and through internal practices and procedures that have not been publicly disclosed. All parties participating in this process acknowledge that while the objective of economic impact analysis can be stated simply, it is difficult in practice to achieve due to limitations in data, time and resources, the need

¹⁰ Testimony of James L. Lambright, Chairman and President, Export-Import Bank, March 29, 2006, before the Subcommittee on International Trade and Finance of the Senate Committee on Banking, Housing and Urban Affairs.

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to rely on potentially conflicting data and opinions regarding future relationships of supply, demand, prices and terms of international trade in changing markets, and the conflicting interests of different segments of the United States economy.

The solution chosen by Congress to address the difficulties of economic impact analysis, as reflected in Section 2(e)(1), (3) and (4) of the Charter,¹¹ has been to assign to the Bank's Board of Directors, a politically accountable body nominated by the President and confirmed by the Senate, the job of considering and balancing all of the competing interests that can be associated with economic impact cases, and then making the final decision as to whether the transaction will or will not receive Ex-Im Bank support:

- (1) In general. The Bank may not extend any direct credit or financial guarantee for establishing or expanding production of any commodity for export by any country other than the United States, if
 - (A) the Bank determines that –
 - (i) the commodity is likely to be in surplus on world markets at the time the resulting commodity will first be sold; or
 - (ii) the resulting production capacity is expected to compete with United States production of the same, similar, or competing commodity; and
 - (B) the Bank determines that the extension of such credit or guarantee will cause substantial injury to United States producers of the same, similar, or competing commodity.
- (2) Exception. Paragraphs (1) and (2) shall not apply in any case where, in the judgment of the Board of Directors of the Bank, the short- and long-term benefits to industry and employment in the United States are likely to outweigh the short- and long-term injury to United States producers and employment of the same, similar, or competing commodity.
- (3) Definition. For purposes of paragraph (1)(B), the extension of any credit or guarantee by the Bank will cause substantial injury if the amount of the capacity for production established, or the amount of the increase in such capacity expanded, by such credit or guarantee equals or exceeds 1 percent of United States production.

¹¹ Economic impact is addressed in more general terms in Section 2(b)(1)(B) of the Charter and in 12 U.S.C. 635a-2, which are discussed in Appendix C.

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Section 2(e)(3) of the Charter grants the Board the power to approve a transaction even if there is evidence that substantial injury to U.S. producers of the relevant Exportable Good¹² might result. To exercise this authority, the Board must determine that the short- and long-term benefits to industry and employment in the United States accruing from the Bank's support of the proposed transaction are likely to outweigh the short- and long-term injury to United States producers of the Exportable Good and related employment that might result from the transaction.

In developing the detailed decisional process that is currently set forth in Section 2(e) of the Charter over the past twenty years, Congress has digested significant volumes of testimony and evidence regarding the objectives and difficulties of this process. Appendix C sets forth the legislative history of the Charter's provisions addressing economic impact. That history reflects the tension between the nation's interest in supporting the creation of U.S. jobs through expanded exports by U.S. manufacturers of capital equipment and other goods and the nation's interest in avoiding transactions where Ex-Im Bank, as a U.S. government agency, would be perceived as assisting foreign manufacturers whose products might cause substantial injury to U.S. producers and their employees as a result of lost sales, operating losses and losses of jobs.

Some members of Congress have argued, unsuccessfully, that the Bank's Charter should contain an absolute prohibition of Ex-Im Bank support for transactions that might have any significant adverse economic impact on U.S. producers.¹³ They have cited transactions where Ex-Im Bank supported significant foreign purchases of U.S. capital equipment that were used to increase coal production in Colombia, copper production in Mexico and Chile, phosphate production in Morocco and Tunisia and steel production in several countries. The Bank's support of these exports was identified as contributing to persistent, long-term operating losses and losses of employment by U.S. producers of those products. This perspective is referred to in this Report as "Economic Impact Advocate" or "Pro-Economic Impact."

12 The principal criterion applied by the Bank's PPG staff to analyze economic impact has been a quantitative "trade flow" analysis that compares the dollar value of U.S. capital equipment exports (i.e. widget making machinery) attributable to a transaction proposed for Ex-Im Bank support to the discounted dollar value of U.S. production of the products produced with that capital equipment (widgets) that might be "displaced" by the new foreign production of widgets. In lieu of using the term "widgets" and to maintain consistency with terminology used by the PPG staff, the products produced by exported capital equipment that would compete with U.S. production are referred to in this Report as "Exportable Goods." This Report in Section B suggests that the Bank should significantly decrease, or eliminate, its reliance on trade flow analysis to decide economic impact cases.

13 See the arguments made by Representatives Rahall, Craig, Levin, Klecza and Richardson in the floor debates occurring in 1986 during the Bank's reauthorization that led to the adoption of Section 2(e) of the Charter excerpted in Appendix C. Representative Rahall's proposed amendment to the Charter would have prohibited Bank support for proposed transactions where:

- (i) the export will be used or is intended for use in the production or manufacture of any commodity, mineral, material, or product which is produced or manufactured in substantial quantities in the United States; and
- (ii) the production or manufacture of such commodity, mineral, material, or product by such foreign entity will result in:
 - (I) the importation of more than an inconsequential quantity of such commodity, mineral, material, or product into the United States; and
 - (II) a net domestic increase in unemployment in the United States over the period during which any portion of the amount of such credit or guarantee is outstanding.

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Other members of Congress have sought, unsuccessfully, to eliminate many instances of economic impact review from the Ex-Im Bank Charter because they believe that the claimed benefit – avoidance of negative impact on the U.S. economy - will not be realized in most cases.¹⁴ They have pointed out that denial of Ex-Im Bank support will produce a “double hit” to the U.S. economy.¹⁵ First, denial will directly and unquestionably injure the U.S. exporter of capital equipment that loses a sale to a proposed new foreign manufacturing facility. Second, denial of Ex-Im Bank support will not prevent the potential for competitive injury to U.S. producers and employment that might result from the new foreign manufacturing facility. In most cases, a foreign competitor will step in and provide substitute capital equipment. The new foreign manufacturing facility will be built and will still produce the new foreign production that will compete with U.S. producers and result in the same degree of any competitive injury to U.S. producers associated with that facility. This perspective is referred to in this Report as “Economic Impact Critical” or “Anti-Economic Impact.”

The PPG staff has observed that if the rationale for the Anti-Economic Impact position is fully adopted, few if any transactions would ever be deemed to cause substantial injury to U.S. producers because the “substantial injury” will occur anyway when a foreign competitor steps in and provides the capital equipment to increase foreign production of the Exportable Good. From this perspective, if a U.S. industry experiences conditions suggesting substantial injury, it is likely to be attributable to causes other than Ex-Im Bank support for a transaction. The Pro-Economic Impact position counters that if other causes have created conditions suggesting substantial injury in a particular U.S. industry, Ex-Im Bank should not be “helping” foreign competitors buy U.S. capital goods exports that will at some level contribute to making things worse. Section B of this Report provides suggestions as to how the Bank could more constructively address this inherent conflict.

14 Ex-Im Bank is the only one of the export credit agencies of the major industrialized nations that participate in the Organisation for Economic Cooperation and Development (“OECD”) that imposes an economic impact condition upon its support for domestic exports of capital equipment. Report to Congress on Export Credit Competition and the Export-Import Bank of the United States for the period January 1, 2008 through December 31, 2008. http://www.exim.gov/about/reports/compet/documents/2008_competitiveness_report.pdf It is fair to point out, however, that the U.S. has by far the largest and most diversified manufacturing economy among the industrialized nations, and therefore will have a greater potential for apparent or actual conflict between the interests of the manufacturers of capital equipment that produces a particular Exportable Good and domestic manufacturers of that Exportable Good.

15 See the arguments made by Representatives Neal, Leach and Frenzel in the floor debates occurring in 1986 that led to the adoption of Section 2(e) of the Charter, excerpted in Appendix C. Representative Neal’s proposed amendment to Representative Rahall’s amendment, as adopted by a substantial majority of the House, would have permitted the Bank to support U.S. exports to a foreign buyer “which would in the absence of such [Ex-Im Bank provided] financing nevertheless produce or manufacture such commodity, mineral, material, or product.” The “Anti-Economic Impact” Neal Amendment was approved by the House in a recorded vote of 307-87.

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Resolution of the Conflict – Determination by the Ex-Im Bank Board of Directors

To reconcile the conflicting policy perspectives presented in Congressional hearings and debate, Section 2(e) (3) specifies that transactions proposed for Ex-Im Bank support that might result in substantial injury to U.S. producers of the Exportable Good (directly, or indirectly because the world market for the Exportable Good is in a condition of “oversupply”) can only be authorized if the Board concludes that the short- and long-term benefits to industry and employment in the United States accruing from the Bank’s support of the proposed transaction are likely to outweigh the short- and long-term injury to United States producers of the Exportable Good and related employment.¹⁶ To exercise this authority the Board relies on the Bank’s PPG staff to provide it with such information and analysis regarding the costs and benefits of the proposed transaction and its effects on the U.S. economy as can be gathered, analyzed and presented within the limited time and resources available.

Cost benefit analysis is at the heart of many governmental decisions. OMB Circular A-4 provides OMB’s primary source of guidance to executive branch agencies on the development of regulatory analysis, and particularly addresses how to construct sound cost benefit analysis in the face of significant uncertainty of the sort that characterizes economic impact analysis. While OMB Circular A-4 is most directly targeted at rule-making processes, the principles it expresses have broader applicability, and should be considered by the PPG staff as they review and improve their economic impact methodology. The 2007 GAO Report notes that “we believe that a consistent set of methodological principles, such as those embodied in OMB guidance, would nevertheless enhance the economic impact analysis process.”¹⁷ Relevant recommendations from OMB Circular A-4 regarding techniques and approaches that support sound regulatory analysis and decisions are cited where appropriate in this Report.

Limitations on Board Action Resulting from Content of Economic Impact Reports

There have been only a small number of economic impact review cases in which the PPG staff reported that the determination of economic impact was difficult or contested.¹⁸ In these cases, the ability of the Board of Directors to carry out its responsibility under Section 2(e) (3) of the Charter appears to have been impaired by the content and focus of the reports prepared by the PPG staff. The PPG staff reports in the

¹⁶ This compromise, which resulted in the enactment of Section 2(e)(1) and (3) in substantially their current form, was presented by Senator Byrd during the Senate’s consideration of the Bank’s reauthorization during 1986 and was accepted by the House during reconciliation. It reflects a consistent perspective in the legislative history that the Board should take greater responsibility for restraining the Bank’s staff from approving transactions where an adverse economic impact might result. Section 2(e)(4) was not part of the 1986 amendments; it was adopted in 1988 without any explanation of its intent being provided in the legislative history.

¹⁷ 2007 GAO Report page 38.

¹⁸ Appendix B summarizes the 25 transactions that have been the subject of detailed economic impact reports prepared by the PPG staff between 2002 and 2009, out of more than 15,000 transactions approved by the Bank during that time period. The 2007 GAO Report describes in detail the screening process by which the PPG staff identifies the small number of transactions requiring full economic impact review.

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cases reviewed (i) did not address directly several elements of economic impact contemplated by the Charter, (ii) did not include available data and analysis that had relevance to the economic impact of the proposed transaction which was not relied upon by the PPG staff to support its recommendation to the Board, (iii) did not state the limitations and qualifications of the data, assumptions, estimates, methods and analysis relied upon by the PPG staff and (iv) did not fully address the sensitivity of the PPG staff's conclusions to possible changes in assumptions and estimates that could be reasonably anticipated, particularly in cases where the data was mixed or inconclusive.

In the limited number of cases where economic impact has been difficult to determine, where the application for Ex-Im Bank support was withdrawn after the PPG staff advised of a likely negative economic impact determination (usually in reliance on trade flow analysis) or where active opposition to a transaction by an affected industry or manufacturer has developed, the cited conditions have had the effect of diminishing the role of the Board of Directors, placing the Ex-Im Bank PPG staff in the position of effectively deciding the cases based on the results of trade flow analysis. The cited weaknesses in economic impact reports have contributed to confusion, questions, and criticism regarding the Bank's Economic Impact Procedures, and the results of economic impact review, from the Reviewing Agencies and from members of the Board of Directors.

The PPG staff has not directly addressed the conflict between the Pro-Economic Impact and Anti-Economic Impact perspectives in the economic impact reports prepared between 2002 and 2009. The PPG staff is keenly aware of the conflict, and in interviews identified the difficulty of that conflict as one of the drivers of the decision to rely heavily on trade flow analysis to support economic impact decisions. The PPG staff takes on a difficult, and statutorily unsupported, task in attempting to resolve the conflict between the Pro-Economic Impact and Anti-Economic Impact perspectives – Section 2(e) of the Bank's Charter assigns that responsibility to the Board. The obligation of the PPG staff is to provide to the Board with such relevant and reasonably reliable data and analysis as can be gathered within the limits of time and resources so that the Board can exercise its responsibility.

The economic impact reports reviewed in the preparation of this Report, and the trade flow analysis upon which they have been based, can be fairly criticized as accepting the Economic Impact Advocate perspective and rejecting the Economic Impact Critic perspective. These reports are based upon the assumptions that (i) if an additional amount of more than 1% of U.S. production will result from a transaction, substantial injury is proven for all purposes, and (ii) if the dollar value associated with a particular volume of new production of an Exportable Good that will compete with U.S. production exceeds the dollar value of the export transaction proposed for Ex-Im Bank support, there is no basis upon which the Board could conclude that substantial injury will not result, demanding that the Board reject support of the transaction.

Unlike the Pro-Economic Impact position expressed in congressional debate, which pointed at specific macroeconomic conditions suggesting substantial injury, such as substantial long-term operating and employment losses, the PPG staff's methodology does not require consideration of whether actual substantial injury is occurring or is likely to occur. No mention of the possible applicability of the perspective of the Economic Impact Critics to the transaction is made, facts relevant to that perspective are generally presented only in passing, if at all, and nowhere in the Bank's Economic Impact Procedures is

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there any discussion that would reasonably support a decision by the Board to act based on the Economic Impact Critic perspective. The result is that the analytical tools used by the Bank's PPG staff effectively usurp the decisional role that Congress intended the Board to exercise.

The only way for the PPG staff's economic impact reports to do justice to the Pro-Economic Impact and Anti-Economic Impact perspectives is to expressly acknowledge the two conflicting views, identify criteria that are relevant to each and provide analysis and data in economic impact reports that address each of them, to the extent it is available. Any other approach puts the PPG staff in the position of having to take sides in an argument that Congress could not resolve, and interposes the staff's judgment for the Board's. The absence of active Board involvement and guidance in deciding Ex-Im Bank support for transactions that present economic impact issues has been a continuing source of frustration to various members of Congress that is reflected in the legislative history and repeated efforts to modify the economic impact provisions of the Bank's Charter.

Consideration of the full range of criteria discussed in this Report, and others that the PPG staff may identify from the two perspectives in specific cases, may indicate to a neutral observer that one or the other of the Pro- or Anti-Economic Impact perspectives is most appropriate to facts of a specific case, a conclusion that the PPG staff could state in its recommendation to the Board. And with which the Board could disagree, provided that the PPG staff makes available to the Board the analysis and data that would support a majority of the Board in adopting an opposing view.

What the Bank's Charter Says About the Role of the Board of Directors in Deciding Economic Impact Cases

The broad, non-technical and future-oriented language used by Congress in Section 2(e) of the Bank's Charter, and the views expressed by Congress and the public in its legislative history, strongly suggest that Congress did not expect that economic impact decisions regarding Ex-Im Bank transactions would be made by experts relying upon exhaustive data or finely tuned quantitative modeling of the economy, employment or international markets. Most of the individual factual determinations required to complete the Board's assigned task of balancing future short- and long-term costs and benefits to the U.S. economy are not capable of certainty. Many are inherently unknowable and can only be indirectly estimated or approximated by reference to historical market data and the expected duration of current or anticipated trends. Congress' choice of language reflects an expectation that politically accountable individuals serving on the Bank's Board of Directors should make these decisions based upon a reasonable knowledge of U.S. business and international trade, supported by more expert advice and data developed by the Bank's staff.

The Bank's PPG staff is assigned the important role of gathering the available information, and making preliminary determinations relevant to the ultimate balancing analysis by the Board that will decide an economic impact case. This task requires that the Bank's PPG staff have a basic understanding of market

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dynamics, sources of relevant information and techniques for analyzing that data. The requirement to notify and consult with other departments of the government and committees of Congress having knowledge of relevant information¹⁹ is intended to supplement the knowledge and data possessed by the PPG staff.

The PPG staff has developed significant experience in analyzing international trade market conditions in the context of the Bank's economic impact cases, although none of the current PPG staff are professionally trained as economists in this discipline.²⁰ The PPG staff has observed that one of the significant challenges in preparing economic impact reports is that each relevant product market has unique characteristics, making it difficult to develop generally applicable procedures and methods, and making it unreasonable to expect that the PPG staff could be expanded to include economists with deep experience in specific relevant markets.²¹

The suggestions made in this and other sections of this Report are based upon the following principles, which are believed to be consistent with the authority given to the Board in the Bank's Charter and Bylaws. As a result, it is within the authority of the Board to request, should it so choose, that the Bank's officers and staff implement Section 2(e) of the Charter in a manner consistent with these principles:

The Board, not the Bank's staff or officers, should make the balancing decisions contemplated by Section 2(e) based upon all material, relevant information that can be reasonably obtained within the resources available to the Bank, in a rational way that is consistent with the ordinary meaning of the words of the statute.

The Board cannot exercise its statutory authority unless the Bank's PPG staff in its economic impact reports provides to the Board information, to the extent available, and a balanced supporting analysis of that information, that will allow the Board to address the considerations expressed in Section 2(e) of the Charter.

19 The Departments of State, Treasury and Commerce and the Office of the United States Trade Representative receive draft copies of the PPG staff's economic impact reports, with the opportunity to comment to the staff and the Board. Section 2(e)(7) of the Bank's Charter requires that the Bank seek comments from the Department of Commerce, the Office of Management and Budget, the Committee on Banking, Housing and Urban Affairs of the Senate and the Committee on Financial Services of the House of Representatives.

20 Section D of this Report suggests that hiring or contracting for the services of a professional economist with training in macroeconomic market analysis would improve the quality of the PPG staff's work on economic impact cases and its reports presented to the Board.

21 The PPG staff could obtain meaningful assistance from an economics PhD at a general level if it adopts this Report's suggestion that economic impact analysis should focus more on large scale, macroeconomic trends. Complex, difficult or contested cases where it becomes necessary to evaluate significant volumes of conflicting market data also represent opportunities to improve the PPG staff's economic impact reports, and the staff's and Board's decision making, by engaging an appropriately trained and experienced economist.

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Because the Economic Impact Procedures do not provide for proponents and opponents of Ex-Im Bank support for a particular transaction to submit evidence and briefs in support of their respective views, it is incumbent on the PPG staff to do a credible job of presenting the Board with data and arguments on both sides of the question, to the extent that it exists and can be developed within the limits of the resources and time available. (Balancing Approach).

When Congress assigns a specific function or decision to a politically accountable body, as it has in the case of the Board's authority under Section 2(e) of the Charter to decide economic impact cases, the informed consent of that body is required to delegate material elements of its decisional authority, or to adopt methodologies that implement that authority in a manner that is materially different than is expressly set forth in the authorizing statute.²²

When the Board delegates portions of its authority to the Bank's staff, or approves the adoption of decisional methodologies with which to exercise its authority, the Board retains the power to review the results of those delegations and methods, and to make changes in them as needed to more effectively reflect the Board's intent, and the intent of Congress as reflected in the Charter.

The Content of Economic Impact Reports – Five Core Questions to Be Answered

Section 2(e) of the Charter (see Appendix A), as implemented through Ex-Im Bank's Economic Impact Procedures (see Appendix E), requires that five core questions of economic impact be addressed when a proposed export of capital equipment will result in the creation of new foreign production of an Exportable Good that is expected to compete with the same, similar or competing commodity produced by U.S. manufacturers. Each of these core questions has presented particular challenges to the development of an effective decisional process relating to economic impact cases. Awareness and attention to the existence of these questions by the Bank's Board and staff and of the Board's responsibility under the Charter will improve the quality of the results of economic impact analysis:

Question 1: Has the Bank's staff determined that there is likely to be a surplus ("oversupply") of the Exportable Good on world markets at the time the new or expanded foreign production of the Exportable Good resulting from a transaction supported by the Bank will first be sold? (Charter Sec. 2(e)(1)(A)(i), EIP Stage V, Section 3.b.i)

²² Specific statutes may be drafted broadly or narrowly, which will impact the degree of discretion for interpretation that is bestowed upon the agency staff and decisional body. In the 2007 OIG Report (Appendix G), which considered the Bank's use of a \$10 million screen to determine whether specific transactions will be considered by the Board, and correspondingly subjected to the Economic Impact Procedures and other statutory evaluations, the OIG concluded that the fact that the Board had expressly considered and adopted that methodology validated it under the Bank's Charter and other relevant law. See *Chevron U.S.A. Inc. v. Natural Resources Defense Council, Inc.*, 467 U.S. 837, 104 S.Ct. 2778, 81 L.Ed.2d 694 (1984) and *U.S. v. Mead Corporation*, 533 U.S. 218, 121 S.Ct. 2164 (2001).

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Question 2: Will the amount of new or expanded foreign production of the Exportable Good resulting from a transaction proposed to be supported by the Bank exceed 1% of U.S. production of the Exportable Good (including similar or competing commodities) at the time the Exportable Good supported by the Bank will first be sold? (Charter Sec. 2(e)(1)(B), 2(e)(4), EIP Stage V, Section 2)

Question 3: Has the Bank's staff determined that the amount of new or expanded foreign production of the Exportable Good resulting from a transaction proposed to be supported by the Bank will cause substantial injury to U.S. producers of the Exportable Good (including U.S. producers of similar or competing commodities)? (Charter Sec. 2(e)(1)(B))²³

Question 4: Has the Bank's staff determined that the foreign manufacturing facility that will benefit from the Ex-Im Bank-financed capital equipment is reasonably likely to produce a commodity in addition to, or other than, the Exportable Good specified in the application for Ex-Im Bank support, and if so, might the production of that additional commodity cause substantial injury to U.S. producers of the additional, or similar or competing, commodities? (Charter Sec. 2(e)(1)(B))²³

Question 5: If any of the preceding questions has been answered in the affirmative by the Bank's staff, then, in the judgment of the Board of Directors, are the short- and long-term benefits to industry and employment in the United States accruing from the Bank's support of the proposed transaction likely to outweigh the short- and long-term injury to United States producers of the Exportable Good and related employment? (Charter Sec. 2(e)(3), EIP Stage V, Section 3.b.ii)

The PPG staff's economic impact reports reviewed for this Report have not systematically addressed each of the first four questions, nor have they generally provided the Board with analysis and data that would support the Board's determination of the answer to Question 5. As described in greater detail in Section B of this Report, the primary criterion applied by the PPG staff to support the staff's recommendations, and the Board's decisions, regarding economic impact cases in recent years is a quantitative trade flow analysis that compares the dollar value of U.S. exports supported by a proposed transaction to a discounted dollar value of projected future foreign production of the Exportable Goods that might "displace" sales of U.S. goods.

The PPG staff's trade flow analysis purports to address Questions 3 and 5 by concluding that "substantial injury" exceeding any possible benefit to the U.S. economy is likely to exist if (a) the new production of an Exportable Good will exceed 1% of U.S. production and (b) the discounted dollar value of the relevant new foreign production exceeds the dollar value of the proposed U.S. export.

²³ The Economic Impact Procedures do not directly address this requirement, which was added to the Charter in 2006. In practice, the PPG staff in its economic impact analysis, and the Reviewing Agencies and the public in their comments, have in some cases considered whether the Ex-Im Bank supported capital equipment can be used to make other products than the Exportable Goods specified in the application, and also whether the Exportable Goods produced by the Ex-Im Bank supported capital equipment are intended to be incorporated in other commodities that would compete with U.S. producers.

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In addition to the trade flow analysis, economic impact reports usually include other data obtained by the PPG staff regarding production capacity and volumes, pricing and other conditions affecting U.S. and foreign markets for the Exportable Goods currently and in the recent past.²⁴ The Economic Impact Procedures do not elaborate on the nature, sources, or impact of this supplemental data beyond the statements reflected in footnote 24.

A review of the economic impact reports prepared between 2002 and 2009 indicates that when supplemental market data has conflicted with the results of trade flow analysis, the PPG staff has generally attempted to modify the trade flow model to better accord with the data, as discussed below in Section B. No instances of economic impact reports were identified where supplemental market data was cited to support a different conclusion than that derived from quantitative trade flow analysis. Only one transaction was identified where the Board, taking all the component data into account, reached a decision differing from the PPG staff's recommendation. The primary sources of data conflicting with the recommendation of the PPG staff have been comments provided by the Reviewing Agencies and affected private parties responding to notice of the proposed transaction.

Misinterpretation of Section 2(e)(4) by the Bank's Staff

The Economic Impact Procedures, and the staff's economic impact reports, do not directly provide for an independent determination of substantial injury. This is surprising, and ultimately undermines the validity of the current Economic Impact Procedures, because the clear statutory objective of Section 2(e) of the Charter is to prevent substantial injury to U.S. producers of an Exportable Good that might result from an Ex-Im Bank supported transaction.

The PPG staff reports that the failure of economic impact analysis to focus clearly on indicia of substantial injury to U.S. producers reflects their interpretation of the effect of Section 2(e)(4) of the Charter, which states that: "For purposes of paragraph (1)(B), the extension of any credit or guarantee by the Bank will cause substantial injury if the amount of the capacity for production established, or the amount of the increase in such capacity expanded, by such credit or guarantee equals or exceeds 1 percent of United States production." This Report disagrees strongly with the PPG staff's interpretation.

²⁴ "In addition to measuring whether the foreign buyer's increased production could displace U.S. production of the same, similar, or competing good in markets where the foreign buyer directly competes head-to-head with U.S. production, the economic impact analysis will also consider other secondary factors and impacts of the proposed transaction. These other factors include: concurrent additions to production capacity of the product in the U.S., buyer's country and any markets that may directly affect the prospects for current U.S. producers, the current and expected international trade flows of the product including the possibility that the foreign buyer's production may displace production from a third-country resulting in displaced U.S. production, or reduced U.S. market share." Economic Impact Procedures, Stage V, Sec. 3.b. "The next step in the economic impact process is the weighing of the analytical findings of the preceding steps and the qualitative information received through the notice and comment period (e.g., views from other USG agencies and affected parties) to determine the overall impact of Ex-Im Bank financing on the U.S. economy. At the conclusion of the economic impact analysis, staff makes a recommendation based on its evaluation of the various components. The Board takes all these components into account in reaching a decision." Economic Impact Procedures, Stage V, Sec. 3.c.

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Section 2(e)(4) clearly states that the “definition” it provides relates only to paragraph (1)(B) of Section 2(e) of the Charter, which states:

- (1) In general. The Bank may not extend any direct credit or financial guarantee for establishing or expanding production of any commodity for export by any country other than the United States, if – . . . (B) the Bank determines that the extension of such credit or guarantee will cause substantial injury to United States producers of the same, similar, or competing commodity.

Section 2(e)(4) clearly does not apply its definition of substantial injury to Section 2(e)(3), which is the source of the Board’s responsibility to make the final decision on transactions that are required to be subjected to economic impact analysis: (3) Exception. Paragraphs (1) and (2) shall not apply in any case where, in the judgment of the Board of Directors of the Bank, the short- and long-term benefits to industry and employment in the United States are likely to outweigh the short- and long-term injury to United States producers and employment of the same, similar, or competing commodity.

The PPG staff’s economic impact reports issued between 2002 and 2009, and the use of trade flow analysis to reach a final PPG staff recommendation, rely excessively on establishment of “substantial injury” as a definitional matter under Sections 2(e)(4) and 2(e)(1)(B) as proof of substantial injury for purposes of the Board’s decisional responsibility under Section 2(e)(3). This result is not supported by the statute.

A more plausible interpretation of Section 2(e)(4) in view of the legislative history from 1986, and from 1988 when Section 2(e)(4) was adopted with almost no legislative comment, is that Section 2(e)(4) is intended to achieve a particular procedural effect – forcing transactions resulting in new production of an Exportable Good above a de minimis percentage of U.S. production (1%) to be decided by the Board of Directors, and not by the Bank’s staff. Without this procedural mechanism, the Bank’s staff would be able to effectively decide all economic impact cases in favor of the U.S. exporter of capital equipment by finding, on the limited available evidence of likely future market conditions that substantial injury to U.S. producers of the Exportable Good was unlikely to occur. Without Section 2(e)(4), the Board’s decisional authority would only be invoked if the Bank’s staff found that actual substantial injury to U.S. producers of the Exportable Good was likely to occur. As is developed throughout this Report, there are few objective tests that have any convincing claim to answer that question, so the Bank’s staff would, if that were their sole task, have relatively unbounded discretion to approve transactions.

A review of the legislative history of Section 2(e) of the Charter, confirmed by the recollection of senior PPG staff, makes it immediately clear that Congress did not engage in any fact-finding effort to determine what level of new foreign production of an Exportable Good would be expected to result in substantial injury to U.S. producers of the Exportable Good. The 1% threshold effectively creates a presumption of substantial injury at the level of the PPG staff’s initial examination of a transaction’s economic impact, but not at the level of the Board’s final decision of the matter.

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The small number of specific industries mentioned in the legislative history appears to have involved levels of production, and imports to the U.S., significantly above the 1% threshold. Using the presumption of substantial injury at a level of 1% of U.S. production to assign the decision to the Board of Directors, rather than the Bank's staff, was reported by a senior member of the PPG staff to have been a compromise of the irresolvable difference in perspective between the Pro- and Anti-Economic Impact members of Congress.

As is developed earlier in this section of the Report, the Economic Impact Advocates during the 1986 Congressional floor debates (excerpted in Appendix C) were soundly defeated by the majority of Economic Impact Critics when the Advocates attempted to include in the Bank's Charter a clear provision that would have prohibited Ex-Im Bank support for transactions where there was evidence that substantial injury could result. The compromise that was achieved was that the Bank's politically accountable Board of Directors would be charged with considering the issue and making the decision, rather than leaving it solely in the hands of the Bank's staff.

Issues in the Bank's Approach to the Five Core Questions

The following subsections examine each of the five core questions which must be analyzed in the Bank's detailed economic impact reviews (i) describing the approach of the PPG staff in addressing each of them in the economic impact reports reviewed for this Report, (ii) analyzing the significance of each question for the Board's decision-making responsibility, and (iii) suggesting how each question could be addressed more consistently with the Bank's Charter.

Question 1 – Oversupply

Has the Bank's staff determined that there is likely to be a surplus ("oversupply") of the Exportable Good on world markets at the time the new or expanded foreign production of the Exportable Good resulting from a transaction supported by the Bank will first be sold? (Charter Sec. 2(e)(1)(A)(i), EIP Stage V, Section 3.b.i)

Economic impact reports typically address the question of oversupply²⁵ in some detail. Congress did not define the concept in the Charter; the PPG staff coined the term as shorthand for a condition where a "commodity is likely to be in surplus on world markets" as expressed in Section 2(e)(1)(A)(i) of the Charter. Section 3.b.i. of the Economic Impact Procedures (Appendix E) provides the Bank's only public statement on the subject. The legislative history of Section 2(e) supports the meaning of oversupply used by the PPG

²⁵ The field of economics does not recognize "oversupply" as a term of art having technical meaning, nor does economic theory generally admit that there can be a "surplus" of a product on a market for any material length of time absent intervention by a government or other controlling actor. If at some point a significant new supply of the product is introduced to the market, or if demand for the product drops sharply, such that supply would exceed demand at the then current price, the price will adjust downward to a point where supply and demand will soon come into balance, making any surplus a temporary phenomenon at most.

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staff. GAO in the 2007 GAO Report observes that “Ex-Im’s oversupply assessment—which can be a key factor in determining economic impact—lacks a clear basis because Ex-Im has not defined oversupply or matched the list of oversupply indicators in its procedures with those that they actually use.”²⁶

Consideration of oversupply as a possible basis for Ex-Im Bank to decline to support a transaction addresses the concern expressed by members and witnesses in Congressional hearings that substantial injury to U.S. producers of an Exportable Good might result if the creation of new foreign production of an Exportable Good occurs at a time when U.S. producers are already suffering substantial injury in terms of declining prices, declining sales volumes, significant reductions in workforce, operating losses and business failures. Under those conditions, it is fair to say that the available supply of the Exportable Good on world markets materially exceeds demand for the Exportable Good at a price that would allow U.S. producers of the Exportable Good to sell their normal levels of production at a reasonable profit and support or expand their employment base.

Among the indicia of oversupply cited in the Economic Impact Procedures are anti-dumping or countervailing duty orders against a product (preliminary or final), Section 201 investigations of unfair trade practices initiated at the behest of U.S. government actors, stagnating or falling global prices and/or falling gross margins (price minus variable cost) of domestic producers, industry bankruptcy trends and/or industry unemployment trends, Trade Adjustment and Assistance (TAA) Program petitions and multi-lateral production limitation agreements.

The fact that the oversupply required to be considered is in the future, at the time the new foreign production facility begins to produce Exportable Goods, complicates the analysis as dynamic and unpredictable economic trends can be expected to impact the future state of the international market. The resulting uncertainty has generally not been addressed systematically by the PPG staff through development of standard methods for projecting future market conditions or through sensitivity analysis. In practice, the most recent data available to the PPG staff, sometimes one or two years old, is generally considered to be a reasonable approximation of the expected future state of the market.

In some economic impact reports the PPG staff has made a distinction between “structural oversupply” and “cyclical oversupply” of an Exportable Good in terms of how the trade flow analytical model is applied. “Structural oversupply” is identified as a condition where underlying fundamentals in an international market result in depressed prices, significant employment losses or other adverse effects to U.S. producers or the international market generally over extended periods of time. In an industry experiencing structural oversupply, any new foreign manufacturing capacity for an Exportable Good would then be predicted by the PPG staff’s trade flow analysis to result in substantial injury to U.S. producers.

“Cyclical oversupply” is identified as a condition where the international market for the Exportable Good fluctuates in a somewhat predictable pattern over time such that in “up” years when demand exceeds supplies of the Exportable Good, producing upward pressure on prices, new foreign production of the

²⁶ 2007 GAO Report, page 30.

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Exportable Good would be expected to be absorbed without any ill effect on U.S. producers. In “down” years when demand weakens and production capacity for the Exportable Good exceeds supply at a desirable price level, a negative impact on U.S. producers would be predicted.

Consideration of oversupply has been effectively incorporated in the PPG staff’s trade flow analysis, and thereby in the balancing of costs and benefits supporting the PPG staff’s recommendations to the Board, by counting the expected foreign production of the Exportable Good on an “every-other-year” basis in industries subject to cyclical oversupply and in every year for industries experiencing structural oversupply. This has been described by the PPG staff as a pragmatic adjustment to the quantitative trade flow analysis to cause it to be more consistent with the observed realities of a specific market.

The PPG staff’s reports distinguishing structural and cyclical oversupply have drawn criticism from the Reviewing Agencies as not having support in Section 2(e) of the Bank’s Charter, where Congress expressly specified the required determination as being whether “the [Exportable Good] is likely to be in surplus on world markets at the time the resulting [Exportable Good] will first be sold.” Using the every-other-year convention in quantitative trade flow analysis has also been criticized by the Reviewing Agencies and by some members of the Bank’s Board as having questionable validity and possibly suggesting a results-driven effort by the PPG staff to produce a particular result from the trade flow model.

The criticism leveled at the consideration of “cyclical oversupply” and the “every-other-year” convention used in trade flow analysis both reflect the inherent difficulty of the task assigned to the Bank and the Board by Congress in Section 2(e) of the Charter, and the inherent weakness of quantitative trade flow analysis as a criterion for deciding economic impact cases, as discussed in more detail in Section B below. Both proponents and opponents of a transaction may seek to use the result suggested by trade flow analysis as the decisive criterion supporting their position without addressing the fundamental issues that the Board is charged with considering under Section 2(e) of the Charter - whether actual substantial injury to a U.S. industry producing an Exportable Good is expected to occur as a result of Ex-Im Bank support of a transaction, and whether that injury is offset by benefits accruing from completing the export of U.S.-made capital equipment.

The concepts of structural and cyclical oversupply also reflects the inherent difficulty of economic impact analysis as laid out in the Charter. If a foreign factory that is proposing to buy Ex-Im Bank supported U.S. manufacturing equipment is projected to begin production eighteen months later, it is not possible for anyone to predict with certainty that oversupply that existed two years ago, and which may or may not exist today (the data being unavailable), will exist on that future day. Further, even if oversupply is presumed to exist on a future date, the inquiry contemplated by Section 2(e) does not stop there. The core question to be decided is whether in view of the full range of data and analysis that may be considered by the Board, “the short- and long-term benefits to industry and employment in the United States [from the proposed transaction] are likely to outweigh the short- and long-term injury to United States producers and employment of the same, similar, or competing [Exportable Good].” Whatever “costs” are considered in that analysis, it is likely that their impact will be felt over an extended period of time, not on a single day when the new foreign production commences.

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If quantitative trade flow analysis is no longer used as the primary criterion for deciding economic impact cases, as suggested in Section B, then the existence of structural as opposed to cyclical oversupply becomes one of a number of relevant criteria to be considered by the PPG staff in its report and recommendation to the Board, and by the Board in its balancing analysis. In a proper case, it would appear reasonable for the Board to conclude that the risk of future harm to U.S. producers from the creation of new, potentially competing, foreign supply of an Exportable Good will be greater where the market is subject to structural oversupply than where oversupply conditions historically have been cyclical.

Question 2 – 1% of U.S. Production

Will the amount of new or expanded foreign production of the Exportable Good resulting from a transaction proposed to be supported by the Bank exceed 1% of U.S. production of the Exportable Good (including similar or competing commodities) at the time the Exportable Good supported by the Bank will first be sold? (Charter Sec. 2(e)(1)(B), 2(e)(4), EIP Stage V, Section 2)

Economic impact reports less frequently and completely address Question 2, although it can have significant effect. If a transaction will not result in the creation of new foreign production that will exceed the 1% of U.S. production threshold, no further economic impact review is required²⁷ unless the market is determined to be in a condition of oversupply.²⁸ The PPG staff reports devoting substantial resources upon receipt of an application for Ex-Im Bank support of an export of capital equipment to identify the relevant Exportable Good market or markets and to obtain data on U.S. production levels in order to support this analysis.

As with Question 1, the PPG staff's analysis is typically based on data that is one or two years old combined with an assumption that the past is a reasonable approximation of future conditions. At one level, applying the 1% of U.S. production test can be fairly simple, and that simple data is typically included in economic impact reports as a comparison of the projected annual foreign production of the Exportable Good in units against U.S. production of the Exportable Goods in units during the most recent available year. A number of potential complicating factors are not typically addressed in economic impact analyses, such as:

Are U.S. production, consumption, inventories, and prices increasing or decreasing over time, and at what rate?

27 Section 2(e), as well as Section 2(b)(1)(B) and 12 U.S.C. 635a-2 (all presented in Appendix C), provide support for the Bank's staff or Board to decline Ex-Im Bank support for any transaction based on concerns that an adverse economic impact to the U.S. would occur.

28 The 2007 OIG Report attached as Appendix G reviews the PPG staff's consideration of applying the concept of "proportionality" to the 1% of U.S. production test. Simply stated, if the Ex-Im Bank supported export of capital equipment only represented 10% of the cost of a new production facility, the proportionality concept would assert that only 10% of the output of the facility should be counted as new production of an Exportable Good attributable to Ex-Im Bank support for purposes of the 1% of U.S. production test. Based on criticism of this use of proportionality, the Economic Impact Procedures now provide that "the concept referred to as "proportionality" . . . shall not be the only element used to avoid a full economic analysis." Stage V, Section 2 (Appendix E).

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Is worldwide demand for the Exportable Good increasing, and at what rate, relative to new worldwide production such that new demand might absorb, or more than absorb, the new production, resulting in rising prices and profits for competitive U.S. producers?

The wording of Section 2(e)(1), (2) and (4) in the context of the inquiry into “substantial injury” raises the question of what Congress intended in stating as a “definition” that a transaction approved by Ex-Im Bank will cause substantial injury if the new foreign production of an Exportable Good that results exceeds 1% of U.S. production. A review of the legislative history of Section 2(e)(4)’s 1% of U.S. production test indicates that it was adopted by Congress based on its use as a minimum threshold for analysis in a single Ex-Im Bank economic impact report, which appears to have adopted it as a de minimis threshold. As a historical note, the 1% threshold has been in effect for approximately 20 years. During that time, the PPG staff reports that only a small fraction, less than 10%, of the transactions evaluated for economic impact by Ex-Im Bank because they would contribute to new foreign production of an Exportable Good have been found to actually involve any conceivable question of substantial injury to U.S. producers of an Exportable Good and related employment.

Viewed as a procedural rule, the 1% test assures Congress that the Bank’s staff does not have the ability to avoid submitting difficult economic impact questions to the Board by the expedient of determining under Section 2(e)(1)(B) that a proposed transaction will not cause “substantial injury” to U.S. producers. The factual determination of substantial injury to U.S. producers is at the core of the economic impact review Congress assigned to the Bank’s Board of Directors. For the same reasons, the PPG staff’s “1% of U.S. production” analysis should not be applied in a way that keeps from the Board of Directors evidence of actual substantial injury to U.S. producers from a proposed transaction, or the absence of any evidence of potential substantial injury.

The data and analysis developed by the PPG staff to support their determination of the “1% of U.S. production” test should be summarized and included in the economic impact reports presented to the Board. In an appropriately supported case, it would appear reasonable for the Board to conclude that the risk of harm to U.S. producers of an Exportable Good and related employment that might result from an Ex-Im Bank supported export of capital equipment will be greater where the new production of an Exportable Good is a higher percentage of U.S. production than in a case where the new production is a relatively lower percentage of U.S. production.²⁹ Comparable data and analysis for international production of the Exportable Good is also likely to be relevant. In many industries, production costs and prices are determined in international markets. U.S. production, even if it has grown domestically, in many sectors has represented a declining percentage of worldwide production.³⁰

²⁹ At the same time, care should be taken to be sure that other data that may impact the conclusion are taken into account. A relatively smaller amount of new foreign production that is specifically targeted at the U.S. market might be found to have a potentially greater economic impact on U.S. producers than would a relatively larger amount of new foreign production that is likely to be absorbed in foreign markets where U.S. producers may have relatively smaller shares of the market.

³⁰ The potential competitive impact of new foreign production equal to 1.1% of U.S. production will be much greater in a market where U.S. production represents 50% of world-wide production than will be the case where U.S. production represents 10% or less of world-wide production, the effects of these considerations were not typically analyzed in the economic impact reports reviewed by the OIG.

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Question 3 – Substantial Injury

Has the Bank's staff determined that the amount of new or expanded foreign production of the Exportable Good resulting from a transaction proposed to be supported by the Bank will cause substantial injury to U.S. producers of the Exportable Good (including U.S. producers of similar or competing commodities)? (Charter Sec. 2(e)(1)(B))

The issue of substantial injury to U.S. producers necessarily reappears as part of Question 5, where the Board is required to evaluate the “short- and long-term costs” to U.S. producers of the Exportable Good and related employment in relation to the “short- and long-term benefits” of the transaction for the U.S. economy and employment. A fair reading of Section 2(e) is that the “short- and long-term costs” to be balanced by the Board are the effects of substantial injury – lost sales, declining prices, operating losses, declining employment. Because the PPG staff has determined to so strongly base its analysis and recommendations on trade flow analysis, as discussed in more detail in Section B of this Report, and because trade flow analysis considers only the relative magnitude of potential head-to-head competition between the new foreign production of the Exportable Good and U.S. production of the Exportable Good, there has been only limited consideration of the likelihood of substantial injury to U.S. producers, independently in response to Section 2(e)(1)(B) of the Charter or in connection with Question 5. This is one of the reasons this Report in Section B suggests decreased reliance on trade flow analysis and expansion of the criteria considered by the PPG staff and presented in its economic impact reports.

The legislative history of Section 2(e) provides a number of examples of what some members of Congress viewed as U.S. industries that were experiencing the sort of “substantial injury” to U.S. producers and related employment that it was concerned about, and where Ex-Im Bank had, or was proposed, to provide support for capital equipment that would increase the foreign production. These examples include Colombian coal production, copper production in Mexico, Chile and Peru, Moroccan and Tunisian phosphate production, world-wide steel production generally and DRAM computer chip production in the Pacific Rim.³¹ In each of these instances, strong foreign competition at significantly lower prices, sometimes supported by foreign government subsidies, produced conditions such as significant reductions in U.S. employment or wages in the affected industries, operating losses incurred by U.S. producers and U.S. producers going out of business over sustained periods. These effects were not cyclical in nature, and did not merely “squeeze” otherwise profitable U.S. businesses. The sort of large scale, prolonged effects on particular U.S. industries are referred to in this Report as “macroeconomic” injury.

It is notable that the examples cited in the legislative history of Section 2(e) do not include cases where the industries were cyclical, enjoying some good years and some bad years, or where increased foreign competition had put pressure on profitability, resulting in U.S. producers working to improve their competitiveness by responding with efficiency improvements that might result in viable, healthy companies even as the industry as a whole experiences employment decreases and sees marginal competitors failing. The examples cited in the legislative history of Section 2(e) contemplate “substantial injury” at a macroeconomic level that is materially above and beyond the sort of pain and dislocation that accompanies

³¹ See Appendix C.

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having to participate in a competitive world economy. In today's economy, it is expected that service and quality will improve over time, while prices decrease, new international competitors regularly appear, and the manpower commitments and other costs associated with producing a given volume of goods will decrease steadily over time.

Despite the clear references in the legislative history of Section 2(e) to U.S. industries experiencing the sort of macroeconomic "substantial injury" conditions that Congress intended should be considered by the PPG staff and the Board of Directors in making economic impact determinations, these conditions are largely unaddressed by quantitative trade flow analysis and other features of the Bank's current Economic Impact Procedures. Interviews of PPG staff confirmed that they have an effective understanding of the significance of the sorts of macroeconomic "substantial injury" conditions identified in the legislative history. It is apparent from the PPG staff's explanations of the results of specific economic impact cases that these conditions, or their absence, were given significant weight by the PPG staff in determining the results indicated by trade flow analysis. In some cases, the PPG staff cited the presence or absence of indicators of macroeconomic injury as the basis for their decision to modify the trade flow analysis methodology so it was more in accord with the observed data. Focus on the largest sources of the costs and benefits considered in economic impact analysis, even if they cannot be quantified, is consistent with the guidance provided in OMB Circular A-4.³²

By failing to identify and analyze the sort of conditions indicating substantial injury that are underlying economic impact decisions, the current Economic Impact Procedures make it difficult for the Board to assess the staff's recommendations, particularly in cases where a Reviewing Agency, or a company or industry that is struggling with international competition, registers opposition to a particular transaction. This is one of the principal considerations underlying the suggestion in Section B of this Report that the Economic Impact Procedures be improved by developing additional criteria for assessing economic impact and decreasing reliance on trade flow analysis.

The PPG staff's economic impact reports prepared during the covered period of 2002 to 2009 and interviews with the PPG staff, the Board and representatives of the Reviewing Agencies convey a consistent impression that macroeconomic data demonstrating the absence of substantial injury in specific U.S. Exportable Goods markets has supported uncontested findings of "no adverse economic impact" in a majority of the cases submitted to the Board of Directors. Macroeconomic market data suggesting conditions consistent with substantial injury, or the lack thereof, also appear to drive the heated arguments among the interested parties over the correct result in the small number of difficult or controversial cases. A careful discussion of what such data show, and do not show, in the PPG staff's economic impact reports would increase the transparency of those reports and policy arguments, and would support the Board's statutory responsibility.

³² "You should exercise professional judgment in identifying the importance of non-quantified factors . . . If the non-quantified benefits and costs are likely to be important, you should recommend which of the non-quantified factors are of sufficient importance to justify consideration in the regulatory decision. This discussion should also include a clear explanation that support designating these non-quantified factors as important." OMB Circular A-4, page 10.

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Question 4 – Adverse Impact from Related Goods

Has the Bank's staff determined that the foreign manufacturing facility that will benefit from the Ex-Im Bank-financed capital equipment is reasonably likely to produce a commodity in addition to, or other than, the Exportable Good specified in the application for Ex-Im Bank support, and if so, might the production of that additional commodity cause substantial injury to U.S. producers of the additional, or similar or competing, commodities? (Charter Sec. 2(e)(1)(B))

This inquiry was added to Section 2(e) of the Charter during the Bank's 2006 reauthorization to address a small number of cases where a proposed transaction would not directly support new foreign production of an Exportable Good that would compete with U.S. production of that Exportable Good, but might cause substantial injury to U.S. producers of other goods indirectly through its incorporation into another product.

An example of a transaction where this issue has arisen involved U.S. manufactured equipment for processing raw titanium. Direct competition with U.S. produced processed titanium was not an issue, but it appeared that the processed titanium might be dedicated to expand the capacity of a specific foreign manufacturer whose output would compete directly with U.S. producers, raising an economic impact issue. Because this issue arises infrequently and has not arisen since the amendment of the Charter in late 2006, it has not been addressed in the Economic Impact Procedures or in subsequent economic impact reports. It is analyzed by the PPG staff as part of their review of proposed transactions involving exports of U.S. produced manufacturing equipment, and therefore it would be appropriate for the staff's analysis and conclusions to be summarized in economic impact reports.

Question 5 – Balancing of Costs and Benefits by the Board

If any of the preceding questions has been answered in the affirmative, then, in the judgment of the Board of Directors, are the short- and long-term benefits to industry and employment in the United States accruing from the Bank's support of the proposed transaction likely to outweigh the short- and long-term injury to United States producers of the Exportable Good and related employment? (Charter Sec. 2(e)(3), EIP Stage V, Section 3.b.ii)

Economic impact reports often include individual items of data and analysis that speak to the considerations to be balanced by the Board pursuant to Question 5. These reports do not undertake to systematically assemble, categorize and evaluate each identifiable element of short- and long-term cost and benefit associated with a proposed transaction in the sort of balancing analysis that Section 2(e)(3) of the Charter expressly contemplates. The principal reasons identified for this pattern are (a) the PPG staff's determination to treat the 1% of U.S. production test discussed above in Questions 1 and 3 as a factual determination of substantial injury rather than a procedural element of Section 2(e) intended to place potentially difficult cases before the Board, and (b) the PPG staff's adoption of trade flow analysis as the primary criterion used to determine the balance of costs and benefits associated with a proposed transaction, as described in more detail in Section B of this Report. As a result, the Board has in most cases not had

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before it the full range of available material data and analysis that would allow it to independently make the balancing determination contemplated by Congress in Section 2(e)(3) of the Charter, particularly in the small number of cases that have been difficult or controversial.

Section B of this Report suggests that (i) the PPG staff's reliance on trade flow analysis as the sole or primary criterion for deciding economic impact cases be discontinued and (ii) the Bank's Economic Impact Procedures be modified to include additional criteria for identifying short- and long-term benefits and costs, and employment effects, associated with transactions subjected to economic impact analysis.

A particularly notable omission from most of the Bank's economic impact reports is any analysis of the benefits to the United States economy associated with the successful completion of the proposed export transaction, beyond the dollar value of the proposed export transaction that is incorporated in the quantitative trade flow analysis. Benefits to the United States from a specific export transaction accrue at two possible levels. First, there is the obvious short-term benefit of the successful manufacture and sale of the exported goods and the employment supported by that production. Second, it is in the long-term interest of the U.S. to have strong, successful competitors in the world manufacturing economy who are technology, performance, and service leaders in their industries.

For example, in an appropriately supported case, it would appear reasonable for the Board to conclude that an Ex-Im Bank financed export transaction that was important to the survival and economic health of a smaller specialized manufacturer would have a long-term benefit to the U.S. economy, or would be responsive to Congressionally directed policy mandating support for small business, and that these benefits should be balanced against any negative comment that might be registered by a Reviewing Agency or a U.S. producer of the impacted Exportable Good. In other cases, the capital equipment proposed to be exported with Ex-Im Bank support might have required many man-years of work of a significant number of highly skilled U.S. workers, whereas the resulting Exportable Good, as produced in the U.S., might support a much smaller number of workers at lower skill levels. Under the current formulation of the Economic Impact Procedures, these sorts of benefits to the U.S. economy and employment from the proposed transaction would typically not be considered in an economic impact report.

It would also be consistent with the language used by Congress in Section 2(e)(3) of the Charter for the PPG staff's economic impact reports to consider the probabilities associated with specific costs and benefits. That section asks the Board to determine whether the short- and long-term benefits "are likely" to outweigh the short- and long-term injury the transaction might cause. A probabilistic analysis is reasonable given that the PPG staff and the Board are being asked to look into an uncertain future. By contrast, trade flow analysis is based on what the PPG staff refers to as a "conservative" assumption that new foreign production that is targeted to the U.S. market has a probability of displacing a sale of a competing U.S. product of 100%, while acknowledging that it is relatively certain in most cases that the "real world" effect of new head-to-head competition will not be the loss of 100% of the sales of the Exportable Good by the U.S. producer.

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Adoption of the most conservative possible formulation can be questioned in view of the Bank's statutory mission of supporting U.S. employment through exports and is inconsistent with OMB's guidance in OMB Circular A-4.³³

Ex-Im Bank disapproval of a transaction typically means that no U.S. export sale will be made, so the probability of a "benefit" from completing the proposed sale, and any related employment effect, with Ex-Im Bank support is 100%. If the new foreign production of an Exportable Good resulting from an Ex-Im Bank supported transaction is targeted at the U.S. market, the probability of some level of "cost" in terms of lost sales, lower prices or decreased employment by U.S. producers of the Exportable Good would be expected, but the likelihood of U.S. producers of the Exportable Good losing an identical volume of unit sales would be less than 100%. The 2007 GAO Report observes that the Bank's methodology for analyzing these issues of cost and benefit could be improved.³⁴

If most of the new foreign production will be directed at foreign markets where U.S. producers have relatively smaller market shares, or if worldwide demand for the Exportable Good has been increasing apace with new production capacity, the probability of specific identified "costs" might be substantially less than 100%, and in some cases might reasonably be determined to be 0%. The fact that the U.S. imports significant volumes of many products today, and the likelihood that the manufacturers of those imported goods might also lose head-to-head sales to the new foreign production can also have a significant effect on the actual competitive effects of a proposed Ex-Im Bank transaction, but is not taken into account in the PPG staff's current mode of economic impact analysis.

This Report does not suggest that the PPG staff adopt expanded or more finely tuned quantitative analytical methods to support the Board's balancing analysis. There is no indication that Congress expects that the Board will base its economic impact decisions on quantitative modeling of the U.S. economy, employment, or international markets. It would be difficult for the PPG staff to assemble accurate, reliable, quantifiable data addressing many elements of cost and benefit associated with a transaction on a consistent basis, project that data forward by months or years and complete the work within the limited available time and resources of the Bank.. At the same time, this sort of information may be available from sources external to the Bank in some cases. If it is available and appears reasonably well supported and relevant, it should be referenced in economic impact analyses and considered by the PPG staff and the Board as one of a number of factors contributing to their determinations.

33 "Your estimates cannot be more precise than their most uncertain component. Thus, your analysis should report estimates in a way that reflects the degree of uncertainty and not create a false sense of precision. Worst-case or conservative analyses are not usually adequate because they do not convey the complete probability distribution of outcomes, and they do not permit calculation of an expected value of net benefits." OMB Circular A-4, page 40. OMB Circular A-4 discusses in detail principles applicable to addressing probability in regulatory analyses.

34 2007 GAO Report, pp. 23-26.

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Disclosure of Assumptions, Estimates, Data Limitations

OMB Circular A-4 describes the characteristics of a well-prepared regulatory analysis:

A good analysis is transparent. It should be possible for a qualified third party reading the report to see clearly how you arrived at your estimates and conclusions. For transparency's sake, you should state in your report what assumptions were used . . . It is usually necessary to provide a sensitivity analysis to reveal whether, and to what extent, the results of the analysis are sensitive to plausible changes in the main assumptions and numeric inputs. A good analysis provides specific references to all sources of data, appendices with documentation of models (where necessary), and the results of formal sensitivity and other uncertainty analyses. Your analysis should also have an executive summary, including a standardized accounting statement.

Several members of the Board and representatives of the Reviewing Agencies commented that the Bank's Economic Impact Procedures and the PPG staff economic impact reports would be improved by providing an understandable explanation of the limitations of the data relied upon by the PPG staff in making their recommendations to the Board. The 2007 GAO Report echoed these concerns.³⁵ These comments reflected awareness of the difficulty of obtaining data addressing the core questions of economic impact analysis in many cases, as discussed in the preceding sections of this Report. For example, significant amounts of recent and projected U.S. and international market data and analysis are generally available for economic cases involving steel production, whereas cases involving less thoroughly studied markets suffer from very limited data. The concern of the individuals commenting was that they did not believe that the PPG staff's economic impact reports adequately distinguished these disparate cases, making it difficult for the Board and the Reviewing Agencies to assess the basis for the PPG staff's recommendations.

A related area of comment from the same individuals focused on the PPG staff's use of assumptions and estimates to support their conclusions and recommendations, to the effect that the Economic Impact Procedures and the PPG staff's economic impact reports would be improved by more thorough descriptions of these assumptions and estimates and the limitations of the degree of reliance that could reasonably be placed on them. The majority of the instances of concern identified in the interviews were associated with the PPG staff's use of trade flow analysis, which is discussed in greater detail in Section B of this Report, and the PPG staff's methods for projecting future market conditions based on current or historical data.

For example, the PPG staff's economic impact reports often assume that future volumes of foreign and U.S. production of an Exportable Good will be identical to the levels in the most recent year for which data is available. Another example is the assumption of trade flow analysis that every unit of new foreign production of an Exportable Good will displace the sale of a unit by a U.S. producer, and not other foreign producers. The PPG staff readily acknowledges actual results will not match these assumptions, but the

³⁵ "[W]e identified limitations in certain assumptions Ex-Im makes to estimate economic impact in its detailed analyses. In some cases, these limitations had not been adequately disclosed nor had the sensitivity of economic impact conclusions to these assumptions been explored. 2007 GAO Report, page 36.

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Economic Impact Procedures and economic impact reports have not been consistent in expressing their limitations, explaining their origins, or assessing the significance of any variance for the conclusions reached by the PPG staff.

In order for the Board and the Reviewing Agencies to understand the basis for the PPG staff's conclusions, the Economic Impact Procedures and individual economic impact reports should address the limitations of the data, assumptions and estimates that the PPG staff as relied upon in reaching its conclusions. Implementing the suggestions in Sections A and B of this Report, particularly decreasing the degree of reliance on trade flow analysis, should make the economic impact review process more understandable by broadening the types of data considered. Even if a broader range of data is considered by the PPG staff and the Board in deciding economic impact cases in the balancing analysis suggested in this Section A, the limitations of the data considered in that analysis, and the limitations of assumptions and estimates relied upon by the PPG staff, should be addressed. For example, the PPG staff might cite slow growth in production capacity in a particular industry as supporting the PPG staff's assumption that production in a future year would be equal to the production reported in a recent year.

Indications of Sensitivity of Results

One conclusion reached from the findings detailed in Sections A and B of this Report, which was supported by comments received from the Board, is that the PPG staff's economic impact reports have frequently presented the Board with a black or white "recommend approval" or "do not recommend approval" conclusion with relatively little information before the Board that would allow it to independently weigh the information and analysis supporting and opposing the PPG staff's recommendation, or to compare that information, analysis and recommendation for consistency with prior cases. In such cases, the PPG staff's analysis and conclusions may be perceived as having supplanted the Board's role in the decisional process contemplated by Section 2(e) of the Charter. This perception may also be supported by the fact that several transactions have been withdrawn by the sponsors when informed that the PPG staff would give them a negative recommendation solely based upon the results of trade flow analysis.

The Bank has provided support for many transactions where the likelihood of substantial injury to U.S. producers of an Exportable Good and related employment was perceived as being so remote that there could be little doubt as to the PPG staff's and Board's conclusions. As noted previously, more than 90% of the cases considered for economic impact received no adverse comment from the public and do not appear to have presented any controversy regarding the possibility of adverse economic impact. However, a review of the small number of the Bank's more difficult economic impact cases, including those that have been actively contested, indicates that they often fall into a gray middle area, where reasonable people could differ in their conclusions as to the nature and extent of any adverse economic impact. In these cases, it is particularly important that a member of the Board be able to read the PPG staff's economic impact report

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and without difficulty ascertain not just the basis for the staff's recommendation, but also whether it is a narrow call that could change with relatively small shifts in the underlying data, assumptions and estimates, and whether there is substantial, or limited, data favoring or opposing the PPG staff's recommendation.

In these more difficult cases, it will be helpful, and may be necessary, to the exercise of the Board's decisional responsibility for the PPG staff to provide some indication of the sensitivity of its conclusions when addressing the five core questions regarding economic impact discussed above to change if underlying data, estimates and assumptions were changed within ranges that could reasonably be expected to occur in the markets being analyzed.³⁶ OMB Circular A-4 emphasizes the important of sensitivity analysis, particularly where the decision made will rely heavily on uncertain, non-quantitative data, noting that "It is usually necessary to provide a sensitivity analysis to reveal whether, and to what extent, the results of the analysis are sensitive to plausible changes in the main assumptions and numeric inputs."³⁷ The 2007 GAO Report cites this OMB guidance in the course of also recommending that the PPG staff incorporate sensitivity analysis in its economic impact reports.³⁸

If, as suggested elsewhere in this Section A, the PPG staff bases its analysis and recommendations on large scale, sustained trends in underlying market conditions, the PPG staff's conclusions and recommendation may be relatively resistant to changes in the underlying data. For markets experiencing more rapid change, or where the data is not conclusive on either side of the question, the PPG staff's conclusions and its recommendation might be subject to material change in response to relatively modest swings in the available data. The sensitivity of the PPG staff's conclusions is likely to be significant to the Board in making its balancing decision to approve or reject a transaction and should be addressed in the staff's economic impact reports.

In the example cited in the preceding subsection of this Section A, if the PPG staff assumes that foreign production of a given Exportable Good in a future year will be equal to the amount of production in a recent year, it is suggested that any available reliable information indicating that future production might increase or decrease be considered, and that the PPG staff provide some analysis of the impact on their conclusions regarding economic impact if production increased or decreased by more than an immaterial amount. Discussions with the PPG staff regarding several of the economic impact reports reviewed indicated that their conclusions regarding economic impact would not have changed even in the face of significant changes in the quantity of foreign production of the relevant Exportable Good due to other conditions

³⁶ See 2007 GAO Report pages 23, 24, 36.

³⁷ OMB Circular A-4, page 3. Circular A-4 goes on to observe: "Use a numerical sensitivity analysis to examine how the results of your analysis vary with plausible changes in assumptions, choices of input data, and alternative analytical approaches. Sensitivity analysis is especially valuable when the information is lacking to carry out a formal probabilistic simulation. Sensitivity analysis can be used to find "switch points" -- critical parameter values at which estimated net benefits change sign or the low cost alternative switches." OMB Circular A-4, page 41.

³⁸ 2007 GAO Report, pages 23-24.

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affecting the market. That being said, the quality of the PPG staff's economic impact reports, and of the Board's understanding of the staff's conclusions, will be improved if the indicated analysis is included in the economic impact reports.³⁹

A related consideration is the relative degree of confidence that the PPG staff has developed in its conclusions and recommendation to the Board. Because of the wide range of products and markets that the PPG staff is required to evaluate in completing economic impact reports, there is a wide range of data quality and quantity that underlies the PPG staff's evaluation of specific cases. When its analysis is supported by more and better data, and by evaluation techniques that have been validated, it should be expected that the PPG staff will have greater confidence in its conclusions and recommendations than it will in other cases less well documented. Members of the Board have commented that they have sometimes found it difficult to distinguish economic impact reports that rely upon significant quantities of reliable data, from those where there is much less data, or its quality is questionable.

Suggestions to Management

- A.1. The PPG staff's economic impact reports should present the available quantitative and qualitative information obtained by the PPG staff that is material and relevant to the determination of economic impact in a concise balancing format that addresses each of the elements of economic impact contemplated by the Charter and which will support the Board's decisional process under Section 2(e)(3) of the Charter.
- A.2. Economic impact reports, supplemented by the Bank's publicly available Economic Impact Procedures, should be written to reasonably inform the reader of the limitations and qualifications of the data, assumptions, estimates, methods and analysis relied upon by the PPG staff and the sensitivity of the conclusions expressed by the PPG staff to possible changes in assumptions or estimates that can be reasonably anticipated. The PPG staff should consider guidance provided by OMB in developing specifications for its analysis and reports to the Board.
- A.3. Reliance on trade flow analysis or any other quantitative methods used by the PPG staff that effectively decide economic impact cases should be made subject to Board approval and subsequent periodic reaffirmation.

These suggestions do not contemplate that the PPG staff should present the Board with a phone-book-sized aggregation of raw data, or that the PPG staff is required to locate, digest and present a larger volume of data relevant to particular economic impact cases than it has been considering in the cases reviewed for this Report. These suggestions are focused more on the manner of presentation of the data and analysis that the PPG staff has developed in the cases reviewed so that it is more complete and responds more directly to the

³⁹ "Inferences and assumptions used in your analysis should be identified, and your analytical choices should be explicitly evaluated and adequately justified. In your presentation, you should delineate the strengths of your analysis along with any uncertainties about its conclusions. Your presentation should also explain how your analytical choices have affected your results." OMB Circular A-4, page 39.

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Board's requirements in deciding economic impact cases. The use of an executive summary style of report that accurately summarizes the information in the complete report and supporting file, particularly focusing on the sort of macroeconomic trends referenced in this Report, should be adequate in most cases. At the same time, that report should reference the more voluminous information that the PPG staff has assembled in order to allow interested Board members to readily identify and access relevant portions of the complete report and supporting data in cases where they desire more information, where the decision is difficult or where the transaction is the subject of conflicting comment from the Reviewing Agencies, the public or Congress.⁴⁰

40 "A good analysis provides specific references to all sources of data, appendices with documentation of models (where necessary), and the results of formal sensitivity and other uncertainty analyses. Your analysis should also have an executive summary . . ."OMB Circular A-4, page 3.

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Section B

Develop Improved Criteria to Guide the Board and Staff in Deciding Economic Impact Cases

Conclusion

Trade flow analysis should not be the sole or primary criterion supporting the PPG staff's recommendations in economic impact reports, and it should not be determinative of the Board's decision. The PPG staff should develop additional criteria that are consistent with the Bank's Charter and Congressional intent to assist the Board in deciding economic impact cases. Ex-Im Bank should validate the criteria relied upon to support economic impact decisions through periodic backward-looking empirical review to evaluate the effects on U.S. producers and employment of transactions that have been the subject of economic impact review. In view of these conclusions, the Bank should reevaluate the inclusion of transactions where the output would be directed to the U.S. market on its "sensitive sectors" list of transactions where rejection is considered by the Bank's President to be likely.

Findings

The Limitations of Trade Flow Analysis

The PPG staff's principal criterion for assessing whether "the short- and long-term benefits to industry and employment in the United States [from a proposed transaction] are likely to outweigh the short- and long-term injury to United States producers and employment of the same, similar, or competing" Exportable Good, has been the quantitative analysis of displaced "trade flows" resulting from a particular transaction. The elements of quantitative trade flow analysis as implemented by the PPG staff are described in detail in Appendix F, which has been confirmed by the PPG staff as a reasonable description of their process. The PPG staff in interviews reported that the use of quantitative trade flow analysis reflects the staff's efforts over the years to work with management, the Board, the Reviewing Agencies and Congress to develop a tool that, within the limited data, time and staff resources available, would serve as an approximate indicator of transactions where adverse economic impact may be an issue. A review of the economic impact cases decided since 2002 indicates that trade flow analysis has in fact been treated as dictating the decision of the PPG staff and the Board.

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Reliance on quantitative trade flow analysis as the principal criterion guiding the PPG staff's recommendation for approval or disapproval of economic impact cases by the Board of Directors is responsible for much of the criticism of the economic impact process by the Board of Directors and the Reviewing Agencies. The 2007 GAO Report also concluded that the Bank's trade flow methodology, and its explanation of that methodology, could be clarified and improved.⁴¹

The current degree of reliance on trade flow analysis appears to be inconsistent with several of the requirements of Section 2(e) of the Bank's Charter. Among the weaknesses of trade flow analysis are that (a) it does not speak directly to several of the determinations required to be made by the PPG staff and Board under Section 2(e) of the Charter (such as employment impact), (b) in some cases it excludes or conflicts with material, relevant market data that is persuasive as to the likelihood, or unlikelihood, of substantial injury to U.S. producers and employment, (c) it has not been empirically validated by the PPG staff or approved by the Board as a controlling decisional tool and (d) the PPG staff's efforts to revise the method to better correlate with conflicting data have been viewed as result-driven by members of the Board and the Reviewing Agencies.

Limited Transparency of Trade Flow Analytical Method

Ex-Im Bank has released relatively limited information regarding its use of and reliance on quantitative trade flow analysis to decide economic impact cases. A brief summary description of trade flow analysis (the Bank's only public statement on the subject) is included in Section 3.b.ii of the Bank's Economic Impact Procedures:

- ii. Valuation of broad competitive impacts to U.S. industry: The foreign project's potential impact on U.S. industry is analyzed in a cost-benefit framework. The economic impact analysis weighs the quantitative benefits (e.g., the value of the U.S. exports, follow-on spare parts sales) and costs (e.g., the value of the displaced U.S. sales or lost market share) of the transaction. In addition to measuring whether the foreign buyer's increased production could displace U.S. production of the same, similar, or competing good in markets where the foreign buyer directly competes head-to-head with U.S. production, the economic impact analysis will also consider other secondary factors and impacts of the proposed transaction. These other factors include: concurrent additions to production capacity of the product in the U.S., buyer's country and any markets that may directly affect the prospects for current U.S. producers, the current and expected international trade flows of the product including the possibility that the foreign buyer's production may displace production from a third-country resulting in displaced U.S. production, or reduced U.S. market share. The time horizon for measuring the economic impact is the length of Ex-Im Bank support.

41 2007 GAO Report, page 26.

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Limited Precision of the Trade Flow Analytical Method

The PPG staff acknowledges that trade flow analysis is not intended to produce precise answers to the questions of relative costs and benefits to U.S. industry and employment of a transaction in the way that a complex econometric model of the relevant Exportable Good markets might address more directly⁴². The PPG staff has described trade flow analysis as a “rough indicator” of transactions where adverse economic impact is possible, and is forthright in acknowledging the practical limitations of trade flow analysis in deciding economic impact cases. Despite the frank acknowledgment of the limits of trade flow analysis, the results of that analysis have been treated by the Bank’s staff, management, and Board as determinative of the question of economic impact. In some cases, proponents of U.S. export transactions were reported to have withdrawn their applications for Ex-Im Bank support when informed that the PPG staff’s initial trade flow analysis produced a negative result. In none of the economic impact reports reviewed for this Report was a negative result from trade flow analysis followed by the sort of balancing analysis of relative costs and benefits associated with a transaction contemplated by Section 2(e) of the Charter.

Interviews with observers of the economic impact review process have confirmed that the acknowledged imprecision of trade flow analysis, and the PPG staff’s efforts to address them, are not uniformly understood. In particular, the PPG staff’s introduction of modifications to the analysis or transaction structure in order to cause the model to better correlate with other macroeconomic data has been questioned by members of the Board and by the Reviewing Agencies as possibly introducing a results-oriented bias into what they have understood to be an objective, quantitative process. Suggestions C.1. and C.2., discussed in Section C of this Report, are intended to address this lack of understanding by increasing the transparency of the Economic Impact Procedures and the decisional process in individual cases.

Causes of, and Responses to, Imprecision in Trade Flow Methodology

The PPG staff acknowledges that a number of the assumptions and methods used in applying its trade flow analysis do not reflect accurately the economic reality of how the international market for a given Exportable Good is likely to operate. Instead, trade flow analysis is described by the PPG staff as an approximate indicator that can be managed during the limited time, and with the limited information, available to the PPG staff to suggest where a negative balance of costs and benefits to the U.S. market might be found to be associated with a transaction such that Ex-Im Bank support for the transaction should be questioned or denied. The causes of, and the PPG staff’s responses to, imprecision in trade flow analysis have not been documented in the Economic Impact Procedures or systematically addressed in the economic impact reports issued during the period covered by this Report.

⁴² The PPG staff reports having experimented with retaining an economic consulting firm to prepare an econometric model addressing economic impact of a proposed transaction. That effort was reported to have been slow, expensive and not particularly helpful in producing clear, reliable answers to the core questions of economic impact because of the limited and uncertain data available to support the model.

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The following sources of imprecision affecting the results suggested by the Bank's quantitative trade flow analytical model have been identified:

- A key focus of Section 2(e) of the Charter is avoiding Ex-Im Bank support for transactions that are likely to result in substantial injury to U.S. producers of an Exportable Good, and related employment. In Congressional debate of these provisions in 1986, the industries cited as experiencing a "substantial injury" level of harm were those that had suffered sustained financial losses and losses of employment over periods of years due to foreign competition that was specifically targeted at the U.S., including Colombian coal production, copper production in Mexico, Chile and Peru, Moroccan and Tunisian phosphate production and Brazilian steel production. The trade flow displacement model assumes that substantial injury of the sort contemplated by Congress is equally likely to result from new foreign production of an Exportable Good in every case.
- Trade flow analysis does not directly consider historical employment data or projected short- and long-term trends in employment data for the relevant industries, even though Section 2(e) of the Charter references effects on U.S. employment as one of the two key factors to be assessed by the Board in economic impact analysis, and the expansion of U.S. manufacturing employment is the primary policy objective of Ex-Im Bank.
- Trade flow analysis assumes that each unit of new foreign production of the Exportable Good will displace a unit of U.S. production (unless it is clear that the new production cannot reach the U.S. or U.S. export markets for the Exportable Good). U.S. producers of the Exportable Good are assumed to be facing lost sales equal to 100% of the new foreign production, which the PPG staff describes as reflecting the most "conservative" possible outcome. The PPG staff acknowledges that, in reality, the actual incidence of lost sales, or declining employment, by U.S. producers of an Exportable Good resulting from new foreign production of that Exportable Good can vary from negligible to significant depending upon the circumstances then existing in the relevant international product markets. In increasingly international markets, where U.S. production may be only a small fraction of the aggregate world production and consumption that set prices, other foreign producers of the Exportable Good might be expected to experience a majority of any "displacement" effect that does occur. These considerations have typically not been addressed in economic impact reports.
- Trade flow analysis assumes that adverse economic impact from new foreign production of an Exportable Good will only continue for so long as the Ex-Im Bank supported financing is in place. Given equal amounts of foreign production of an Exportable Good, a transaction with a three-year term is assumed to have approximately half the adverse impact of a transaction with a six-year term (actually, slightly more than half due to discounting the trade flows to present values). In reality, the adverse impact on U.S. producers of the new foreign production of the Exportable Good is going to be the same in either case, and is likely to be most noticeable in the early years after the new production commences, with lessening impact as international and U.S. markets react to other changes in supply and demand in later years.

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Most economic impact reports reviewed for this Report cite other relevant data, including broader macroeconomic data of the sort discussed in Section A. of this Report, that are not reflected in the inputs or results of quantitative trade flow analysis. Section 3.b.ii of the Bank's Economic Impact Procedures cited above expressly references some of these additional considerations. The PPG staff reports that these other data are considered in determining the staff's recommendation to the Board. Instead of broadening the economic impact analysis in these cases in an express balancing presentation, as suggested in Section A of this Report, the PPG staff has focused more on changes in transaction structure or refinements in the trade flow methodology to allow it to better correlate with the conflicting data. Examples of these refinements include:

- Considering new foreign production of an Exportable Good only in every other year for cyclical industries where any possible competitive injury to U.S. producers would be likely to be intermittent rather than continuous.
- Reducing the term of the supported loan so that fewer years of imports of the relevant Exportable Good are balanced against the value of the proposed export of capital goods.
- Obtaining the agreement of the purchaser of the Ex-Im Bank supported capital equipment not to sell its output in designated markets where head-on competition with U.S. exporters might occur during a specified period of time, reducing the dollar value of potential displacement of U.S. export sales.

Another example of a modification to trade flow analysis that has been evaluated by the PPG staff, and included in a small number of preliminary reports without being relied upon in any final economic impact report, is the concept of "proportionality." Proportionality, which is discussed in greater detail in the 2007 OIG Report attached as Appendix G, would result in only a small percentage of the new foreign production of Exportable Goods being considered as displacing U.S. production where the contribution of the Ex-Im Bank supported capital equipment to the new foreign production capacity is small or indirect.

OMB Recommendations for Analysis Supporting Regulatory Actions

Elevating one or a small number of factors to the status of the sole or primary criterion for deciding economic impact cases through creation of a mathematical formula that (i) is acknowledged to contain significant imprecision in one or more of its elements, (ii) has not been mandated by law, (iii) is not based upon recognized industry or professional practice and (iv) has not been empirically validated, will of necessity leave out, or undervalue, other material considerations that are excluded from the formula because they are not able to be expressed quantitatively, or do not apply to every case analyzed.

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OMB Circular A-4 provides guidance to executive branch agencies on developing their analysis to support regulatory action. A number of observations from Circular A-4 are particularly relevant to the challenge posed by Section 2(e) of the Bank's Charter and the suitability of trade flow analysis as the core methodology for deciding economic impact cases:

[Y]ou cannot conduct a good regulatory analysis according to a formula. Conducting high-quality analysis requires competent professional judgment.

It will not always be possible to express in monetary units all of the important benefits and costs. When it is not, the most efficient alternative will not necessarily be the one with the largest quantified and monetized net-benefit estimate. In such cases, you should exercise professional judgment in determining how important the non-quantified benefits or costs may be in the context of the overall analysis.

A complete regulatory analysis includes a discussion of non-quantified as well as quantified benefits and costs. A non-quantified outcome is a benefit or cost that has not been quantified or monetized in the analysis. When there are important non-monetary values at stake, you should also identify them in your analysis so policymakers can compare them with the monetary benefits and costs.

Your estimates cannot be more precise than their most uncertain component. Thus, your analysis should report estimates in a way that reflects the degree of uncertainty and not create a false sense of precision. Worst-case or conservative analyses are not usually adequate because they do not convey the complete probability distribution of outcomes, and they do not permit calculation of an expected value of net benefits.⁴³

Absence of Historical Validation

Despite the use of various formulations of quantitative trade flow analysis as the primary criterion for deciding economic impact cases during the period covered by this Report (2002-2009), its reliability in predicting actual substantial injury to U.S. producers of an Exportable Good from the creation of new foreign production capacity as a result of projects proposed for Bank support – whether the transactions are accepted or rejected - has not been validated by post-transaction empirical analysis.

Economic impact analysis is required by the Bank's Charter to be forward looking – to predict the likely economic impact of Ex-Im Bank support for a specific transaction, or the failure of the transaction to occur, at the future date when new production of an Exportable Good reaches the market. The methods that the Bank has relied upon – primarily trade flow analysis – are subject to significant uncertainty. The absence of any empirical data regarding how specific Exportable Good markets actually developed, compared to how economic impact analysis predicted they would develop, makes much more difficult any attempt to

⁴³ OMB Circular A-4, pages 3, 2, 3, 40.

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review the effectiveness of the Bank's economic impact procedures. Similarly, when the economic impact procedures are reviewed as part of the Bank's periodic reauthorization by Congress, the absence of empirical data forces the Bank's leadership and the Congressional oversight committees to address any needed or proposed changes to Section 2(e) of the Charter based on conjecture or anecdote, not facts.

The sort of backward looking review suggested in this Report is not intended to be excessively quantitative or exhaustive. What is contemplated is an examination of the results experienced by the market for the Exportable Good in the two or three year period after the new foreign production supported by Ex-Im Bank came on line in terms of large-scale aggregate economic data, with the objective of addressing questions such as: Did U.S. production, imports, exports and inventories of the Exportable Good change materially, and if so why? Have U.S. or foreign producers experienced declines in employment, or depressed prices, or operating losses, and if so, why? If a particular transaction was rejected, was the project completed using alternative U.S. or foreign produced capital equipment, and has the new foreign production of the Exportable Good commenced and had any impact on U.S. producers? Empirical data providing, or at least suggesting, the answers to these questions will allow future generations of observers of economic impact review to more accurately assess the policy issues inherent in the economic impact review process and determine whether Congress has given the Bank and its Board a difficult task.

Development of Additional Criteria

It is suggested that the PPG staff expand the criteria expressly considered, and balanced, in economic impact reports. The specific criteria considered, and how they are analyzed by the PPG staff, Bank management and the Board, are properly decisions for them to reach. This section of the Report offers commentary on a number of possible criteria that were identified during the interviews with the PPG staff, Bank management, the Board and Reviewing Agencies that should be considered by them during their review and revision of the Economic Impact Procedures. In each case, the validity and relevance of a specific criterion will be dependent on the availability of appropriate factual support.

Consideration of Benefits to U.S. Economy

A particularly notable omission from most of the Bank's economic impact reports is any analysis of the benefits to the United States economy associated with the successful completion of the proposed export transaction, beyond the dollar value of the proposed export transaction that is incorporated in the quantitative trade flow analysis. Benefits to the United States from a specific export transaction accrue at two possible levels. First, there is the obvious short-term benefit of the successful manufacture and sale of the exported goods and the employment supported by that production. Second, it is in the long-term interest of the U.S. to have strong, successful competitors in the world manufacturing economy who are technology, performance, and service leaders in their industries.

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For example, in the proper case, it would appear reasonable for the Board to conclude that an Ex-Im Bank supported export transaction that was important to the survival and economic health of a smaller specialized manufacturer would have a long-term benefit to the U.S. economy, or would be responsive to Congressionally directed policy mandating support for small business, and that these benefits should be balanced against any negative comment that might be registered by a Reviewing Agency or a U.S producer of the impacted Exportable Good. The economic impact analysis might also consider other secondary factors and impacts of the proposed transaction. These other factors could include: concurrent additions to production capacity of the product in the U.S., buyer's country and any markets that may directly affect the prospects for current U.S. producers, the current and expected international trade flows of the product including the possibility that the foreign buyer's production may displace production from a third-country resulting in displaced U.S. production, or reduced U.S. market share.

Criteria from Congressional Testimony

Among the criteria that should be included in the PPG staff's evaluation of economic impact cases, which address specific circumstances referenced in the legislative history of Section 2(e)(3) of the Charter, are (i) whether the U.S. industry that produces the Exportable Good is experiencing substantial distress due to foreign competition currently, (ii) whether that foreign competition is being subsidized by foreign government intervention or other circumstances that would indicate the absence of fair terms of international trade and (iii) whether the new foreign production of the Exportable Good will be directly targeted at the U.S. market.

Trade Flow Analysis and Its Components are not Without Value

This Report does not conclude that trade flow analysis has no value or relevance to the determination of economic impact cases, or that it, or its components, should not be discussed in economic impact reports – only that it should not be relied upon as the primary or controlling criterion in the analysis. The PPG staff's trade flow analyses presented in the economic impact reports produced during the period covered by this Report did typically quantify for the Board the dollar value of the proposed export transaction and possible related transactions, indicating at least in very general terms the benefits of the proposed transaction for the U.S. economy and employment.

Trade flow analysis also calls for the staff to prepare a projection of the expected stream of foreign production of the Exportable Goods in future years that might displace U.S. production, and the markets where that displacement might occur, which gives a general sense of the maximum possible magnitude of "cost" that might be experienced by U.S. producers in terms of additional head-to-head competition. The concepts of "proportionality" and "value added," which consider the relatively small or indirect contribution of an Ex-Im Bank supported export to a larger project that will result in new or increased production of

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an Exportable Good, would also appear to merit consideration as one of a number of criteria relevant to economic impact analysis, despite significant opposition to their use as a decisive criteria by some observers from the Bank's Board and the Reviewing Agencies.

Criteria Identified in Existing Economic Impact Documentation

The Economic Impact Procedures, the PPG staff's economic impact reports and discussions with the PPG staff, Bank management and the Board undertaken for this Report identified significant sources and types of data relevant to economic impact analysis as contemplated by Congress in Section 2(e) of the Charter that are not incorporated in quantitative trade flow analysis. Some of these additional criteria are referenced in Stage V of the Bank's Economic Impact Procedures:

- (i) stagnating or falling global prices and/or falling gross margins (price minus variable cost) of domestic producers;
- (ii) industry bankruptcy trends and/or industry unemployment trends;
- (iii) Trade Adjustment and Assistance (TAA) Program petitions;
- (iv) preliminary Anti-Dumping or Countervailing Duty determinations;
- (v) multi-lateral production limitation agreements;
- (vi) concurrent additions to production capacity of the Exportable Good in the U.S. and in any markets that may directly affect the prospects for current U.S. producers; and
- (vii) concurrent additions to production capacity of the Exportable Good in the buyer's country.

External Sources of Relevant Data

The PPG staff also includes in its economic impact reports other relevant data that speak to conditions and trends affecting the relevant world and U.S. markets for the Exportable Goods which are obtained from transaction proponents, the Reviewing Agencies, other published government reports, parties responding to public notices of the proposed transaction, trade association studies and publications and trade, business and popular press accounts. When opponents to a specific transaction appear, their arguments are typically based on the analysis of these sorts of relevant data. Because of the limited public information available

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regarding the use of trade flow analysis, parties commenting on the transactions reviewed for this Report have generally not been able to propose modifications to the PPG staff's trade flow analysis or comment on its results.

Consideration of U.S. and World Market Dynamics

In a proper case, it would appear reasonable for the Board to conclude that the risk of harm to U.S. producers of an Exportable Good and related employment from the creation of a new, potentially competing, foreign supply of an Exportable Good will be greater where the new production is a higher percentage of U.S. production than in a case where the new production is a relatively lower percentage of U.S. production.⁴⁴ Comparable data and analysis for international production of the Exportable Good is also likely to be relevant. In many industries, production costs and prices are determined in international markets, and U.S. production, even if it has grown domestically, in many sectors has represented a declining percentage of worldwide production.

In most cases, the potential competitive impact of new foreign production equal to 1.1% of U.S. production will be much greater in a market where U.S. production represents 50% of worldwide production than will be the case where U.S. production represents 10% or less of worldwide production. It would also appear to be reasonable in a properly presented case for the PPG staff and the Board to consider proposed transactions that will result in smaller and more gradual changes in international or U.S. markets to be less likely to produce substantial injury conditions than in cases where the changes will have a larger-scale, more immediate impact.

Consideration of the Bank's Mission - "Ties Go to the Exporter."

The Bank's Charter directs it to support U.S. employment by providing financing for the export of U.S. goods and services in circumstances where the private sector is unable or unwilling to provide financing, provided that it is determined that there is a reasonable likelihood of repayment. The requirement to verify a reasonable likelihood of repayment prevents Ex-Im Bank support from being available to U.S. exporters as a matter of right, but if that assurance is present, the Bank's Charter, its policies and the commitment of its staff all work together to create a regime in which there is a strong presumption that such transactions will be approved for support unless there is a clear reason not to. Section 2(b)(1)(B) of the Charter provides that the Bank cannot decline to approve applications for credit for non-commercial reasons unless the Bank's president determines that it would be in the national interest, after first consulting with Congress.

⁴⁴ At the same time, care should be taken to be sure that other data that may impact the conclusion are taken into account. A relatively smaller amount of new foreign production that is specifically targeted at the U.S. market might be found to have a potentially greater economic impact on U.S. producers than would a relatively larger amount of new foreign production that will be absorbed in foreign markets where U.S. producers may have relatively smaller shares of the market.

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As discussed at some length in Section A of this Report, Section 2(e)(3) of the Charter states that the Bank may not support a transaction if (i) “oversupply” of an Exportable Good is likely or (ii) more than 1% of U.S. production of an Exportable Good will result, unless “in the judgment of the Board of Directors of the Bank, the short- and long-term benefits to industry and employment in the United States are likely to outweigh the short- and long-term injury to United States producers and employment of the same, similar, or competing commodity.” The determination of the balance of benefits against costs requires a determination of whether the benefits are “likely” to outweigh the costs. In several of the small number of cases that proved difficult to decide, trade flow analysis produced dollar values of potentially displaced sales of the Exportable Good (based on the most “conservative” assumptions) relatively close to the dollar value of the proposed export of capital equipment. In these cases relatively minor changes in any of the variables would change the outcome of trade flow analysis, and actual market data was also indecisive.

In an appropriately supported case of the nature described, it would be reasonable for the PPG staff, or the Board, to look at the full range of available data with respect to the prospects for actual substantial injury, and ideally a sensitivity analysis of that data as suggested in Section A of this Report and in OMB Circular A-4, and determine that the likelihood of substantial injury resulting from the transaction, or a balance of costs that exceeds the assured benefits of the proposed export transaction, cannot be predicted with any assurance. In such cases where assessment of all available data is indeterminate, it would be appropriate for the Board to look to the Bank’s mission of supporting U.S. employment to essentially break the “tie” resulting from indeterminate data, resulting in a determination that the Bank should support the transaction. For the reasons discussed in Section A and above in this Section B, the Bank’s decisions in close cases should not rely excessively on a quantitative method such as trade flow analysis, which has not been approved by the Board.

Criteria Addressing Conflicting Congressional Views

A significant challenge for the PPG staff, Bank management and the Board is how to integrate the conflicting views in Congress of the Economic Impact Advocates and the Economic Impact Critics discussed in Section A above into the broader balancing analysis required by Section 2(e) of the Bank’s Charter and as suggested by this Report. The following subparts of this Section B offer some suggestions of analytical approaches to economic impact review that are believed to be more consistent with the Bank’s Charter than those applied during the review period.

Distinguishing Damaged, Concerned and Successful Industries

Only a small number of economic impact cases since 2002 have proven to be controversial, with producers of the relevant Exportable Good presenting active opposition to a proposed transaction. These controversial cases can be divided into two groups. In some of these cases other conditions in the relevant international

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markets, independently of the proposed Ex-Im Bank transaction, were causing U.S. producers in the Exportable Good industry to experience conditions of substantial injury (operating losses, job losses, company failures) at the macroeconomic levels as cited in the legislative history of Section 2(e). For purposes of this Report, these industries can be referred to as “Damaged Industries.” The market for the Exportable Goods in some, but not all, of these cases could also be characterized as experiencing “oversupply” conditions as discussed in Section A of this Report.

In the remainder of the difficult cases, U.S. producers in the Exportable Good industry were not experiencing substantial macroeconomic injury at the time the transaction was proposed for Ex-Im Bank support, but (i) had in the past, (ii) feared that they might at some time in the future as a result of the transaction proposed for Ex-Im Bank support, (iii) were otherwise being affected by effective foreign competition at a level below that of “substantial injury” or (iv) appear to have adopted an aggressive program to oppose any action by the U.S. government that might benefit a foreign competitor. For purposes of this Report, these industries can be referred to as “Concerned Industries.”

Outside of the small number of controversial cases there exists a third category of industries where U.S. producers appear to be competing with foreign producers successfully in the U.S. and internationally without a history of, or signs of future, macroeconomic “substantial injury.” For purposes of this Report, these industries can be referred to as “Successful Industries.”

It appears likely that the actual economic impact of a transaction proposed for Ex-Im Bank support might vary significantly depending on whether the impacted Exportable Good industry is a Damaged Industry, a Concerned Industry, or a Successful Industry. The PPG staff’s economic impact reports have not made any formal distinction between Damaged Industries, Concerned Industries, and Successful Industries. The PPG staff’s efforts to modify trade flow analysis to better accord with observed data appears in large part to represent an effort to deal with the disparate conditions of, and likely impact of an Ex-Im Bank supported transaction on, Successful Industries and Concerned Industries as compared to Damaged Industries.

As discussed in Section A of this Report, the absence of formal consideration of the actual conditions existing in affected Exportable Goods industries is a consequence of the PPG staff’s misguided interpretation of the “1% of U.S. production” threshold expressed in Section 2(e)(4) of the Charter. The PPG staff has treated this as a factual conclusion by Congress that substantial injury to U.S. producers of an Exportable Good should be presumed to exist if the new foreign production of an Exportable Good will exceed 1% of U.S. production. The implausibility of this interpretation is made clear when the PPG staff has applied trade flow analysis to a proposed Ex-Im Bank transaction where the Exportable Good will compete with the production of a Successful Industry. In those cases, the PPG staff has acknowledged that it is highly implausible that actual substantial injury to the Successful Industry will result from the proposed transaction, but the current formulation of economic impact analysis can nevertheless require that Ex-Im Bank support for the transaction be rejected.

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The quality of the analysis and results presented in the PPG staff's economic impact reports can be substantially improved if the PPG staff includes the historical, current, and forecast conditions of the relevant Exportable Good industry among the criteria that are considered in documenting the staff's economic impact analysis. If a quantitative analysis such as trade flow analysis continues to be used in the staff's economic impact reviews, it would appear reasonable to "raise or lower the bar" on how that quantitative analysis is applied based on current and forecast industry conditions. In particular, it is important that criteria identifying a Damaged Industry that are consistent with the concerns cited by Congress be identified, since the content and results of the analysis suggested in this Section B may vary substantially depending on whether those conditions in fact exist. The PPG staff has struggled to identify objective criteria to guide economic impact analysis – this is one area in which it should be reasonably possible to do so.

For example, consider the case of an Exportable Good industry that would be judged as a Damaged Industry in the recent past without signs of imminent improvement, or where expected significant increases in world productive capacity or declines in demand result in reasonable forecasts that the industry will meet criteria for a Damaged Industry in the near future. In that case, the result of trade flow analysis or another quantitative tool might suggest that Ex-Im Bank support for a transaction should be declined if the dollar values of the proposed export and displaced production of the Exportable Good were roughly equal in amount. Approving Ex-Im Bank support for a transaction might not strictly "cause" substantial injury in the future, but it is not a stretch to say that by supporting the creation of additional productive capacity, Ex-Im Bank's transaction would be "piling on" to existing adverse conditions. By contrast, if the relevant industry forecast would show the Exportable Good industry to be merely a Concerned Industry, or a Successful Industry, a significantly larger negative quantitative balance of the calculation would be required to suggest that the Bank not support a transaction.⁴⁵

An increased emphasis on examining current and forecast industry conditions in the relevant Exportable Good industry will relieve some of the pressure on the PPG staff to predict the precise effect of an Ex-Im Bank transaction. The PPG staff in interviews has acknowledged the practical impossibility of predicting the future effect of a specific Ex-Im Bank supported transaction on world and U.S. supply, demand, and prices of the Exportable Good, which is what the literal language of Section 2(e) of the Charter calls for. Given the increasing size of world markets, and the increasing internationalization of trade, it is much more difficult today than it might have been in previous decades to associate a given U.S. export of capital equipment with direct causation of specific changes in the terms of world supply, demand, and prices of Exportable Goods. The necessary data and analytical tools will seldom if ever be available to the PPG staff,

⁴⁵ This approach would be comparable to the economic impact review process implemented by the Overseas Private Investment Corporation (OPIC). While OPIC's economic impact review methodology reflects a number of features specific to its mission and authorizing legislation, there are significant analogs to the process contemplated in the Bank's Charter and as suggested by the OIG in this Section B of the Report. A member of OPIC's senior management reported in an interview with the OIG that OPIC's primary focus is identifying U.S. industries that might be impacted by new foreign production associated with an OPIC supported development projects that appear to be experiencing distress. Where potentially impacted U.S. industries are not experiencing distress, a more streamlined review results. When a relevant U.S. industry is in distress, the transaction faces a higher threshold of review before it can be approved.

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or to the Board, to allow them to do what the Charter requires with confidence and precision. If what Congress has directed is not possible, the modes of analysis presented in this Report are suggested as the closest feasible alternatives that are consistent with the Bank's Charter.

What is called for is a methodology that allows the PPG staff, and the Board, to analyze specific transactions in broader, more general terms, and in view of industry trends independently of specific Ex-Im Bank transactions. The criteria discussed in this Section B can be helpful in that regard. If modern conditions of international trade make it more difficult to say with confidence that an Ex-Im Bank transaction that will increase production of an Exportable Good by more than 1% of U.S. production will have any discernable effect on world and U.S. supply, demand and prices, then that conclusion will generally be supportive of an Anti-Economic Impact perspective that will suggest that it is better for the U.S. economy on balance for Ex-Im Bank to support a specific transaction. On the other hand, if current or impending conditions suggest that a U.S. Exportable Good industry is experiencing substantial injury, or is at imminent threat of experiencing substantial injury, then a more careful analysis of Ex-Im Bank support for the transaction is warranted.

The most difficult cases that the PPG staff has addressed have arisen when an Ex-Im Bank transaction will result in increased foreign production of an Exportable Good in a Concerned Industry. By definition, a Concerned Industry is not experiencing conditions that would support a finding of current substantial injury, and is not able to present clear evidence that it is on the road to becoming a Damaged Industry in the near term, nor that the Ex-Im Bank transaction will cause it to become a Damaged Industry. Some Concerned Industries may be quite successful, and part of their success may derive from active and effective strategies to limit foreign competition. These are the cases where the disagreements between the Pro-Economic Impact and the Anti-Economic Impact adherents among the public, the Reviewing Agencies and the Board will be sharpest. Section A of this Report strongly suggests that in those cases the PPG staff's reports should (i) acknowledge the extent of the available data, or lack thereof, (ii) identify the available data that would be relevant to each of the two perspectives, (iii) express whatever conclusion the PPG staff believes it can fairly present and support, and then (iv) allow the Board to make the final decision based on a balancing analysis.

It is important to note that Section 2(e) of the Charter requires that the Board also consider the impact of rejection of Ex-Im Bank support for a transaction on the U.S. economy, which would generally focus on the impact on the exporter or the exporter's industry. Similar considerations should be applicable to the exporting industry. The loss of an export sale in a U.S. industry that would be classified as a Damaged Industry would have a greater negative impact than in an industry that is classified as Successful. Similarly, the loss of a key sale could undermine the relative success or dominance of U.S. manufacturing in a particular field, which the PPG staff or Board might conclude should be given greater weight than, for example, the loss of an export sale in a more commoditized field. Accordingly, it is suggested that the PPG staff consider applying comparable criteria and methods to its analysis of the effect of an Ex-Im Bank supported transaction on the U.S. export industry and the U.S. Exportable Good industry.

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Reconciling Conflicting Perspectives and Industry Conditions

Integrating the analytical perspectives of the preceding two subsections will allow the PPG staff to develop criteria, and economic impact reports that are more transparent, more manageable, and more rational while embracing the difficult and conflicted task Congress has given the Bank and its Board in Section 2(e) of the Charter.

For example, consider a proposed Ex-Im Bank transaction where the resulting Exportable Good would compete with the output of a U.S. industry that meets the criteria for a Damaged Industry.

The application of the pure Anti-Economic Impact perspective to proposed Ex-Im Bank support for this transaction would generally result in a determination that the transaction was not likely to cause any adverse economic impact - adverse economic conditions consistent with substantial injury at a macroeconomic level already exist in the Damaged Industry, so the proposed Ex-Im Bank transaction could not be the cause-in-fact of the ongoing substantial injury to U.S. producers of the Exportable Good. At the same time, the advocates of the Pro-Economic Impact perspective would point to the severe economic losses and losses of employment in the impacted U.S. Exportable Good industry to argue that it would be wrong for Ex-Im Bank to support foreign producers of the Exportable Good. They would assert that providing foreign producers of the Exportable Good with favorable financing terms that allow them to buy U.S. capital equipment to increase their output will make an existing bad situation for U.S. Exportable Goods producers worse.

The PPG staff, and the Board, could reasonably conclude in an appropriately supported case that there is logical and moral appeal to the argument that it is not appropriate for the U.S. government to assist a foreign competitor in striking directly at U.S. producers in an industry that would qualify as a Damaged Industry, even if another U.S. business and its employees might benefit in the process. Reasonable individuals faced with balancing these circumstances could come to different conclusions where it appeared that the Bank's support would not directly or materially contribute to the loss of U.S. sales or jobs in an Exportable Good industry, while reaching unanimity if conditions in the Exportable Good industry are dire. Adhering more closely to the specific language of Section 2(e)(3) of the Charter, the PPG staff, and the Board, could determine that there were independent costs associated with assisting the foreign manufacturer of the resulting Exportable Good that shifted the balance against the admitted benefits of the export transaction in cases where the U.S. Exportable Good industry is experiencing substantial injury conditions at the hands of foreign competition.

If the Bank elects to develop criteria for deciding economic impact cases based on the ideas expressed in the preceding paragraphs as part of a broader balancing analysis, that will also support formalizing the consideration of criteria based on the concepts expressed in the PPG staff's proportionality and value added analyses discussed above in this Section B and in the 2007 OIG Report. Proportionality and value added analyses by the PPG staff reflect the common sense view that in an economic impact context that is not black and white, the smaller or more indirect the contribution of an Ex-Im Bank supported transaction to

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a foreign manufacturing project, the less reasonable it is to say that Ex-Im Bank support for the transaction is 100% responsible for any new foreign production of an Exportable Good that might compete with U.S. producers.

In the context of the industry condition criteria discussed above, if the U.S. Exportable Good industry is experiencing significant distress, a Pro-Economic Impact perspective might consider any degree of association with new foreign production to be morally or politically unacceptable. Where the degree of distress is less or the relevant Exportable Good industry might be considered to be a "Concerned Industry," other mitigating conditions exist or the degree of contribution of an Ex-Im Bank transaction is proportionally smaller or indirect, the balance might shift in favor of the transaction. Similarly, the relative percentage of U.S. and international production the new production of an Exportable Good supported by an Ex-Im Bank transaction will represent would appear to be a relevant criterion, in relation to other macroeconomic trends affecting that industry. All things being equal, a proposed transaction that will result in new foreign production of 10% or more of recent world production or world demand for an exportable good would be expected to have a much more significant potential adverse impact than a transaction that will result in new foreign production of 2% of recent world production.

Congress assigned to the Bank's staff and Board of Directors a difficult task in Section 2(e) of the Charter. That being said, their duty is to work to develop reasonable policies, procedures and methods that come as close as possible to accomplishing Congress' objectives. The PPG staff has described the development and use of trade flow analysis as responsive to that objective. The criticism of the Bank's economic impact procedures generally, and trade flow analysis specifically, presented in this Report suggests that an effort to develop other avenues that are more consistent with the Bank's Charter is both required and attainable. This Section B offers a number of examples that are intended to be responsive to the requirements of the Charter and illustrative of the sort of analysis that could be adopted by the Bank. The expertise, and the responsibility, to develop a workable solution to this problem rests with the Bank's staff, officers, and Board.

Sensitive Sector Disclosure Driven by Trade Flow Analysis

Congress adopted Section 2(e)(5) of the Bank's Charter in the 2006 reauthorization of the Bank as a response to reports of a lack of transparency and uncertainty associated with transactions requiring economic impact review. Section 2(e)(5) is intended to give potential sponsors of Ex-Im Bank supported transactions that are deemed likely to be rejected on economic impact grounds prior warning by requiring that:

[T]he Bank shall submit a list to the Committee on Banking, Housing, and Urban Affairs of the Senate and the Committee on Financial Services of the House of Representatives, which designates sensitive commercial sectors and products with respect to which the provision of financing support by the Bank is deemed unlikely by the President of the Bank due to the significant potential for a determination that such financing support would result in an adverse economic impact on the United States. The President of the Bank shall review on an annual basis thereafter the list

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of sensitive commercial sectors and products and the Bank shall submit an updated list to the Committee on Banking, Housing, and Urban Affairs of the Senate and the Committee on Financial Services of the House of Representatives of such sectors and products. (Emphasis added)

In response to this requirement, Ex-Im Bank posted on its web site the following statement dated April 26, 2010⁴⁶:

Sensitive Commercial Sectors and Products List

Sectors

Steel: Additions to global raw steel-making capacity. As a general rule, transactions that involve replacing existing capacity are not subject to economic impact analysis beyond a check for applicable trade measures.

Basis for inclusion on the list: General view that long-term surplus in raw steel-making capacity exists globally.

Products

DRAM semiconductors: Additions to global DRAM semiconductor-making capacity.

Basis for inclusion on the list: Extended cyclical imbalance in which supply is forecast to exceed demand over an extended period going forward. This imbalance means the new production from any project seeking Ex-Im Bank financing over the next year is likely to come online at a time of oversupply.

Transaction Characteristics

U.S. market oriented: Products associated with projects where a significant portion of the output directly produced by the project is destined for the U.S. market and will compete directly with U.S. production. Recent examples include flat glass produced in Mexico and automotive engine parts produced in Mexico.

Basis for inclusion on the list: Likely net negative trade flow implication.

In view of the suggestions above at A.1., 2., and 3. and below at B.1. and 2, and the findings presented in Sections A. and B. of this Report, it is suggested that the PPG staff reevaluate the sensitive commercial sectors list. In particular, it is suggested that the PPG staff further refine or omit reference to “Products associated with projects where a significant portion of the output directly produced by the project is destined

⁴⁶ http://www.exim.gov/products/policies/list_sensitive_comm_sectors_products.cfm

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for the U.S. market and will compete directly with U.S. production.” The inclusion of this broad category, based on “transaction characteristics,” is an honest acknowledgment by the Bank that trade flow analysis will frequently result in rejection of a transaction on economic impact grounds, without regard to the conditions existing in a specific industry or a finding of any actual likelihood of substantial injury.

This “sensitive sector” disclosure reflects the problems with the current mode of economic impact analysis in a nutshell. It suggests to capital equipment manufacturers in the U.S. that they should not seek to sell their equipment with Ex-Im Bank support anywhere in the Western Hemisphere or most of the Pacific Rim. It goes beyond the position of the strongest Economic Impact Advocates in the 1986 Congressional debates over Section 2(e) of the Bank’s Charter, who sought only to block transactions that the Bank determined were likely to cause substantial harm to U.S. producers of Exportable Goods. In the Bank’s sensitive sector formulation, there is no requirement that actual harm, or the likelihood of harm, must be shown in order for Ex-Im Bank to decline to support a transaction. If the PPG staff determines that a material amount of the foreign buyer’s production will be directed to the U.S., and the amount of new production exceeds 1% of U.S. production of the Exportable Good, the sensitive sector list puts the world on notice that the Bank will not support the transaction.

It is also suggested that the President of the Bank seek the concurrence of the Board of Directors with the information that is presented in the annual sensitive sectors report to Congress that is published on the Bank’s website. As discussed in Section A, Section 2(e)(3) grants to the Board, not the Bank’s staff, the responsibility for deciding whether the Bank should support an export transaction, even in the face of evidence of oversupply or substantial injury affecting U.S. producers of the Exportable Good that will result from the proposed transaction. This Report’s principal criticism of the Bank’s current mode of economic impact analysis is that the Bank’s staff appears to have assumed the responsibility for deciding economic impact cases, and has not provided the Board with the necessary information or opportunity to make its own decision based on a balancing of the relative costs and benefits of specific transactions.

Section 2(e)(5) of the Charter does expressly require that the Bank’s President make the report to Congress identifying “sensitive commercial sectors and products with respect to which the provision of financing support by the Bank is deemed unlikely by the President of the Bank due to the significant potential for a determination that such financing support would result in an adverse economic impact on the United States.” Given the potential for individual members of the Board to hold divergent views of economic impact, it is possible that the same facts might produce differing results if the Board’s composition changes. The Bank’s President can attempt to assess these differences, or may be able to identify Damaged Industries where he or she has relative confidence of accurately predicting what the Board will do if presented with a transaction requiring economic impact review. An approach more in accord with the Board’s statutory responsibility will be to seek the Board’s confirmation that that it would in fact be likely to decide economic impact cases against support of transactions in the affected industry. Without this consultation, the President risks discouraging otherwise viable transactions from being submitted to the Bank, and thereby effectively usurps the Board’s responsibility to decide economic impact cases under Section 2(e) of the Charter.

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The Bank has experienced a material decrease in transactions requiring economic impact review during 2008 and 2009, despite an increased need for Ex-Im Bank supported financing due to the deteriorating availability of private sector export credit. It is suggested that the PPG staff evaluate whether the inclusion of “Products associated with projects where a significant portion of the output directly produced by the project is destined for the U.S. market and will compete directly with U.S. production” as a category of transactions where “provision of financing support by the Bank is deemed unlikely by the President of the Bank” has contributed to the decrease in the number of capital equipment financing transactions submitted to the Bank.

Suggestions to Management

- B.1. While the data supporting trade flow analysis and the conclusions that may be drawn from that data and analysis have relevance to the Board’s consideration and determination of economic impact cases, trade flow analysis should not be the sole or primary criterion for deciding economic impact cases addressed in the PPG staff’s economic impact reports, and it should not be determinative of the PPG staff’s recommendation, or the Board’s decision, in economic impact cases.
- B.2. The PPG staff should develop additional criteria for analysis of economic impact that are consistent with the Bank’s Charter and Congressional intent to assist the Board in deciding economic impact cases. These criteria should focus on the sort of macroeconomic trends that were characteristic of the U.S. industries that were cited as experiencing substantial economic injury at the hands of foreign competitors in Congressional hearings preceding the enactment of the current economic impact requirements expressed in Section 2(e) of the Bank’s Charter.
- B.3. It is suggested that the Bank’s Economic Impact Procedures provide for a periodic backward-looking empirical review to determine whether it appears that transactions approved have in fact caused or contributed to any substantial injury to U.S. producers of an Exportable Good or related employment under the criteria relied upon by the PPG staff and the Board, and whether any projected benefits to the U.S. economy and employment of approving, or disapproving, specific transactions were in fact realized.
- B.4. It is suggested that in view of the suggestions above at A.1., 2., and 3. and B.1. and 2., the PPG staff should reevaluate the “sensitive commercial sectors list” promulgated by the Bank pursuant to Section 2(e)(5) of the Charter. In particular, it is suggested that the Bank further refine or omit reference to “Products associated with projects where a significant portion of the output directly produced by the project is destined for the U.S. market and will compete directly with U.S. production,” which is based on “likely net negative trade flow implication.”

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It is also suggested that the Board be consulted before the sensitive sector list is published to confirm that they are in general accord with it in order to avoid the Bank's President effectively usurping the Board's final authority to decide economic impact cases.

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Section C

The Bank Should Improve the Transparency of Its Economic Impact Procedures and Its Economic Impact Determinations

Conclusion

The Bank should advance the transparency of its economic impact policy and determinations by (a) revising its publicly available Economic Impact Procedures to include more information about its methodology (b) revising the Bank's internal procedures to more fully and accurately describe the PPG staff's methodology in preparing economic impact reports and (c) making economic impact reports publicly available after redacting them, or delaying their release, to protect sensitive business confidential information of the transaction proponents.

Findings

Causes of Limited Transparency of Economic Impact Procedures

The Economic Impact Procedures adopted by the Bank in April 2007, while still relatively brief, represent a significant expansion of the publicly available information regarding the Bank's economic review process, which was encouraged, and in some aspects required, by the terms of Congress' reauthorization of the Bank in 2006. The Bank's PPG staff has developed an internal instruction manual containing a number of relatively brief and general directions to staff and providing examples of documents generated in support of economic impact analyses to provide guidance in implementing the Economic Impact Procedures. The instruction manual does not expand substantially on the statements found in the Economic Impact Procedures. The instruction manual, examples of prior economic impact analyses and related files and the PPG staff's office files and experience provide the principal internal sources of procedural guidance for the preparation of economic impact analyses. The PPG staff reported that because of the relatively unique facts relating to individual proposed transactions and product markets and the disparate sources of market information to support economic impact analyses, they had found it difficult to generalize or standardize their procedures.

The Bank has not made its written economic impact analyses nor the specifics of its analytical methods public, nor are they generally available to Bank officers, PPG staff or members of the Board of Directors other than through requests placed with the PPG staff. The Federal Register notices of proposed

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transactions subject to economic impact review published pursuant to Section 2(e)(7) of the Charter (see Appendix A) provide the only publicly released description of pending transactions, based upon the following guideline:

The content of the notice shall include appropriate, nonproprietary information about: (i) the country to which the goods involved in the transaction will be shipped; (ii) the type of goods being exported; (iii) the amount of the loan or guarantee involved; (iv) the goods that would be produced as a result of the provision of the loan or guarantee; (v) the amount of the increased production that will result from the transaction; (vi) the potential sales market for the resulting goods; and (vii) the value of the transaction. The buyer's and the applicant's names, as well as any proprietary information, will not be released. (Economic Impact Procedures, April 2007, Stage V, 3.a.)

The economic impact reports prepared by the PPG staff contain detailed information about the specific transactions, which the Bank treats as sensitive confidential business information that is generally not made available to the public.

The need to respond to the imprecision of the "trade flow analysis" methodology with a range of mitigating techniques, discussed in Sections A and B of this Report, has required the PPG staff to maintain the Economic Impact Procedures in a continuous state of development. When application of trade flow analysis to an economic impact case presents a negative result in an industry that clearly is unlikely to experience conditions of substantial injury, the PPG staff has responded by considering modifications to its methods to cause the quantitative result to better reflect market conditions. These concerns, along with the concern that sensitive confidential business information of transaction proponents not be released, have contributed to the Bank's reluctance to publish individual economic impact reports, summaries or other statements of the PPG staff's recommendations or the Board's decisions.

The Impact of Low Transparency

Businesses considering the submission of transactions to the Bank, parties considering opposing transactions published in the Federal Register, members of the Board and management who are new to their role in considering economic impact cases, members of Congress and their staffs, and representatives of the Reviewing Agencies all have had difficulty understanding the Bank's economic impact policies and determinations. The complexity of the issues raised by the Bank's economic impact responsibilities, and the unresolved inherent conflicts affecting the review process called for by the Bank's Charter, present significant challenges for an agency committed to transparency. The current low level of transparency contributes to the risk that the Bank's actions will be perceived as being arbitrary, or politically motivated, undermining the legitimacy of the Bank's actions.

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The limited external and internal statements of the Economic Impact Procedures and their application to specific cases make it difficult for Congress, the public, transaction proponents, Reviewing Agencies, members of the Bank's Board and officers and employees new to Ex-Im Bank to understand the Bank's methodology in preparing economic impact analyses or to place the Bank's determinations in any specific case in a general or historical context. This circumstance was reported to raise concerns regarding consistency of methodology, practice, and result over time among the individuals reviewing economic impact analyses who were interviewed by this office, including representatives of the Reviewing Agencies and members of the Board. The current practice was also described as presenting a risk of a material loss of capability were the PPG staff to experience turnover among its senior members.

Several Board members suggested during interviews that they found it difficult to determine the extent and adequacy of the support for PPG staff recommendations to approve or decline a transaction. They reported that further inquiry would sometimes show that the PPG staff had considered an extensive body of reliable data, while in other cases it appeared that the staff's recommendation was based on limited or less reliable data. In some instances other considerations, such as active opposition to a transaction from representatives of an impacted Exportable Good industry or possibly congressional interest in support of one or the other of the affected industries, were perceived as having impacted the PPG staff's conclusions.

The Bank's decisions to an outside observer could appear inconsistent and politically driven, even if a review of the full record supports the reasonableness of the action taken and the procedures used to support the result. These perceptions have been described as undermining the Bank's credibility and discouraging the submission of otherwise viable projects for Ex-Im Bank support. One of the principal recommendations in the 2007 GAO Report is that the Bank increase the transparency of its methodology for considering proposed transactions under its Economic Impact Procedures. The work supporting the 2007 OIG Report confirmed the desirability, and the difficulty, of achieving this objective based on the limited written materials available publicly or to the PPG staff and the Bank's management and Board of Directors.

President Obama's Directive on Transparency and Open Government

On January 21, 2009, the first day of his administration, President Obama issued a government-wide directive to increase transparency, stating:

My Administration is committed to creating an unprecedented level of openness in Government. We will work together to ensure the public trust and establish a system of transparency, public participation, and collaboration. Openness will strengthen our democracy and promote efficiency and effectiveness in Government.

Government should be transparent. Transparency promotes accountability and provides information for citizens about what their Government is doing. Information maintained by the Federal Government is a national asset. My Administration will take appropriate action, consistent

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with law and policy, to disclose information rapidly in forms that the public can readily find and use. Executive departments and agencies should harness new technologies to put information about their operations and decisions online and readily available to the public. Executive departments and agencies should also solicit public feedback to identify information of greatest use to the public.⁴⁷

Opportunities to Improve Transparency

The Bank's Economic Impact procedures provide an excellent opportunity to put these words into action. The current lack of transparency surrounding economic impact review can be materially improved if the Bank's PPG staff prepares and publishes guidelines identifying the criteria used by the Bank's staff and Board to evaluate economic impact cases and explaining the sort of data that is likely to be relevant to those criteria. The Bank's Economic Impact Procedures should include definitions of terms and concepts that are not commonly understood by the public, commonly used sources of relevant data, explanations of the application of any quantitative analytical methods, and illustrations of their application in either hypothetical or actual case settings. Where a given method is known to be only a very rough approximation of the likely empirical circumstance, or is known to be subject to substantial imprecision, that should be noted and, to the extent possible, the driving factors for that imprecision should be discussed. Section B of this Report suggests that the Bank expand the Economic Impact Procedures to include a number of additional criteria. Those that are selected should be made the subject of transparent disclosure on the Bank's website.

It is further suggested that the Bank's requests for comment on economic impact transactions delivered to the Reviewing Agencies emphasize that the Bank is seeking detailed comment on the data and analysis contained in the draft report. It appears that one consequence of the Bank's current practice of relying on the PPG staff to effectively decide the small number of controversial economic impact cases has been that the Reviewing Agencies' comments on economic impact reports in those controversial cases have tended to be result-oriented, and sometimes have not been accompanied by data supporting the Reviewing Agency's comments. If economic impact cases are to be decided by the Board, by balancing the data and perspectives on both sides of the question as suggested in Section A of this Report, the data supporting a Reviewing Agency's position will be of interest to the Board as well as the PPG staff.

The Bank's PPG staff, while taking due care to protect confidential business information, can without undue difficulty prepare redacted versions of its economic impact reports, or case summaries describing the actions taken in specific economic impact cases and the evidence supporting that action. Those redacted reports or summaries can be made available to the transaction participants, and the public, along with the expanded information on the Bank's economic impact methodologies suggested elsewhere in this Report. A review of economic impact reports delivered since 2002 suggests that much of the information regarding the PPG staff's analysis and industry economic data are not sensitive business information that require protection from disclosure.

⁴⁷ http://www.whitehouse.gov/the_press_office/TransparencyandOpenGovernment/

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Because of the various criticisms of prior economic impact review methods leveled in this Report, and the significant suggested changes, it would likely not be constructive to provide redacted economic impact reports from prior years if they are not representative of the Bank's policies going forward. It may be helpful to consider transparent disclosure and expanded participation in the process by the Reviewing Agencies, members of the Board and, if the suggestions in Section D of this Report are adopted, proponents of transactions, if the PPG staff prepares and publishes one or two hypothetical economic impact analyses demonstrating its revised Economic Impact Procedures if material changes are adopted.

Suggestions to Management

The Bank should advance the transparency of its economic impact policy and determinations by:

- C.1. Revising the Economic Impact Procedures to include more information about the PPG staff's methodology and publishing the expanded description on the Bank's website.
- C.2. Revising the Bank's internal procedures to more fully and accurately describe the PPG staff's methodology in preparing economic impact reports.
- C.3. Making economic impact reports publicly available after redacting them, or delaying their release, to protect sensitive business confidential information of the transaction proponents.

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Section D

The Bank Should Improve the Efficiency and Responsiveness of the Economic Impact Procedures by Simplifying the Process and Reallocating Resources

Conclusion

Other U.S. government agencies that evaluate the impact on the U.S. economy of specified transactions or developments apply a number of strategies to advance the goals of achieving transparency, reasonably accurate determinations and responsiveness to the interests of the public, transaction participants and other stakeholders that have not been fully evaluated or applied in the context of Ex-Im Bank's Economic Impact Procedures. Ex-Im Bank management can increase the accuracy, transparency and responsiveness of the Bank's Economic Impact Procedures by developing methodologies to accelerate the consideration of economic impact cases and hiring, or contracting for the services of, a trained economist with a background in macroeconomic market analysis of the sort required by economic impact review.

Findings

The PPG staff has described its quantitative trade flow analysis as an approximate indicator that can be managed during the limited time, and with the limited information, available to the PPG staff to suggest where a negative balance of costs and benefits to the U.S. market might be found to be associated with a proposed transaction such that Ex-Im Bank support for the transaction should be questioned or denied. While Section B of this Report suggests that the PPG staff no longer place the same degree of reliance on quantitative trade flow analysis as the principal criterion applied to decide economic impact cases, the staff's objective of developing a prompt and easy to manage process for economic impact review is consistent with the Bank's mission and deserves continuing study and effort. This Section D addresses a number of suggested actions that can contribute to that effort.

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Developing Methods to Quickly Clear Low-Risk Transactions

Given that more than 90% of economic impact cases do not appear to have been difficult or controversial to decide, it would speed transaction approval if the PPG staff organized the Bank's Economic Impact Procedures to efficiently identify those transactions at an early stage of the review process. This would then free up PPG staff resources to focus on the smaller number of cases that are difficult or where opposition to the transaction develops from affected industries or Congress, allowing those cases to be addressed and disposed of more efficiently as well. Efficient allocation of resources will also support the PPG staff's effort over the past year to screen transactions below the \$10 million threshold⁴⁸ to determine whether they raise economic impact issues outside of a formal economic impact review process.

Because of the wide variety of industries that the PPG staff may have to analyze for economic impact, the unique features of many industries relative to their structures and data availability and the PPG staff's limited resources, the PPG staff reported in interviews that they often find it challenging to respond to the requirement for preparation of a well documented and reasoned economic impact analysis within the limited time available to them, particularly in new industries where they do not have accumulated experience or file data. They also noted that in their experience, there is a broad range of sophistication among transaction proponents, with some having resources and background to understand the requirements of the process while others do not.

It should be possible for the PPG staff to evaluate its prior economic impact reports to identify common elements among the more than 90% of economic impact review transactions that have not been difficult or controversial that could be applied as a screen to identify transactions eligible for expedited processing. The screen might not be effective at a 90% level, but even identifying 50% of the Bank's economic impact review transactions for expedited processing would provide a significant benefit to the transaction proponents and to the use of PPG staff resources. Among the criteria that should be evaluated for inclusion in that screening process would be:

- (a) Recent results for U.S. producers of the Exportable Good – if U.S. producers of the Exportable Good and related employment have been experiencing relatively consistent positive results in recent years, the likelihood of adverse economic impact from the creation of new foreign production would appear to be small unless the amount of new foreign production is significant. If U.S. producers of the Exportable Good have been experiencing depressed prices, operating losses and employment losses attributable to foreign competition, the

⁴⁸ As discussed in detail in the 2007 GAO Report, the Bank subjects transactions involving less than \$10 million of support to less rigorous and time-consuming procedures for review; these transactions are not subjected to formal economic impact review. Based on findings and recommendations in the 2007 GAO Report, the PPG staff has begun an informal screening process to identify smaller transactions that might raise economic impact issues. Based on amendments contained in Section 2(e)(6) of the Charter enacted during the Bank's 2006 reauthorization, the PPG staff is also tracking transactions below the \$10 million threshold that might aggregate to more than that amount over a 24 month period.

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likelihood of adverse economic impact would be greater⁴⁹. This approach would track the analysis and suggestions for improvement discussed above in Section B - Distinguishing “Damaged Industries,” “Challenged Industries” and “Successful Industries.”

- (b) Relative percentages of the U.S. market and the world market represented by the new foreign production – if the new foreign production is less than a low percentage of world output, for example 2 or 3%, and if U.S. production is a low percentage of world output, for example less than 50%, then it might be reasonable to conclude that the impact of the new foreign production is likely to be greater on foreign producers of the Exportable Good than on U.S. producers, and that any identifiable adverse impact on U.S. producers would be materially diluted as a result. In markets experiencing “oversupply,” as discussed in Section A, a different conclusion might result that would justify more extensive analysis.
- (c) The location of the new foreign production and its potential for direct competition in the U.S. market as opposed to foreign markets. The PPG staff has noted that new foreign production located in North America or in the western hemisphere is more frequently focused on delivery to the U.S. market, presenting an increased likelihood of direct competition that might produce an adverse economic impact.
- (d) The presence of U.S. trade-related actions affecting foreign producers of the Exportable Good anywhere in the world, or the presence of material foreign government subsidies or support for the manufacture of the Exportable Good anywhere in the world, which would suggest an increased likelihood of adverse economic impact on U.S. producers from foreign production of the Exportable Good generally and from the transaction under consideration specifically.

As discussed in Section A of this Report, the sorts of industry conditions identified by Congress as raising serious concerns of net negative economic impact have not been subtle or required trained economists to identify. A few hours spent scanning the internet for industry coverage and financial reports of U.S. producers would in most of those cases identify negative results such as multiple years of operating losses, employment losses, and failures of U.S. companies that should signal the potential existence of a Damaged Industry where a finding of adverse economic impact would be most likely. The absence of those publicly discussed negative results and prospects should correspondingly signal a case where an expedited review should be possible. And even in cases identified for expedited review, the identification of the case as expedited to the Reviewing Agencies, and possibly to the public and Congress in the Bank’s public notice, should provide reasonable assurance that if there is an issue that the screen overlooks, it is likely to be brought to the Bank’s attention in time to be acted upon.

⁴⁹ The economic impact review process implemented by the Overseas Private Investment Corporation (OPIC), while having a number of features specific to its mission and authorizing legislation, has some analogs to the process contemplated in the Bank’s Charter; OPIC reports that their primary focus is identifying U.S. industries that might be impacted by new foreign production associated with an OPIC supported development projects that are experiencing distress. Where affected U.S. industries are not experiencing distress, a more streamlined review results. When a relevant U.S. industry is in distress, the transaction faces a very high threshold of review before it can be approved.

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Develop Screening Method Comparable to Hart-Scott Antitrust Review

The Bank should consider alternatives to simplify the screening process currently used in its Economic Impact Analysis. An example of a simplified approach to complex market analysis by a government agency is the pre-transaction antitrust review applied to corporate mergers and acquisitions by the Federal Trade Commission (“FTC”) under the Hart Scott Rodino Antitrust Improvements Act of 1976 (“Hart-Scott”).

To read more about the Hart-Scott Method please see Appendix H of this Report.

Request Transaction Proponents to Provide Relevant Information

Two other practices included in the FTC’s Hart-Scott review process could be profitably implemented by Ex-Im Bank as part of its Economic Impact Procedures. The first is to request that proponents of transactions involving capital equipment provide a small amount of information that is highly relevant to economic impact review and the second is to encourage transaction proponents to submit white paper analyses addressing the concerns of economic impact analysis in more difficult cases.

Exporters and foreign buyers seeking Ex-Im Bank support for capital equipment transactions should be requested to provide a limited amount of data relevant to economic impact at or before the submission of their application. Specifically, the transaction proponents should be asked to provide a description of the Exportable Goods expected to result directly or indirectly from the new foreign production created by the transaction, including their NAICS codes, an estimate of the units and dollar volumes of annual production that might be anticipated and an indication of the markets to which the new production will be directed. An indication of the “U.S. jobs” value of the transaction – the approximate number of U.S. worker days represented by the exported capital equipment should also be requested.⁵⁰ This is substantially the same information that the Bank is required to include in the Federal Register notice of transactions receiving full economic impact review pursuant to Section 2(e)(7) of the Charter discussed below.

The indicated information should be easily available to the proponents of capital equipment export transactions – the seller knows the production capacity of its equipment and the buyer knows what it plans to do with the equipment and its output – if they are on notice that they need to provide the information when they submit an application for Ex-Im Bank support. There will be questions of accuracy and reliability of the proponents’ data for the PPG staff to consider, but those questions exist with regard to

⁵⁰ This data is relevant to determining the cost to the U.S. economy if the transaction is lost because Ex-Im Bank support is not provided, and is also one of the key metrics that Ex-Im Bank uses to evaluate the effectiveness of its actions in support of its mission of supporting U.S. jobs.

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much of the data supporting economic impact analysis. And, as noted above and in Sections A and B, economic impact analysis should focus more on large-scale aggregate data and economic effects, such that modest potential rates of error in the data should not materially impact the final conclusions.

The Bank should also encourage transaction proponents in more difficult cases to submit white paper analyses addressing more fully the concerns of economic impact analysis. If the suggestions made in Section C of this Report are implemented, providing exporters with much more information about how economic impact analysis is approached by the PPG staff, transaction proponents will be able to make their own optimizing decisions of whether to submit a report supporting their transaction, and how much time and effort to expend in doing so. It is reasonable to expect that the sellers and buyers of capital equipment subject to detailed economic impact analysis regularly obtain information regarding the markets for their direct and indirect products in order to maintain their competitiveness and to plan their operations. They should be in a position to provide that information to Ex-Im Bank early in the application process, which should provide the PPG staff with a significantly improved base of information to support their work.

Transaction proponents are highly motivated to assist and accelerate the Bank's review process, and are also in the best position to be aware of available sources of reliable data and provide them to the Bank's PPG staff at the beginning of their transaction approval process, or perhaps even in advance of that process. Many transaction proponents, particularly those who are less sophisticated, are assisted by finders, agents, lenders and other advisors who deal with the Bank and its policies more frequently and will be able to contribute their experience to assist less sophisticated parties in responding. The PPG staff has expressed some doubt as to the ability of transaction proponents to contribute useful information. The PPG staff is encouraged to test this perspective by inviting proponents to submit relevant market information in the small number of cases that are subjected to detailed economic impact review over a test period of two or three years in order to allow the Bank to determine the usefulness of the data submitted.

Section A of this Report notes that the PPG staff's current mode of economic impact analysis has tended not to formally consider adverse effects on the U.S. economy and employment resulting from a decision to decline Ex-Im Bank support for a transaction, despite the clear requirement in Section 2(e) of the Charter that it do so. The adverse effects from rejecting a transaction will typically be centered on the exporter of capital goods, its industry, its employees, and its vendors. The exporter will typically be in the best position to explain what the lost work hours, lost market position, lost profitability and other negative impacts of a lost sale will represent for that company and for the U.S. economy if Ex-Im Bank support is not provided. The Bank's PPG staff will have difficulty obtaining data to present to the Board on these points if they do not ask the exporter to provide it.

In those cases where transaction proponents submit supporting information as part of the application process that addresses the criteria identified by the Bank as being relevant to economic impact analysis, the demands on the PPG staff should be reduced, allowing it to accelerate its work. The information received by the PPG staff from transaction proponents combined with the results of their review of any other easily obtainable sources of data might be deemed a sufficient factual basis to support a recommendation to the Board, and to constitute the bulk of the PPG staff's economic impact report, where other significantly negative indicators, such as conditions indicating the existence of a Damaged Industry for the Exportable Good, are not present.

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Section A of this Report observes that the Board is substantially dependent on the PPG staff to provide them with a balanced and complete presentation of the data and analysis necessary for the economic impact determinations the Board is required to make under the Bank's Charter. Section 2(e)(7) of the Charter requires the Bank to provide to the Board the comments of persons adversely affected by a proposed transaction. Consideration of the comments of persons positively affected (i.e. the U.S. exporter and foreign buyer) would seem to be reasonable as well. The receipt of relevant data and analysis from transaction proponents should improve the quality and completeness of the PPG staff's reports, and provide the Board with greater assurance that they are considering the full range of balancing factors in support of the transaction, even if circumstances where they may disagree with the specific conclusions advocated.

There is also an element of fairness in the PPG staff and the Bank's Board formally considering economic impact analyses prepared by transaction proponents. In the small number of controversial economic impact cases considered by the Bank, opponents of the transactions, alerted by notice in the Federal Register, have sometimes provided the Bank with data and analysis supporting their opposition, which has impacted the PPG staff's final report and recommendation. It seems fair and reasonable that the transaction proponent's view of the economic impact of the transaction should also be considered as part of the total mix of information that is evaluated by the PPG staff and the Board of Directors.

Reorder the Stages of Economic Impact Review to Accelerate the Process

The typical economic impact review case is initiated when a lender submits an application for Ex-Im Bank guarantee or insurance coverage for a proposed export transaction involving capital equipment. The PPG staff subjects these transactions to a detailed screening process that is described in detail in the Economic Impact Procedures and in the 2007 GAO Report. The initial screening process takes several weeks and appears to be effective in identifying and excluding from economic impact review the 95% or more of Ex-Im Bank transactions that do not raise economic impact issues. If a detailed economic impact review is indicated, the PPG staff then commences that work. Questions may be directed to the proposed exporter and foreign buyer to confirm information such as the specific Exportable Good that will result from the export of capital equipment, the volume of production and the markets it will be sold into. The PPG staff also obtains business and economic data from industry and reference sources and frequently requests relevant market information informally from one or more of the Reviewing Agencies.

The results of trade flow analysis and other market and transaction data deemed relevant by the PPG staff under the Economic Impact Procedures are included in a draft report two to three months after the initial application is filed. The review of economic impact reports over the period covered by this Report confirmed that it would be fair to typify the PPG staff's preparation of economic impact reports as conscientious, thorough, and time-consuming. At this point the draft is provided to the Reviewing

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Agencies, and a notice of the transaction is published in the Federal Register.⁵¹ The PPG staff then waits for the Reviewing Agencies to express a comment on the proposed transaction, or waive comment, which is requested within 30 days but in practice has sometimes taken two to three months. Controversial cases receiving active opposition from an impacted Exportable Good industry, a member of Congress or a Reviewing Agency generally have taken longer to complete, adding months to the process.

Once the Reviewing Agencies have responded, the economic impact report is finalized, and the transaction scheduled for Board decision, with each director being briefed on the PPG staff's recommendation and the content of the economic impact report prior to that vote. Because of the delays associated with the process, the completion of the economic impact report can be the last step in the transaction approval process, resulting in a short period of time, sometimes as little as a week, for the Board to consider a transaction. Having access to the PPG staff's report, and an ability to question it or examine underlying data, for such a short period of time impairs the Board's ability to exercise its responsibility under Section 2(e) of the Bank's Charter to decide economic impact cases. An uncertain process that can take six months or more to complete impairs the utility of Ex-Im Bank support for U.S. exporters. Unreasonable delay will for many exporters have the same effect as a denial of Ex-Im Bank support.

A review of the economic impact cases decided by the Bank since 2002 (see Appendix B) suggests that it is possible to reduce the amount of time and uncertainty associated with the economic impact review process if changes are made in the order in which the various required actions and notices to the public and the Reviewing Agencies are completed so as to identify sources of controversy early in the process, rather than at the end.

The leading triggers for controversy (opposition from impacted industries or U.S. producers of the relevant Exportable Good, from the Reviewing Agencies or from the Board) and associated delays can be summarized as:

- Consideration of cases where the Exportable Good will compete with U.S. producers in a Damaged Industry.

⁵¹ Section 2(e)(7) of the Charter requires that the Bank publish a notice in the Federal Register if "the Bank intends to conduct a detailed economic impact analysis or similar study," alerting Congress, the public and affected industries to the potential transaction. The required notice provides limited, nonproprietary information about the transaction:

- (i) the country to which the goods involved in the transaction will be shipped;
- (ii) the type of goods being exported;
- (iii) the amount of the loan or guarantee involved;
- (iv) the goods that would be produced as a result of the provision of the loan or guarantee [Exportable Goods];
- (v) the amount of increased production [of the Exportable Good] that will result from the transaction;
- (vi) the potential sales market for the resulting [Exportable] goods; and
- (vii) the value of the transaction.

Section 2(e)(7) of the Charter provides for a fourteen day comment period after publication of the EI Notice, which may be extended to thirty days upon the request of any affected party, and for republication of the notice if specified material changes in the transaction are later made (a change in the Exportable Good or an increase in the requested loan of 25% or more).

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- Consideration of cases where the Exportable Good will compete with U.S. producers in a Challenged Industry.
- Consideration of cases opposed by a U.S. producer of the Exportable Good who enlisted active support from a member of Congress.
- Applications of trade flow analysis where the result or the methodology appeared inadequately supported to one or more of the Reviewing Agencies or a member of the Board.

The leading causes of controversy identified by members of the Board have been: (i) the lack of transparency of trade flow analysis, (ii) applications of trade flow analysis that were contradicted by other information about the affected industries, (iii) inadequate time provided to the Board to evaluate the PPG staff's recommendation and supporting economic impact report and (iv) fundamental differences of opinion between directors holding Anti-Economic Impact perspectives discussed in Section B of this Report and the generally Pro-Economic Impact bias of the current Economic Impact Procedures.

Negative responses to the PPG staff's draft economic impact reports by the Reviewing Agencies have tended to fall into two categories: (i) comments about the advisability of Ex-Im Bank support for the transaction on policy grounds and (ii) comments about the methodology used by the PPG staff (most frequently some aspect of the staff's trade flow analysis) to support their recommendation. The information contained in the Federal Register notice would appear to be sufficient to allow the Reviewing Agencies to provide the first category of comments in the transactions reviewed for this Report; the second category of comments has generally required a review of the PPG staff's draft report. To the extent that the PPG staff ceases to rely heavily on trade flow analysis, the second category of Reviewing Agency comment will cease to be applicable.

The Bank's current Economic Impact Procedures, and the PPG staff's methodology in executing them, tend to result in one or more of the impacted industries, Congress, the Reviewing Agencies and the Board receiving notice of a pending transaction, or an opportunity register their objection later, rather than earlier, in the process. This is a consequence of the PPG staff's procedures requiring completion of their draft economic impact report and resulting recommendation before the interested parties are notified of the existence of the proposed transaction and the basic facts concerning it. This has resulted in the economic impact review process taking months to complete even for transactions involving Successful Industries where none of the Reviewing Agencies nor any member of Congress or representative of an impacted U.S. producer of the relevant Exportable Good has expressed any concern about a transaction.

It is entirely supportable that the Board of Directors would not make a final decision until its members have reviewed the PPG staff's final report. However, it appears that most of the negative comments delivered for comment on these transactions are attributable to the basic facts of the transaction that are known to the PPG staff much earlier in the economic impact review process, and that preliminary comment from the Board could be collected and addressed by the PPG staff and the Bank's senior management as part of the process of completing the initial draft of economic impact report without damaging the integrity or effectiveness of the process. This will be particularly helpful information if individual members of the

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Board come from a strong Pro-Economic Impact or Anti-Economic Impact perspective. The Reviewing Agencies are not called upon to express an opinion on the Bank's final decision on an economic impact case – they should be able to express their views in favor or against Ex-Im Bank support for a transaction in most cases much earlier in the process, and then confirm that their views have not changed when the final economic impact report draft is circulated.

The basic insight of this section of the Report is that if these sources of controversy are identified and addressed earlier in the process, less delay and uncertainty will be imposed on transaction participants. Less delay and uncertainty will benefit exporters and should increase their willingness to submit transactions for Ex-Im Bank support. This Report suggests that the Bank should move away from reliance on trade flow analysis, and towards a broader balancing analysis of economic impact transactions based on publicly disclosed criteria, and make its Economic Impact Procedures more transparent. If these suggestions are acted upon, then providing notice of economic impact transactions to the Reviewing Agencies and the Board containing essentially the information now contained in Federal Register notices of economic impact transactions, supplemented by any information provided by the transaction proponents and the PPG staff, will support a more transparent and responsive process. Providing the existing Federal Register notice to alert Congress and impacted industries at the same early date will similarly elicit their likely response, if any, much earlier in the process.

Management should evaluate whether application of the suggested method to the indicated sources of controversy could have the following positive effects:

- Cases involving Damaged Industries – representatives of the Damaged Industry, Reviewing Agencies aware of those conditions and Board members strongly in the Pro-Economic Impact camp will in most cases be able to articulate their opposition to transactions supporting new foreign production of an Exportable Good that will compete with a U.S. Damaged Industry without the benefit of a full economic impact report. That response might dissuade the Bank from pursuing the transaction unless a majority of the Board indicates an interest in giving it fuller consideration.
- Cases involving Challenged Industries – representatives of the Challenged Industry, Reviewing Agencies aware of those concerns and Board members strongly of the Pro-Economic Impact or Anti-Economic Impact perspectives will be able to articulate their opposition or support for the proposed transactions based on the summary information provided. If none of those sources register a negative view within a reasonable time after receiving notice, the PPG staff could accelerate its process, and the Bank's decision. If mixed views are registered, the PPG staff can engage with the sources of the disparate views and reflect them in the draft economic impact report.
- Cases involving parties enlisting the interest of Congress – the views of the party and the interested member of Congress can be received by the Bank's staff and considered along with other data received by the Bank at an early point during the review process. Whatever response the Bank determines to make, the result for the integrity of the Bank's processes will be better if this sort of issue is dealt with at an early stage rather than later.

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- Cases involving disagreements over the results or methodology of trade flow analysis – to the extent that trade flow analysis is dispensed with or significantly reduced in its influence, these specific sources of controversy should diminish. If the Bank adopts a broad, non-quantitative balancing mode of analysis as suggested in this Report, obtaining a preliminary reaction from the Board and the Reviewing Agencies at an earlier stage of the process will allow them to identify the criteria and related data that they believe will be most relevant to their final determinations regarding the case.

Each of these instances of early exposure of economic impact cases should contribute to the quality of the PPG staff's analysis and should allow them to accelerate the process of reaching a well-supported final conclusion that can be provided to the Board and the Reviewing Agencies. In a majority of the cases identified in Appendix B that were reviewed in the course of preparing this Report it appears that the PPG staff's work could have been completed and the case referred for final decision by the Board after the sort of preliminary report described above.

The PPG staff communicates with the Bank's transactional staff as they work on economic impact analyses. If it appears that a transaction may not receive approval on economic grounds or is lacking necessary information, the PPG staff may reallocate their limited resources to other work until they receive word that the transaction is moving forward. Similarly, early indicators of a negative economic impact determination may be communicated to the Bank staff handling the transaction, resulting in discussions with the proponents, or even suggestions that the transaction be withdrawn. These events and discussions can contribute to delays in completing draft economic impact analyses.⁵²

A number of instances were reported in interviews with the Board where the PPG staff's final economic impact report containing its recommendation to the Board was provided to the Board only a week before a transaction was to be submitted for Board approval. Being forced into a rushed decision was reported to be particularly problematic to the Board in the small number of cases where opposition to the transaction had emerged or members of the Board had been contacted by proponents or opponents of the transaction,

⁵² In expedited transactions, it might be expected that the conclusions from the PPG staff's preliminary screen might be known, and notice of the transaction provided to the Reviewing Agencies, Congress and the public, within 30 days after submission of the initial application. In the vast majority of cases where no adverse comment is received, a draft economic impact report could be distributed 30 days after that, with final action by the Board set shortly thereafter. If the Reviewing Agencies and the Board were inclined to agree with the results of the PPG staff's preliminary screen indicating that adverse economic impact is unlikely, comment by the Reviewing Agencies and briefing by the Board might be waived, allowing final action in approximately 60 days.

If a case is expected to be difficult or controversial, requiring a significant investment of time by the PPG staff, the initial notice of the transaction to the Reviewing Agencies, Congress and the public could still occur within 30 days, and the PPG staff's work to support the draft economic impact report could commence. As comment and related information is received in the following months, the PPG staff could develop its balancing analysis to be presented in the draft report. Depending on resources available and the extent of interaction with interested parties, the substantive work on the report might occupy the PPG staff for as much as 60-90 days, with the goal of producing a draft report that was inclusive of all information received, as discussed in Section A of this Report, that would be distributed to the Reviewing Agencies and the Board and then considered by the Board 30 days later, allowing final Board consideration to occur within 120 days for more difficult cases.

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particularly in view of the limitations of the economic impact reports received by the Board as detailed above in Section A. Use of both the expedited and extended review timelines described above would allow the Board to be aware of and to follow the progress of economic impact reviews.

Set Reasonable Time Limits for Response by the Reviewing Agencies

Members of the Board and the PPG staff in interviews commented that in several of the small number of more difficult economic impact cases the Reviewing Agencies had not responded to the PPG staff's draft economic impact reports for periods of several months, delaying consideration and authorization of the pending transactions. Internal Reviewing Agency delays in providing comments on draft economic impact reports were attributed to the relative infrequency of economic impact cases, and the broad range of markets that they might impact, which were cited as preventing the development of specific personnel and processes to address economic impact cases. The PPG staff's practice of not actively engaging with the Reviewing Agencies until the draft economic impact report is completed also contributes to delay – the Reviewing Agencies cannot begin to evaluate the transaction until the PPG staff's work is complete.

The Bank's use of trade flow analysis as the primary determinant of economic impact cases, and the lack of transparency associated with that method, have understandably limited the ability of the Reviewing Agencies to undertake independent analysis of the economic effect of a proposed transaction. External facts regarding U.S. and foreign markets for the proposed export and the resulting Exportable Goods are generally given little or no effect by trade flow analysis. A Reviewing Agency has little choice but to wait and see what result is produced by the PPG staff's trade flow analysis, compare that result with what the Reviewing Agency knows of the underlying facts, identify any other relevant policy concerns with the PPG staff's conclusion and then provide comment.

Several of the suggestions made in this Report should make it easier for the Reviewing Agencies to contribute to the economic impact review process. If the Bank decreases or eliminates reliance on trade flow analysis and adopts a balancing analysis that considers a broader range of criteria that are transparently disclosed to the Reviewing Agencies, the Reviewing Agencies will not have to wait until the PPG staff's draft report is completed to begin working on an economic impact case. If the PPG staff provides early notice of pending cases as suggested in this Section D, the Reviewing Agencies should be in a position to consult their own sources for relevant data and policy prior to receiving the PPG staff's draft report. If work can begin before the draft report is issued by the PPG staff, then it will be fair and reasonable to request the Reviewing Agencies to complete that work more promptly.

Assuming that progress is made on the suggestions described above, it is suggested that the PPG staff establish reasonable time periods for receipt of Reviewing Agency comment after its draft report is circulated, after which comment will be deemed to have been waived, allowing the Bank to proceed with the other necessary steps to obtain final Board consideration. Congress in Section 2(e)(7) of the Charter set an outside limit of thirty days for comments by interested parties in response to public notice of an economic

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impact case in the Federal Register. A comparable 30-day comment period would typically give the Reviewing Agencies at least sixty days to consider the transaction and respond if the PPG staff takes thirty days following the date of a prompt Federal Register Notice to complete its draft report.

Obtain Expert Professional Assistance for Difficult Transactions

The PPG staff acknowledges that none of its members has received advanced professional training or a post-graduate degree in economics, and describes their work as reflecting a practical education in the economic issues they have identified as relevant to economic impact review. The PPG staff has in the past experimented with retaining private sector economists to apply more quantitatively rigorous methods of conventional economic analysis to look at such matters as the “price elasticity of demand” in a particular U.S. market.⁵³ These efforts were described by the PPG staff as slow, expensive, and unsatisfactory in that the results did not speak with any clarity to the fundamental question of substantial injury to U.S. producers of the Exportable Good. This conclusion is reflected in this Report’s suggestion that the Board’s economic impact decisions, and the PPG staff’s work to support them, should be driven by larger-scale “macro” market data and trends rather than by complex quantitative analysis.

The Bank employs economists in its Country Risk and Economic Analysis Division, but the work of that group focuses on determining credit ratings for the more than 150 countries where the Bank does business, requiring a different expertise than what is being suggested here. Congress attempted to address the Bank’s need for applied economic analysis in 12 U.S.C. 635-a2, which provides: “the Bank shall request, and the United States International Trade Commission shall furnish, a report assessing the impact of the Bank’s activities on industries and employment in the United States. Such report shall include an assessment of previous loans or financial guarantees and shall provide recommendations concerning general areas which may adversely affect domestic industries, including agriculture, and employment.” The PPG staff reported that an attempt was made to access this resource, but the absence of funding, the irregularity of the demand and the significantly different focus and timing requirements of the Bank’s process prevented the International Trade Commission from proving a viable resource.

The economic impact review process, as currently conducted and as it may be improved by the actions suggested in this Report, can benefit from the participation of an expert economist having a strong foundation in analyzing U.S. and international markets at a macroeconomic level, including analysis of the drivers of changes in supply and demand, profitability in industries and individual participants and U.S. labor market dynamics. If the economic impact process moves away from reliance on trade flow analysis and begins to consider and attempt to balance other relevant criteria, much of the data that will be assembled will be familiar to an economist with the indicated expertise. This individual will also be

⁵³ Price elasticity of demand calculations seek to estimate how much the price for a U.S. product might have to be decreased in order to maintain existing sales volumes in the face of the introduction of new supplies of the product in U.S. or international markets.

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able to explain to the PPG staff and the Board assumptions and limitations underlying that data, whether it is obtained by the PPG staff, is provided by a reviewing agency, or is submitted by a party opposing a particular transaction.

It is suggested that the Bank hire or contract for the services of a degreed and experienced professional economist to assist with the development of Bank policy relative to economic impact review, preparation of economic impact reports, handling contested economic impact cases and related matters. The PPG staff has questioned whether the volume of economic impact reviews would be adequate to justify a full-time Bank employee given the substantial decrease in the volume of economic impact cases. There are other areas of the Bank where this individual's expertise could be found to be valuable. Among these would be assisting the Trade Finance and Credit Underwriting Groups in analyzing economic forecasts and business plans that provide data and make assumptions about international markets and helping the Bank develop improved methods of gathering and analyzing information relating to the effectiveness of its programs and developing improved policy choices based on that data. Seeking a contractor to provide this expertise on less than a full-time basis would be another viable alternative.

Suggestions to Management

The Bank should increase the efficiency and responsiveness of the Bank's Economic Impact Procedures by:

- D.1. Developing and making public a methodology to identify at an early stage transactions where there appears to be little risk of adverse economic impact in order to allow expedited handling of those cases.
- D.2. Requesting exporters of capital equipment to provide relevant data that is reasonably available to them, without undue burden, during the application process to support an accelerated review by the PPG staff.
- D.3. Inviting (but not requiring) proponents of transactions subject to formal economic impact review to submit white paper analyses addressing economic impact concerns that might be raised by the transaction.
- D.4. Providing earlier notice to Congress and the Reviewing Agencies of the initiation of a substantive economic impact review, after an initial screening review but before the PPG staff has prepared a complete economic impact report.
- D.5. Implementing a policy or reaching agreement with the Reviewing Agencies that would set a specified limited time period after they receive a draft economic impact report in which to submit their comments.

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- D.6. Hiring, or contracting for the services of, a trained economist with a background in macroeconomic market analysis of the sort required by economic impact review to assist in implementing the improvements suggested in this Report.

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Appendix A - Statutory Provisions Relevant to Economic Impact Determinations

Export-Import Bank Act of 1945, as amended

Sec. 2(e) Limitation on assistance which adversely affect[s] the United States.

(1) In general. The Bank may not extend any direct credit or financial guarantee for establishing or expanding production of any commodity for export by any country other than the United States, if –

- (A) the Bank determines that –
 - (i) the commodity is likely to be in surplus on world markets at the time the resulting commodity will first be sold; or
 - (ii) the resulting production capacity is expected to compete with United States production of the same, similar, or competing commodity; and
- (B) the Bank determines that the extension of such credit or guarantee will cause substantial injury to United States producers of the same, similar, or competing commodity.

In making the determination under subparagraph (B), the Bank shall determine whether the facility that would benefit from the extension of a credit or guarantee is reasonably likely to produce a commodity in addition to, or other than, the commodity specified in the application and whether the production of the additional commodity may cause substantial injury to United States producers of the same, or a similar or competing, commodity.

(2) Outstanding Orders and Preliminary Injury Determinations.

- (A) Orders. The Bank shall not provide any loan or guarantee to an entity for the resulting production of substantially the same product that is the subject of—
 - (i) a countervailing duty or antidumping order under title VII of the Tariff Act of 1930; or
 - (ii) a determination under title II of the Trade Act of 1974.
- (B) Affirmative Determination. Within 60 days after the date of the enactment of this paragraph, the Bank shall establish procedures regarding loans or guarantees provided to any entity that is subject to a preliminary determination of a reasonable indication of material injury to an industry under title VII of the Tariff Act of 1930. The procedures shall help to ensure that these

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loans and guarantees are likely to not result in a significant increase in imports of substantially the same product covered by the preliminary determination and are likely to not have a significant adverse impact on the domestic industry. The Bank shall report to the Committee on Financial Services of the House of Representatives and the Committee on Banking, Housing, and Urban Affairs of the Senate on the implementation of these procedures.

(C) Comment Period. The Bank shall establish procedures under which the Bank shall notify interested parties and provide a comment period of not less than 14 days (which, on request of any affected party, shall be extended to a period of not more than 30 days) with regard to loans or guarantees reviewed pursuant to subparagraph (B) or (D).

(D) Consideration of Investigations under Title II of the Trade Act of 1974. In making any determination under paragraph (1) for a transaction involving more than \$10,000,000, the Bank shall consider investigations under title II of the Trade Act of 1974 that have been initiated at the request of the President of the United States, the United States Trade Representative, the Committee on Finance of the Senate, or the Committee on Ways and Means of the House of Representatives, or by the International Trade Commission on its own motion.

(E) Anti-Circumvention. The Bank shall not provide a loan or guarantee if the Bank determines that providing the loan or guarantee will facilitate circumvention of an order or determination referred to in subparagraph (A).

(3) Exception. Paragraphs (1) and (2) shall not apply in any case where, in the judgment of the Board of Directors of the Bank, the short- and long-term benefits to industry and employment in the United States are likely to outweigh the short- and long-term injury to United States producers and employment of the same, similar, or competing commodity.

(4) Definition. For purposes of paragraph (1)(B), the extension of any credit or guarantee by the Bank will cause substantial injury if the amount of the capacity for production established, or the amount of the increase in such capacity expanded, by such credit or guarantee equals or exceeds 1 percent of United States production.

Sec. 2(e)(5) Designation of Sensitive Commercial Sectors and Products.- Not later than 120 days after the date of the enactment of this Act, the Bank shall submit a list to the Committee on Banking, Housing, and Urban Affairs of the Senate and the Committee on Financial Services of the House of Representatives, which designates sensitive commercial sectors and products with respect to which the provision of financing support by the Bank is deemed unlikely by the President of the Bank due to the significant potential for a determination that such financing support would result in an adverse economic impact on the United States. The President of the Bank shall review on an annual basis thereafter the list of sensitive commercial sectors

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and products and the Bank shall submit an updated list to the Committee on Banking, Housing, and Urban Affairs of the Senate and the Committee on Financial Services of the House of Representatives of such sectors and products.

Sec. 2(e)(7) Procedures to Reduce Adverse Effects of Loans and Guarantees on Industries and Employment in United States. –

- (A) Consideration of Economic Effects of Proposed Transactions - If, in making a determination under this paragraph with respect to a loan or guarantee, the Bank conducts a detailed economic impact analysis or similar study, the analysis or study, as the case may be, shall include consideration of--
 - (i) the factors set forth in subparagraphs (A) and (B) of paragraph (1); and
 - (ii) the views of the public and interested parties.

- (B) Notice and Comment Requirements
 - (i) In General.- If, in making a determination under this subsection with respect to a loan or guarantee, the Bank intends to conduct a detailed economic impact analysis or similar study, the Bank shall publish in the Federal Register a notice of the intent, and provide a period of not less than 14 days (which, on request by any affected party, shall be extended to a period of not more than 30 days) for the submission to the Bank of comments on the economic effects of the provision of the loan or guarantee, including comments on the factors set forth in subparagraphs (A) and (B) of paragraph (1). In addition, the Bank shall seek comments on the economic effects from the Department of Commerce, the Office of Management and Budget, the Committee on Banking, Housing, and Urban Affairs of the Senate, and the Committee on Financial Services of the House of Representatives.

 - (ii) Content of Notice.- The notice shall include appropriate, nonproprietary information about--
 - (I) the country to which the goods involved in the transaction will be shipped;
 - (II) the type of goods being exported;
 - (III) the amount of the loan or guarantee involved;
 - (IV) the goods that would be produced as a result of the provision of the loan or guarantee;
 - (V) the amount of increased production that will result from the transaction;
 - (VI) the potential sales market for the resulting goods; and

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(VII) the value of the transaction.

(iii) Procedure Regarding Materially Changed Applications.-

(I) In General.- If a material change is made to an application for a loan or guarantee from the Bank after a notice with respect to the intent described in clause (i) is published under this subparagraph, the Bank shall publish in the Federal Register a revised notice of the intent, and shall provide for a comment period, as provided in clauses (i) and (ii).

(II) Material Change Defined.- As used in sub clause (I), the term 'material change', with respect to an application, includes--

(aa) a change of at least 25 percent in the amount of a loan or guarantee requested in the application; and

(bb) a change in the principal product to be produced as a result of any transaction that would be facilitated by the provision of the loan or guarantee.

- (C) Requirement to Address Views of Adversely Affected Persons - Before taking final action on an application for a loan or guarantee to which this section applies, the staff of the Bank shall provide in writing to the Board of Directors the views of any person who submitted comments pursuant to subparagraph (B).
- (D) Publication of Conclusions - Within 30 days after a party affected by a final decision of the Board of Directors with respect to a loan or guarantee makes a written request therefore, the Bank shall provide to the affected party a non-confidential summary of the facts found and conclusions reached in any detailed economic impact analysis or similar study conducted pursuant to subparagraph (B) with respect to the loan or guarantee, that were submitted to the Board of Directors.
- (E) Rule of Interpretation - This paragraph shall not be construed to make subchapter II of chapter 5 of title 5, United States Code, applicable to the Bank.
- (F) Regulations - The Bank shall implement such regulations and procedures as may be appropriate to carry out this paragraph.

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Appendix B - Transactions Subject to a Detailed Economic Impact Analysis 2002 - 2009

I. Transactions for which Ex-Im Bank's Board rendered a decision (20)		
Status	Country	Project
Board Approved 4/14/2009	Germany	Photovoltaics
Board Approved 1/24/2008	Spain	Steel Plate/Coil Production
Board Approved 9/12/2007	Saudi Arabia	Petrochemical Production
Board Approved 8/8/2007	China	Titanium Production
Board Approved 5/16/2007	Singapore	Semi-Conductor (Logic)
Board Approved 5/16/2007	India	Polypropylene, Sulfur & Petcoke Production
Board Approved 8/22/2006	Japan	Titanium Production
Board Denied 3/2006	Saudi Arabia	Direct Reduced Iron for Steel Production
Board Approved 9/8/2005	Turkey	Denim Fabrication
Board Approved 7/14/2005	Qatar	Petrochemical Production
Board Approved 2/3/2005	Egypt	Ammonia
Board Approved 2/3/2005	Israel	Polypropylene
Board Approved 12/22/2004	Russia	Polystyrene
Board Approved 11/12/2004	Singapore	Semi-Conductors
2-2 vote by Board 5/24/2004 (effective denial)	Ukraine	Steel Service Center
Board Approved 3/26/2004	Argentina	Gold & Silver Mining

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I. Transactions for which Ex-Im Bank's Board rendered a decision (20)		
Status	Country	Project
Board Approved 6/5/2003	India	Pure Terephthalic Acid
Board Approved 4/3/2003	Russia	Metallurgical Coal
Board Approved 1/30/2003	Uzbekistan	Gold Mine
Board Approved 10/25/2002	China	Petrochemical Production

II. Transactions for which Staff completed a detailed Economic Impact Analysis that was not put before the Board for a Decision (5)		
Status	Country	Project
Withdrawn for credit reasons 6/3/2008	Hong Kong	Auto Molds
Withdrawn for credit reasons 7/18/2007	Russia	DRI Production
Withdrawn for credit reasons 3/20/2006	Portugal	Photovoltaic Modules
Withdrawn for credit reasons 8/3/2005	Greece	Photovoltaic Modules
Withdrawn for credit reasons 11/2/2004	Mexico	Flat Glass

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Appendix C - Legislative History of Economic Impact at Ex-Im Bank 1968 to 1988

1968 – Economic Impact Appears on the Legislative Agenda

The subject of potential adverse economic impact of Ex-Im Bank on the U.S. economy has been referenced in the Bank's Charter since 1968, when Section 1 was amended to include a provision requiring the Board of Directors when authorizing loans to take into account the possible adverse effects upon the economy of the United States. [Pub.L. 90-267]

1975 – Pro-Economic Impact and Anti-Economic Impact Perspectives Emerge

In 1975, Congress addressed the issue of economic impact more directly by enacting the following provision:

Section 2(B)(1) of the Export-Impact Bank Act of 1945 is amended to read as follows: (B) It is further the policy of the United States that . . . in authorizing any loan or guarantee, the Board of Directors shall take into account any serious adverse effect of such loan or guarantee on the competitive position of United States industry, the availability of materials which are in short supply in the United States, and Employment in the United States. [Pub.L. 93-64]

This provision represented an early compromise between the "Pro-Economic Impact" perspective that any adverse effect on U.S. industry should be enough to prevent Ex-Im Bank support and the "Anti-Economic Impact" recognition of the practical difficulty of determining whether a given transaction will have a net negative effect on the U.S. economy:

The Senate amendment contained a provision specifying that the Board of Directors of the Bank should not authorize loans, guarantees, or insurance which may have serious adverse effects on the competitive position of United States industries, the availability of materials which are in short supply in the United States, or employment in the United States. The House bill contained no comparable provision. The conferees accepted an amendment which specified that the Board of Directors, in authorizing loans or guarantees, shall take into account any serious adverse effects on the competitive position of United States industry, the availability of materials which are in short supply in the United States, and employment in the United States. [H.R. Conf. Rep. 93-1633, 93th Cong., 2nd Sess. 1974]

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1978 – Continued Congressional Interest Produces Modest Tweaking, Limited Effect

Section 2(B)(1) continues to exist in the Bank's Charter, slightly modified in 1978 to reflect a stronger Anti-Economic Impact viewpoint through the addition of the final clause:

Sec. 2(b)(1)(B). It is also the policy of the United States that . . . in authorizing any loan or guarantee, the Board of Directors shall take into account any serious adverse effect of such loan or guarantee on the competitive position of United States industry, the availability of materials which are in short supply in the United States, and employment in the United States, and shall give particular emphasis to the objective of strengthening the competitive position of United States exporters and thereby of expanding total United States exports. [Pub.L. 95-630]

In 1978, Congress also appended to the Bank's Charter a policy statement that the Bank should implement regulations and procedures to address the possibility of adverse economic impact from Ex-Im Bank supported transactions:

12 U.S.C. 635a-2 Implementation of regulations and procedures to lessen adverse effect of loans and guarantees on industries in United States; report by United States International Trade Commission. The Bank shall implement such regulations and procedures as may be appropriate to insure that full consideration is given to the extent to which any loan or financial guarantee is likely to have an adverse effect on industries, including agriculture, and employment in the United States, either by reducing demand for goods produced in the United States or by increasing imports to the United States. To carry out the purposes of this subsection, the Bank shall request, and the United States International Trade Commission shall furnish, a report assessing the impact of the Bank's activities on industries and employment in the United States. Such report shall include an assessment of previous loans or financial guarantees and shall provide recommendations concerning general areas which may adversely affect domestic industries, including agriculture, and employment. [Pub.L. 95-630]

The PPG staff reports that discussions were held with the International Trade Commission ("ITC") relative to preparing the report contemplated by this provision, but no report was ever produced. The cited causes were the lack of staff time for a large special project, the absence of funding and the shared perception that the ITC's perspective and expertise, being focused on enforcement of international trade agreements, were not well suited to undertaking the sort of analysis the provision contemplated.

1986 – Intense Focus on Economic Impact Produces a Compromise

1986 represented the next occasion on which the subject of economic impact received focused attention from Congress, a high-water mark not reached again until 2006. By 1986, a number of key members of Congress had become strongly dissatisfied with some of the transactions supported by the Bank that resulted in export

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financing being provided to foreign producers of Exportable Goods that, when imported to the U.S., were contributing to severe economic dislocations in certain industries. The explanations provided by the Bank as to the basis for approving these transactions appears to have been unsatisfactory with respect to the extent to which the Bank's staff and Board had considered economic impact issues as contemplated by the Bank's Charter as it then existed, producing the responses described below.

The result of this active engagement with economic impact in both houses was the adoption of the compromise reflected in Section 2(e) of the Charter. The record of the debates in both houses of Congress illuminates many of the issues that are discussed in the Report to which this account is appended, particularly the Pro-Economic Impact and Anti-Economic Impact perspectives and the inherent difficulties in resolving them.

The debate in the House centered around the efforts of Representative Rahall of West Virginia to introduce strongly Pro-Economic Impact amendments to the Bank's Charter that would effectively prohibit support for certain classes of transactions. The final version of his proposed amendment was stated [Congressional Record - House of Representatives, Proceedings and Debates of the 99th Congress, Second Session Tuesday, July 15, 1986]:

Section 2(b) of the Export-Import Bank Act of 1945 is amended by adding at the end thereof the following new paragraph:

(11) LIMITATION ON ASSISTANCE WHICH WOULD ADVERSELY AFFECT THE DOMESTIC ECONOMY

(A) IN GENERAL.-The Bank may extend no direct credit or financial guarantee in support of any export to any foreign entity if-

(i) the export will be used or is intended for use in the production or manufacture of any commodity, mineral, material, or product which is produced or manufactured in substantial quantities in the United States; and

(ii) the production or manufacture of such commodity, mineral, material, or product by such foreign entity will result in-

(I) the importation of more than an inconsequential quantity of such commodity, mineral, material, or product into the United States; and

(II) a net domestic increase in unemployment in the United States over the period during which any portion of the amount of such credit or guarantee is outstanding.

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(B) EXCEPTIONS.-Subparagraph (A) shall not apply with respect to any extension of credit or a financial guarantee which the Bank determines is-

- (i) in the strategic interest of the United States; or
- (ii) necessary to counter any unfair trade practice or unfair and predacious export financing practice of a foreign country.

Representative Neal of North Carolina objected to the potential negative impact of Mr. Rahall's amendment on Ex-Im Bank support for U.S. exporters on the fundamental Anti-Economic Impact premise that in most cases, prohibiting Ex-Im Bank support for U.S. exports will damage U.S. producers of the goods proposed to be exported, while producing no assurance of any corresponding benefit to U.S. producers of resulting exportable good. The adverse effect of new foreign production would still hit U.S. industry and employment because the foreign production would be supplied and financed by other nations. Representative Neal offered an amendment to the Rahall amendment that would allow Ex-Im Bank support for a transaction to proceed, despite the determination of adverse impact on U.S. industry or employment, if the Bank determined that the new foreign production of Exportable Goods would be created by other means so that U.S. producers would still end up facing new foreign competition:

or (iii) for the financing of American exports to any foreign entity which would in the absence of such financing nevertheless produce or manufacture such commodity, mineral, material, or product.

Mr. Rahall immediately recognized the extent to which Mr. Neal's amendment would undercut the intended effect of his proposal, and very expressly affirmed his intention that the Bank should not support transactions that would contribute to a negative impact on U.S. producers, even if some other nation did finance the project so that the foreign production would affect the U.S. economy nonetheless:

Mr. RAHALL. [Congressional Record - House of Representatives, Proceedings and Debates of the 99th Congress, Second Session Tuesday, July 15, 1986] Mr. Chairman, I appreciate the effort of the subcommittee chairman to modify my amendment with his, adding a third exception. I must say, though, that that is a loophole through which there would be many financing projects that would be allowed to proceed which I am trying to stop which would have a net adverse impact upon employment in the United States.

The gentleman is making an exception, as I understand the amendment, for those projects that could go elsewhere and obtain the money and would proceed anyway, whether they had Eximbank financing or not.

Mr. NEAL. Exactly.

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Mr. RAHALL. Now I say to the gentleman that that is going to happen. There are plenty of other countries that would be willing to finance that project, so it does not make any sense in my opinion to still allow that to happen. If Japan or some other country wants to finance unemployment within their boundaries, then I say let them do it, but let us not have the American Government, the U.S. Government, continue to use American taxpayer dollars to finance foreign projects that then put our workers out of jobs. Let them go elsewhere.

Mr. Chairman, I would therefore respectfully have to oppose the gentleman's amendment to my amendment, if I understand that that is the way that he is offering it.

....

Mr. RAHALL. Mr. Chairman, let me say in further response to the gentleman from North Carolina, the subcommittee chairman, that I have narrowed this amendment down from its original introduction, as we have discussed on a number of occasions.

This amendment is very specific in its intent, and that is to prevent the American taxpayer dollars from financing foreign projects that manufacture commodities or materials that then are imported into the United States when the United States is producing or is capable of producing those products in substantial quantities to be able to rely upon our own resources. That is the intent of the amendment, and I would say that any other modification of it any further than what I have already done would really be a killer amendment, and I do not feel that it would carry out the intent of the sponsors of the amendment.

It should be noted that the meaning of the term "foreign entity" in the amendment is to be construed in its broadest sense and includes all direct and indirect foreign entities proposing the Eximbank assistance such as foreign governmental entity as well as any subsequent foreign entity such as a company on whose behalf the assistance is being proposed. The phrase "commodity, mineral, material or product" should also be broadly construed and covers all produced or manufactured items with the exception of services. The use of the term "substantial quantities" is meant to allow assistance to foreign projects which would lead to exports to the United States of items not domestically produced or manufactured, such as certain strategic and critical minerals, or are produced domestically but in quantities not adequate to fully meet the defense, industrial and commercial needs of the Nation.

In addition, the import sensitivity of a domestic industry would not be a consideration. The key criteria is that imports of more than an inconsequential quantity would be fostered by the development of the foreign project and these imports calculated over the time during which the Eximbank assistance would be outstanding would lead to a net domestic employment loss.

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By the term “inconsequential quantity” I am seeking to allay concerns that, say 1 ton of steel which may be exported to the United States would cause the Eximbank to make a determination under this amendment. However, it is intended for this term to represent a very strictly construed minimum. For example, the El Cerrejon project, if considered under this standard, would have been disqualified from receiving Eximbank support. The use of the term “inconsequential quantity” shall not in circumvention of the intent behind the general thrust of the amendment.

....

Representative Craig then rose in support of the Rahall Amendment, and proceeded to identify the sorts of U.S. industries that had in the recent past experienced substantial injury resulting from new foreign production of Exportable Goods that were the intended beneficiaries of the provision:

Mr. CRAIG. . . The opponents of the Rahall amendment will argue, the amendment smacks of protectionism. The amendment will hurt U.S. producers and manufacturers.

Our domestic producers are already being hurt. Foreign imports have derailed and curtailed a major portion of our mineral domestic production industry already. The copper industry has suffered through one of its worst downturns in years. One of the reasons for this downturn can be attributed to the export-import bank (Eximbank) lending practices.

Since 1980, the Bank has granted \$279.9 million in assistance for copper-related projects. The draglines and smelters are running night and day in countries like Peru, Chile, and Mexico. While, the U.S. copper mines and smelters are being closed and people remain unemployed.

I realize the primary objective of the Eximbank is to assist in the financing of exports and imports of the United States. But one thing the bank is required to do, is to take into consideration any potential serious adverse effects of a loan or guarantee on U.S. employment as well as on the competitive position of the affected U.S. industry. In my opinion, the Bank has failed to do so.

Copper isn't the only example of where Eximbank loans have hurt a U.S. industry. The phosphate industry has been significantly impacted from loans that have been made to Morocco and Tunisia. The Eximbank lent Morocco and Tunisia moneys exceeding \$200 million, during the 1979 through 1985 period. The phosphate industry has resultantly lost a share of the foreign export market that almost equals the amount of loan guarantees given to Morocco and Tunisia. In 1984, the phosphate industry lost \$200 million and consequently, \$450 million was lost in wages paid because of the loss of jobs in the phosphate industry.

Not all of the losses of the phosphate industry can be attributed to the Eximbank loans to Morocco and Tunisia, but the figures are suspiciously very close to the injury that has occurred within the phosphate industry. . . .

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This is why the Rahall amendment is needed. The Eximbank is only one part of the international lending community, but nevertheless, it plays an important role. We cannot simply sit back while we lose our domestic production capacity and do nothing. The amendment is a first step. As I alluded to earlier, the amendment needs to be applied to other international financing communities. At a time when our domestic industry is suffering from unfair trade practices, the international financial community fails to recognize the detrimental economic impact of their actions on our country.

The amendment is very straightforward. It is saying, the Eximbank will not make loans or loan guarantees to countries that produce or manufacture a product or a commodity that is readily available in the United States. The United States should not be advocating the lending of money to foreign countries that will develop projects and cause the loss of jobs and domestic production. We cannot support lending practices that penalize our domestic producers and reward our foreign competitors.

I do urge my colleagues to stand in strong support of the Rahall amendment today. It is a small step in the right direction, but in my opinion, Mr. Chairman, it is a necessary step.

....

Mr. Neal then offered specific examples of the issues presented by the Rahall Amendment in defense of his proposed amendment:

Mr. NEAL. Mr. Chairman, I understand the purpose of the amendment of the gentleman from West Virginia. He wants to protect his coal producers from foreign competition. That would be find and good-but only if American producers are actually protected. In most cases however the gentleman's amendment would backfire. In practice it would destroy American jobs, not protect them.

American exporters are almost never the only ones competing to help build or develop a foreign project. International competition to win export contracts for these projects is intense. If American exporters don't win the contracts, I can assure you that our main competitors will. The Japanese, the French, the Germans-they will all be in there bidding for the sale, and will have generous support from their own export financing agencies. The minerals, commodities, or products will still be produced, but with the aid of exports from other countries, not with American exports.

What will we have gained? Not a single American job will be protected. But countless American jobs will be lost, since American exporters will be abandoned, the exports they might have won with proper financing will be forfeited.

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I understand the gentleman has been very concerned about a large coal project developed in Colombia, in part with Eximbank financing. The Colombian entity developing this project, Carbocol, was not dependent on American goods or services. It received financial commitments from the export credit agencies of Canada, Japan, Britain, France, Germany, Holland, Belgium, Brazil, and Sweden. In fact, three of these countries—Canada, Japan, and Britain—all won a share of the project, and financed their sales at rates lower than Exim financing for the American share. It should be perfectly obvious that, if the amendment by the gentleman from West Virginia had cut off any U.S. sales to Carbocol, the project would have nonetheless gone ahead full steam, producing the same amount of coal. Not a single coal miner's job would be protected. But countless American export jobs would have been lost.

I have a list of the U.S. export sales, State by State, that have gone to this Carbocol project, through the end of 1985. It is too long to read in full, but I will give some examples: California, \$61 million; Florida, \$45 million; Illinois, \$29 million; Louisiana, \$19 million; Massachusetts, \$19 million; Michigan, \$6 million; New Jersey, \$11 million; New York, \$38 million; Ohio, \$26 million; Pennsylvania, \$21 million; Texas, \$43 million; Wisconsin, \$25 million. In all there are 48 States on this list, with total export sales of about \$378 million. The amendment of the gentleman from West Virginia is designed to block all these exports. And for what purpose? Not a single coal mining job—I repeat, not a single coal mining job—would have been protected.

This coal project is only one of many cases in which the gentleman's amendment would effectively block American exports, and thereby destroy American jobs. It is true that his amendment is cast in terms of the net impact of the foreign project on American jobs. It does, therefore, take into account the jobs created by American exports, and compare them with the jobs supposedly threatened by imports. This is certainly an improvement over an earlier version of the amendment, which ignored entirely the positive impact of exports on employment. The amendment is still fatally flawed, however, since it ignores those cases in which the imports will occur anyway, with or without Eximbank financing. If the imports will occur anyway, because the foreign project is going to be developed with or without Eximbank financing, then the only impact of Eximbank financing will be to create jobs, through exports. Some jobs might be lost through imports, but, since they would be lost anyway, with or without Eximbank financing, it makes no sense to include them in any calculation of the net impact of that financing on employment. My amendment to the amendment of the gentleman from West Virginia simply stipulates that his prohibition on Eximbank financing not apply if the foreign project would be developed anyway, with or without Eximbank financing. It would prevent us from shooting ourselves in the foot by sacrificing exports in cases where that sacrifice will do nothing to protect American workers threatened by imports. Otherwise, we might as well close down the Export-Import Bank, and abandon the field to our competitors.

....

Representatives Leach and Frenzel followed these remarks by emphasizing additional problems that would result from the Rahall Amendment:

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Mr. LEACH of Iowa. Mr. Chairman, I rise to support the gentleman from North Carolina <Mr. NEAL> and I would only stress that I think the concerns that Mr. RAHALL and Mr. CRAIG have indicated are very real, very valid, very heart-wrenching; but the consequences of this amendment are devastating.

They represent a head-in-the-sand approach to international trade, and what they say is, because some American industry is hurt, let us hurt other parts of American society. We are going to devastate labor-intensive America by adoption of this amendment. Major losers, just by way of industry in this country, will be workers in industries producing goods or services that are produced in other countries that want to compete with the United States.

. . . . Mr. Chairman, these industries include those that make trucks, earthmoving equipment, tractors, diggers, machine tools, computers, robotics, control instruments, construction bulk equipment; valves, cable, pipe, wire production, welding machines, cranes, drag lines, design and engineering services, turbines, generators, canning and bottling equipment.

Anyone who makes any of that will be devastated by this particular amendment; and as competition in world trade grows, we are going to see even more negative effects as the years go by. I represent, in my district, a company called Caterpillar, a company that used to be America's largest exporting company.

Caterpillar estimates that in the last 15 months alone, if this amendment has been on the books, they would have lost \$125 million in sales. Thousands of jobs would be lost.

What this amendment does; it is what might be considered the "Japanese bonanza amendment of 1986." This supports Japanese industry, it supports German industry, it supports Belgian industry- and the intent of this bill is to support American industry and American jobs.

So I certainly hope that the refinement of the Rahall amendment offered by the gentleman from North Carolina <Mr. NEAL> is adopted, and with that, let me also express my own concern that the views that Mr. RAHALL has expressed are views that must be borne in mind by this body as we develop legislation of this nature; but let us not be so concerned that we do something that ends up being counterproductive and irrational; let us get about the business of dealing with Mr. RAHALL's concerns in the proper format, not in this particular legislation where I think his own industries will be negatively, not positively impacted.

. . . .

Mr. FRENZEL. . . . However, there is only one thing standing between this splendid bill and House passage, and that is the Rahall amendment, which in effect tries to prohibit any adverse impact and in fact, in my judgment, gums up all Exim decision-making for the future.

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The Neal amendment would, I think, rescue us from the worst effects of the Rahall amendment but in my judgment, the law should remain as it is.

The situation is that as of now we have three statutory provisions that require Exim to take into account serious effects of the U.S. economy. As has been pointed out more than once here today, most cases the project is going to go forward anyway. The Neal amendment at least takes that basic fact into account. The Rahall amendment does not.

I believe because it does not, the Rahall amendment would wreak greater havoc on Exim's programs and greater havoc on American exports than any of the budget cuts that have yet been suggested for Exim.

The Rahall amendment says in effect, "Never mind if the project goes through; never mind if the effect on us is exactly the same: As long as we're going to suffer, let's make some other U.S. industries suffer with us."

It says that, "As long as my favorite industry, in this case coal, is going to be hurt, let's hurt somebody else as well." It is a sort of a pull-up-the-gangplank-I'm-on-board sort of amendment, which then finds out "never mind if it isn't even on board, let's all drown together."

That does not make any sense, Mr. Chairman. The Neal amendment at least says, if we are going to have some kind of an impact in any case, let us make sure we get some American jobs involved. I think the committee has been very careful to try to defend these American export jobs.

What I think is at the heart of the whole problem is that many of us still look on Exim as some form of foreign aid, and that we can express our displeasure about foreign actions or projects or even politics by voting against Exim or voting to condition Exim operations.

Actually, Exim is American aid. It is designed to sell American products made by American labor and sold by American people abroad. For us to try to limit Exim by the adoption of the Rahall amendment, in my judgment would be one of the most serious mistakes we could make.

To do it at a time we are suffering a \$150 billion trade deficit would be, I think, compounding a folly.

So I would urge the Members of this body, if they believe that American jobs are worthwhile, to support the Neal amendment to the Rahall amendment and at least preserve some sense in our export program.

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After these remarks, Representatives Levin and Chandler took up the arguments on each side of the issue:

Mr. LEVIN: . . . Mr. Chairman, there has been a lot of emotion expressed here, and I think there should be. I think it is somewhat misplaced. Let me, if I might, put it in a context that I think is relevant. Our main emotion should be about what is happening to industrial America. A lot is happening throughout this country. It is not only coal. There is very little coal in Michigan. It is not only steel, it is not only automobiles, it is not only textiles; it is across America.

I looked again at the figures for the last few months, and I think there is a kind of, if not euphoria, a complacency that is spreading through parts of America because the stock market, at least until a few days ago, was up.

Industrial jobs are down. In March the number of industrial jobs lost 39,000. Then in April down to 10,000. I think many people felt we were turning that corner.

But in May 45,000 and in June 56,000 jobs lost, manufacturing jobs lost. That is where the emotion should be placed.

What is a problem is that we have no policy. America has no policy, no industrial policy. America's industry is being nibbled to death and we are nibbling each other to death.

One area has a temporary opportunity to gain some more jobs, so they take it even though it is going to do in other areas. Suppliers from other countries are now coming in here and they are gaining bonanzas to come here even though they are going to eliminate jobs of American producers. That is the crux of the problem here. It is not just a blind gesture to get at coal. I do not think that is Mr. RAHALL's purpose, at least alone, to get at coal. We ought to take it much more seriously than that.

Now here is the nub of the problem: A proposal comes before Eximbank, I am a supporter of Eximbank, and I am worried about Third World countries, as the gentlemen know, as former Assistant Administrator of AID; but here is the problem: When an applicant comes before Eximbank, and Eximbank is supposed to make an impact study, and let us say that Eximbank makes that impact study and determines that if that job proceeds, if that project overseas proceeds, there is going to be a net loss of American jobs. That is what this amendment, as it has been redrafted-far different than its original language-that is what it suggests, what it is based on, a net loss of American jobs.

Are we going to use American taxpayer dollars to support an application for participation in a project after Eximbank determines that there is going to be a net loss of American jobs? Now that is not an easy decision to make because there are some jobs involved, there are some jobs involved in the applicant.

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Now, it may be trucks for steel plants overseas, or it may be railroad equipment for a copper project overseas, or I suppose it could be some bearings or whatever it is for a large auto plant overseas. But this amendment talks about a net loss.

Mr. NEAL. . . . Mr. Chairman, here is the difficulty I see in the gentleman's view of this: if a project is going to be built, whether it is coal, copper, steel, cars, you name it, and the import is coming into this country anyway, how can you factor in those jobs that import into any kind of equation? It is happening anyway, whether Eximbank is involved or not. There is no way to make that kind of assessment that the gentleman is talking about, net job loss.

. . . .

Does the gentleman see the point? There is no reason in the world for factoring those jobs into any kind of equation. That is happening anyway. If you want to stop that, you have got to stop it some other way. You have got to stop it by some protectionist legislation somewhere that will simply keep those products out of our country.

The Eximbank does not do that. My point is that every single job that Eximbank finances is a net plus. There is nothing on the other side of the equation. There is no net loss because of Exim financing. These 21,000 man-years of employment that went into building this coal project in Colombia, those are the net gains, every single job is a net gain for this country.

If some of that coal comes back in here, whether Eximbank had anything to do with it or not, it comes in. That is the point.

Mr. LEVIN of Michigan. The gentleman has made the point well, and I believe it needs a response. And I think the response is twofold or threefold.

First of all, we have provisions in the law today requiring Eximbank to make an impact study. Those provisions do not have the condition that you want to attach to this bill or this amendment.

What this amendment tries to tell Eximbank, and it is not in the most artful way, it is hard to get at larger industrial policy issues in a specific piece of legislation, but it is an honest attempt. What it says to Eximbank is, "Look at the impact on net employment in this country. And if net employment is going to be negative, then do not provide the loan."

Now, there are three other provisions in the law. It has been referred to here.

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The gentleman used it as an argument against the Rahall amendment. But then I have to point out that the condition that the gentleman from North Carolina would provide does not apply to these other three provisions, and they should not. And I will tell you why: because we need in this country to begin to look at the overall impact of our policies. We need in this country not to be piecemealing ourselves to industrial death. That is the long and short of it, it seems to me. The same argument can be used, for example, in arms sales. We hear it: "Well, somebody else is going to provide those arms, so vote for it anyway because the only impact if you vote against American arms sales is the loss of American jobs." And most of us do not buy that argument. Why do we not buy it? We do not buy that because we think there is a need for an overall American policy regarding that arms sale.

....

We also do not buy it when it comes to issues of economic sanctions. Somebody else may supply the goods, but we do not want American tax dollars participating in that particular project if there is a question of economic sanctions.

The same thing is true here, it seems to me. We need to ask ourselves: What are we going to do about the loss of American industrial jobs? Are we going to ask the Eximbank more effectively to take into account employment, net employment factors? I think they should. It is interesting, the Chamber of Commerce indicates that using the three provisions already in the law, since 1981 the Bank has used this authority to deny support on proposed exports valued at \$385 million. That is using the three provisions already in law.

If Mr. Neal's amendment were adopted and applied as to those three other provisions, those \$385 million would have proceeded.

....

But Eximbank documents indicate that virtually all of their loans are in situations where there is competition. So, look, you have to face the basic issue, whether without an industrial policy you want Eximbank to proceed taking into less account than they should the issues of net employment impact in America. I think the time has come to say clearly, "We need to look at net employment in industrial and in the rest of America." This is an effort to do that. It is not a perfect way. It is much more perfect than it was as originally introduced, but it clearly is one way. Eximbank has indicated to us they could carry it out, they do not want to but it is a practical factor to look at net employment.

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If you want to go back into your districts, in the absence of a steel policy in this country and say that you support loans in situations where there is going to be a net employment loss in America, go ahead and do it. But what I want to do is go back to my district and to the rest of the country and say that we in this Congress are trying at long last to force the adoption in this country of some kind of overall industrial policy, not central planning by any means but some overall industrial policy so we make sense of everything including Eximbank.

Mr. CHANDLER. . . . Mr. Chairman, the gentleman from Michigan, a good friend of mine, serving on the committee who does an outstanding job, said a moment ago something I very much agree with even though I disagree with his fundamental stand. He said we should not piecemeal ourselves into industrial bankruptcy. If we need an industrial policy for the United States, and I am not sure that we do, you certainly do not find it in this amendment. If ever I saw piecemealing, this is it, piecemealing at its worst.

He said this is not the most artful way of getting at what he wants. If that is not an understatement, I do not know what is.

We are going to cause the Bank to determine whether to grant a loan based on two of the broadest directions I can imagine. They are going to have to determine whether the loan will result in the importation of more than an inconsequential quantity, stating it in the negative, and also a net domestic increase in unemployment in the United States. I just have to ask you: How on Earth are you ever going to determine that? And that is going to be determined over the life of the loan.

Then he asked what is happening in America? Well, I think we are finding ourselves faced with some pretty fierce competition in the rest of the world, that is what is happening in America. And to quote one of today's great orators, "Dandy Don" Meredith, he says: "If 'ifs' and 'buts' were candy and nuts, what a wonderful world it would be." I think we ought to entitle this the "Candy and Nuts" amendment because what you are suggesting is: Let us ignore the fact that labor costs in the rest of the world are less than here; let us ignore the fact that many countries around the rest of the world are manufacturing products in competition with us in plants that are new and modern while many of ours are dilapidated. They are doing that because they have savings rates of 20 percent-plus while ours is down around 5, and they have the money to recapitalize and we do not.

Out home right now our workers in the timber products industry are on strike against the Weyerhaeuser Co. I suspect that this is one isolated example of a great overall realignment of what is going on in industrial America.

I do not like it any better than you. I represent many of those people whose homes are being lost and who are facing real tragedy in their lives. But, darn it, let us not kid them by coming in here and saying we have an answer in something like this, when all this is going to do is turn around and put their brethren at Pac Car over in the gentleman from Washington's Seventh District out of work. That is all this is going to accomplish.

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....

Mr. Rahall continued to rise to respond to the opponents of his amendment to emphasize his view, and that of his supporters, that it was simply wrong for the U.S. government to support new foreign exports that would inflict substantial injury on U.S. industries, even if the U.S. gained in exports and employment in other sectors:

Mr. RAHALL. . . . The basic question is, "What should U.S. policy be?" There comes a time, in my opinion, when the U.S. Government and the U.S. taxpayer says enough is enough, that enough of our tax dollars, through U.S. entities, are going to finance foreign products that come into the borders of the United States, thereby putting out of work our domestic workers.

That is what has happened through the financing mechanisms of the Export-Import Bank in the past.

This amendment, narrow enough in scope, gives the feeling of the American people that enough is enough of American taxpayer dollars going to finance jobs outside this country and causing unemployment in this country.

During the debate, it was noted that the Bank's Charter already required that the Board consider economic impact issues. Mr. Rahall expressed his frustration that it appeared that the Bank and its Board were not in fact considering economic impact issues in making their decisions.

Mr. ROEMER. Mr. Chairman, if we read the charter of the Eximbank, it says that the board of directors shall take into account any serious adverse effect of such loan or guarantee on the competitive position of U.S. industry and employment in the United States. As I understand the Rahall amendment, what the gentleman is trying to do in this amendment is to make sure that in the recapturing there be a requirement that if we use the taxpayers' money to extend credit, we do it in such a way that we not lose on a net basis American jobs. Am I right in my understanding?

Mr. RAHALL. The gentleman is correct, but that study is not being implemented today. It is not being done. What is on the books not being done by the Export-Import Bank when they make these loans, such as the case in Columbia, there was no examination of what the long-term adverse impact on United States jobs would be over the life of that loan that was granted by the Export-Import Bank.

The practical impossibility of the task that the Rahall amendment would require of the Bank's Board, and the limits of its effectiveness were also noted in the debate. The severe conditions affecting basic extractive industries in the states that sought to benefit from the Rahall Amendment were reiterated, as was the countervailing view of the damage the Rahall Amendment would do to manufacturers in other states, and the interstate conflict the whole discussion revealed.

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Mr. KLECZKA. . . . Mr. Chairman, a lot has been said this afternoon relative to the Rahall amendment. Coming from the Midwest where we are producers of machines and machine tools, I see this amendment as totally devastating.

The gentleman from Wyoming indicated that copper and coal are in trouble. Well, I say that if we look at other areas of our economy, they are in trouble also.

The problem with Rahall is that we are going to make it much worse for those other industries. If I can give an example, and a very crude one at best of Rahall in operation, let us say that Bucyrus Erie in South Milwaukee, WI, was selling a dragline, a large shovel, to a country, Colombia or Jordan, and let us say that after Eximbank looked at it, they indicated that the Baker-Western Corp., which owns Bucyrus Erie, will gain 50 jobs over the life of the contract; however, and I do not know how they are going to ascertain this, but however Eximbank looks at Rahall and indicates that this sell will result in the importation of more than an inconsequential quantity of commodities, which possibly could be true, but let us say that answer is in the affirmative and it will result in a net domestic increase in unemployment.

Well, the Bank would indicate that because of the sale, it is expected that we will lose 100 mining jobs; so the net decrease in employment is 50 at tAt that point, we do not provide any direct loan or any I-match to the corporation involved. They lose the order.

The United Kingdom and a host of other countries are just waiting, chomping at the bit to sell that dragline; so in essence, instead of losing a net of 50 jobs in this country, we will lose 150. That is the effect of Rahall. That is the net effect of Rahall.

Mr. Chairman, I tried to work with the gentleman from West Virginia in what is really a serious problem for the coal-mining States, for the copper States. It is a serious problem.

We looked at the Rahall I. It was ill advised.

We looked at Rahall II, which the gentleman from West Virginia indicated he went a whole mile, and I found that it really did not cross the street; but nevertheless; we are faced here with Rahall III, which will provide the same problems as the first two products.

I do have a substitute amendment prepared, which hopefully will alleviate some of the ill-advised aspects to the amendment; however, I do not think even that will get the job done.

So our best bet at this point is to support Neal, which makes a terrible amendment somewhat better. It does not have the effect of closing the Eximbank.

My friends, just read the amendment. With such wording like the importation of more than an inconsequential quantity of a commodity, my God, that covers everything.

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We also indicate that no guarantee shall be offered if the export will be used or is intended for use in the production or manufacture of any commodity, mineral or material or product, which is produced or manufactured in substantial quantities in the United States.

As we all know, that includes almost everything.

So first of all, I say for the Eximbank to try to ascertain whether the ill effects of the loan would come under Rahall, I think is difficult at the front end.

Second, for those in the coal States and the copper States, if this amendment would stop the production of one piece of coal or one ounce of copper, if it would stop the production or importation of one ounce-not a pound, not a ton-I might look favorably on the amendment, but it will not. Those commodities will be ending up at our door and I say the answer is the Bunker bill, which would address the trade practices of this country.

It is an issue to be taken up by the trade representative, not the Eximbank; but the net effect is to do disaster to areas that I happen to represent that make machines and machine tools or the litany of the other products that the gentleman from Iowa <Mr. LEACH> has enumerated so eloquently before.

So I ask the Members to support Neal, and if in fact that is adopted, I think Rahall at that point is palatable. It is not good, and in fact if Neal is not adopted, I think instead of closing the Eximbank, that should just close down the amendment.

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Mr. RICHARDSON. . . .I would just like to say that the last thing I think we want to do is pit region against region, industry against industry. I think we have a situation where the gentleman from Wisconsin has been very eloquent in some of the concerns he has voiced; but as a Representative of a coal State and a coal area and a copper area and a uranium area and a strategic minerals area where we have been devastated, literally devastated, where towns have died, where men and women have lost their jobs, where industries have collapsed, where state economies are on the brink of ruin, I think all we are asking is for a little gasp of support.

We are not saying close down the Eximbank. I think it has had some substantial positive effects on the world economy and our foreign policy and international commercial policy. All we are saying simply is, for God's sakes, do not give an unfair competitive advantage that is going to bring domestic unemployment to some of our industries.

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Let me be specific. Copper, since 1980 the Bank has granted \$279.9 million in assistance for copper-related projects. We have got copper plants in Arizona, in New Mexico, in the Southwest closing down, not simply gasping. They are literally closing down. It is not a question of a revival for them.

Mexico in seven instances has received a total of \$162.7 million from 1980 to 1984, including \$9.2 million in 1981 for construction of a copper smelter and \$75.7 million in 1982 for expansion of a copper mine.

In May 1986 the Copper Caucus in this House wrote to the bank questioning an additional line of credit of \$23.5 million to Campania Minerva de Cannae in Sonora State for equipment to expand their copper operations. Also, Peru received a \$45 million loan in 1982, a country that is refusing to pay their debts.

Let me just explain the irony of the situation. The copper operation in Mexico in Cannae is polluting the Southwest of this country. Do you know how we are going to get out of polluting the Southwest of this country? We are considering loans from our multilateral institutions to these mining projects that have been financed by the American taxpayer and now we are going to bail them out again by giving them loans so that they can clean up their pollution which they refuse to do internally.

I mean, how much are we going to put up with? This is why I think a clear signal in support of the amendment of my colleague, the gentleman from West Virginia, is important.

Mr. KLECZKA. . . . Is the gentleman saying that if in fact Rahall was part of the law during the time of those transactions that additional copper ore would not have been mined or those countries involved would not have been able to get the equipment to mine that product on the international markets?

Mr. RICHARDSON. I would say so. I do not know of cases where Mexico or some of the copper-producing countries, the Peruse of the world with their debt records, whether anybody else is lending them money at this time.

I mean, here we have a case where if we can send a signal, and we know that this is going to be diluted, I do not see why the gentleman is so negative toward it when I think it could have a positive effect.

Mr. KLECZKA. Well, if the gentleman from New Mexico will yield further, if in fact that is the case and these other countries were not vying for the sale of that equipment, then the Neal amendment which is before us next would apply and if there is no competition, then the other criteria; so basically what the gentleman is doing with that example anyway is arguing for Neal; but to say that the additional copper would not have been mined, that the equipment would not have been purchased from the United Kingdom or any other country, is sheer hogwash.

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The only thing we are doing with the Rahall amendment is denying our manufacturers and our U.S. employees from making that equipment, because it is going to be made and sold anyway. 132 Cong. Rec. H4439-02, 1986 WL 778329 (Cong.Rec.)

At that point, Representative Rahall requested a vote on the addition of Representative Neal's amendment that would allow the Bank to approve transactions if the new foreign production of Exportable Goods would occur anyway. Representative Neal's Anti-Economic Impact amendment which was then approved by a large margin of 307 to 87.

Congress did not depart 1986 with the Rahall Amendment as the final expression of its intent regarding economic impact issues. During the Senate's consideration of the Ex-Im Bank reauthorization bill Senator Byrd introduced an amendment proposing the fundamental compromise that became the basis for Section 2(e) of the Bank's Charter [Congressional Record- Senate Proceedings and Debates of the 99th Congress, Second Session Monday, July 21, 1986]:

Section 2 of the Export-Import Bank Act of 1945 is amended by adding at the end thereof the following:

(e) The Bank may not make any loan, any assistance, or any other financial commitment for establishing or expanding production of any commodity for export by any country other than the United States, if-

(1)(A) the commodity is likely to be in surplus on world markets at the time the resulting productive capacity is expected to become operative, or (B) the resulting production capacity is expected to compete with United States production of the same, similar, or competing commodity; and

(2) the assistance will cause substantial injury to United States producers of the same, similar, or competing commodity.

Such prohibition shall not apply in any case where, in the judgment of the Board of Directors of the Bank, the short and long-term benefits to industry and employment in the United States are likely to outweigh the injury to United States producers of the same, similar, or competing commodity.

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Mr. BYRD. [Congressional Record- Senate Proceedings and Debates of the 99th Congress, Second Session Monday, July 21, 1986] . . . Mr. President, the Export-Import Bank has supported an estimated \$160 billion in exports since its inception in 1945. In a year in which our trade deficit could exceed \$160 billion, American exporters need and deserve help in competing with foreign subsidies and loans-especially through programs such as Eximbank which do not cost taxpayer dollars. Japan supports about 35 percent of its exports with government financing-Great Britain assists more than 40 percent of its exports with government loans.

Exim has helped one of America's best export commodities-coal-to compete in a world market where American workers and companies increasingly find themselves in competition with foreign governments. From October 1, 1985 to July 3, 1986, Exim has assisted more than \$12 million in West Virginia coal exports through its credit insurance program. I am pleased that Exim has begun to be more aggressive in its support of coal sales overseas. Manufactured goods are vital to our export economy, but we are shortsighted if we do not promote all our competitive exports-including coal-to the fullest extent possible.

...

In 1984, a new surface mine known as El Cerrejon began production in the South American nation of Colombia. The mine is one of the largest surface mining operations in the world, with estimated reserves of 1.6 billion tons and a productive capacity of 15 million tons per year. Productive capacity is projected to reach 30 million tons per year in the not-too-distant future.

The El Cerrejon mine produces high quality, low-sulfur steam coal, which is very attractive to utilities in the east and gulf coast regions of the United States.

The mine is a \$3.2 billion joint venture between Exxon Corp., and the Colombian Government through Carbocol, the state-owned coal company. Financing of the mine includes about \$1 billion provided by government export banks in Canada, Japan, England, and France. In addition, the U.S. Export-Import Bank provided \$200 million for mining equipment.

The entry of Colombian coal into international coal markets will intensify the already fierce competition for markets in Western Europe and other countries. This has disturbing implications for U.S. coal exporters. Colombia is actively marketing its product in Western Europe, the Caribbean, Mexico, and Japan-which collectively accounted for about two-thirds, or 51 million tons, of the United States coal exports in 1983. Thus, Colombian coal may displace United States coal in foreign markets because of a price advantage resulting from lower mining costs and lower transportation costs. In fact, Colombia has recently negotiated contracts with several nations that currently are or have been consumers of United States coal, including Denmark, Israel, Mexico, Finland, Spain, Ireland, Jamaica, Puerto Rico, and the Dominican Republic.

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I appreciate that the goal is to allow American equipment companies to get a piece of the Colombian market—a market that will otherwise go to Japanese equipment producers. But I am also convinced that the Bank needs to reexamine its priorities and assume a more balanced approach.

That is why I offer this amendment. This legislation amends the Export-Import Bank Act of 1945 by explicitly prohibiting the Bank from making loans when those loans will result in production capacity that is expected to compete with U.S. production of the same or similar commodity if such loans will cause substantial injury to a U.S. producer of that commodity. The law had prohibited such loans when the result was overproduction. My amendment keeps that prohibition, but adds the constraint on loans that will create competing production, and incorporates both provisions as part of the charter language in the original Bank legislation. In addition, it requires the Bank to look at the short and long-term employment consequences in deciding whether such loans do more harm than good to employment in the United States.

Let me be very clear about the intent here. This language prohibits any direct loans to projects that would, upon their completion, produce commodities that compete with American commodities, when such loans would injure U.S. producers and workers. I believe this amendment will erase any doubt that the management of Eximbank might have about the intent of Congress as regards loans to increase foreign coal production, copper production, or production of any commodity—including steel or chemicals—that will displace American commodities from their natural markets in this country, or abroad, and cause injury to American workers and industry.

The board should be assured that this Senator and many of his colleagues—including, I know, the distinguished chairman of the Banking Committee, Senator GARN and the distinguished ranking member of that committee, Senator PROXMIRE—are going to watch that process with the utmost care. . . .

Mr. HEINZ. As the Senator says, the purpose of his amendment is to make sure that the Eximbank does not lend money for exports of equipment, machinery that would be employed in some third country, some foreign country, to add to the already great woes of commodity surplus categories, whether it be coal, steel, or copper, any number of commodities which we can name.

He further states that the only exception to such a prohibition would be if the Eximbank Board found that the short- and long-term benefit of not making that loan was outweighed by the benefit of making that loan. And I suppose—and here is where I seek clarification—that the Senator was referring to—and this is to the best of my knowledge a hypothetical example, although there are parallel ones like it—where the Brazilian Government decides, because they are a state-controlled economy, that they are going to build a steel mill.

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Now, the Senator from West Virginia and I know that there is already a worldwide overcapacity in steel. Indeed, my projections are that there are in excess of 200 million tons of excess capacity in the world today. And for anybody who follows this, U.S. steel-making capacity is in the neighborhood of around 100 million tons.

Our capacity utilization of that tonnage is currently about 60 percent. We are, therefore, only making about 60 million tons versus a world capacity situation of roughly 200 million tons, almost 3 1/3 times the amount of steel we currently ship from U.S. mills in this country.

To return to the example, the Brazilians, notwithstanding the fact they know they have to subsidize the production of that steel, they are probably going to have to dump it on the world market; they have made that decision and they are entertaining bids for steel mills. One is from the United States, another is from the French, another is from the Germans, a fourth is from the Japanese. And, as I understand what the Senator's amendment does, is it says to the Eximbank, "You have a decision to make. You have to decide, with too much capacity, whether or not that steel mill is going to be built; we are simply not going to support United States suppliers who are in competition with French, German, Japanese, and others, or whether or not the decision not to do that would be balance be a mistake as that mill is going to be built anyway."

They have to make that judgment, one way or the other, and we do not know how they are going to decide, but that is the judgment, in effect, as I understand the Senator seeks to explicitly ask them to make. And I think, by the way, they should make it. But do I understand the Senator's amendment more or less correctly?

Mr. BYRD. Yes, the distinguished Senator does understand the intent of the amendment. It would be a tough decision but the board would have to make that decision, and it would have to make the decision on the basis of whether or not that particular loan-in the short and long term-benefits American workers or whether or not, overall, it is a detriment to the industry and the employees in that industry in this country. It would be a tough decision, but that board would have to make that decision.

I think this language would give the board better guidance on which to make the decision and would assure-come nearer assuring-American industry and American workers that they are going to be protected in that decision.

Mr. HEINZ. Mr. President, I thank my friend and colleague, the Democratic leader, for clarifying his amendment.

I wanted to be assured that the Bank was going to have the appropriate role of making judgments on these matters. As the Senator from West Virginia has indicated, they are inherently difficult judgments, and the Bank is being asked, as I understand the amendment, to safeguard American economic interests first and foremost.

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Sometimes that is going to cause the Bank to say “no” to somebody applying for a direct loan or a guarantee or insurance, and sometimes they are going to decide to say “yes” and they will have to justify those judgments.

Above all, I think what the amendment of the Senator from West Virginia does is to say to the Bank: “From here on out, we are going to hold you accountable for your judgments, because they are very important to the economic well-being of this country; and the time has to come to an end where you can make those judgments irrespective of any of the circumstances.” That is what we are asking with the amendment of the Senator from West Virginia, that those judgments be made and that they consider those consequences.

On that basis, Mr. President, I am prepared to accept the amendment.

Mr. PROXMIRE. . . .The bill provides on page 6, line 4, as follows-this was my amendment in committee:

In all cases to which this section applies, the Bank shall consider and address in writing the views of parties or persons who may be substantially adversely affected by the loan or guarantee prior to taking final action on the loan or guarantee.

The purpose of that was to serve the same purpose as the amendment by the Senator from West Virginia, but his amendment is very useful because it makes it explicit and particular, and I think it serves a very useful purpose, and I welcome it.

Mr. BYRD. . . . The language in the bill does say, as the distinguished Senator from Wisconsin pointed out, that the banks shall “consider and address in writing the views of parties or persons who may be substantially adversely affected by the loan or guarantee prior to taking final action on the loan or guarantee.”

I think this amendment adds teeth, by virtue of the fact that it does not just require the bank to consider and address in writing the views. It requires the Bank to determine whether or not injury will be caused to American workers.

It should erase, as I say, any questions or doubts the Eximbank may have as to what the intent of Congress is in the making of these loans. It forces the board to weigh the benefits. Do the benefits outweigh the damaging effects, or vice versa?

I thank both managers, and I hope the Senate will adopt the amendment.

The PRESIDING OFFICER. The question is on agreeing to the amendment.

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The amendment (No. 2215) was agreed to. 132 Cong. Rec. S9367-01, 1986 WL 776919 (Cong. Rec.)

As Senator Proxmire notes in the preceding section, the 1986 reauthorization of the Bank also included an amendment to the policy statement in 12 U.S.C. 635a requiring that “the Bank shall consider and address in writing the views of parties or persons who may be substantially adversely affected by the loan or guarantee prior to taking final action on the loan or guarantee. In the reconciliation of the House and Senate bills in the Fall of 1986 the Byrd amendment was adopted substantially intact and became Section 2(e) of the Bank’s Charter:

(2)(e) Limitation on assistance which adversely affects the United States

(1) In general - The Bank may not extend any direct credit or financial guarantee for establishing or expanding production of any commodity for export by any country other than the United States, if--

(A) the Bank determines that--

(i) the commodity is likely to be in surplus on world markets at the time the resulting productive capacity is expected to become operative; or

(ii) the resulting production capacity is expected to compete with United States production of the same, similar, or competing commodity; and

(B) the Bank determines that the extension of such credit or guarantee will cause substantial injury to United States producers of the same, similar, or competing commodity.

(2) Exception - Paragraph (1) shall not apply in any case where, in the judgment of the Board of Directors of the Bank, the short- and long-term benefits to industry and employment in the United States are likely to outweigh the injury to United States producers of the same, similar, or competing commodity.

The reports to each house by the sponsors of the specific amendments addressing economic impact in the 1986 legislation confirmed that the language finally adopted met their intent.

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Mr. RAHALL. [Congressional Record — House of Representatives Proceedings and Debates of the 99th Congress, Second Session Monday, September 22, 1986] Mr. Speaker, the legislation before us today is a compromise between the bill originally passed by the House on July 15 and the version adopted by the other body on July 22 to reauthorize the programs of the U.S. Export-Import Bank. When the House considered this legislation last July, I along with our colleague from Michigan, SANDY LEVIN, sought to amend the bill (H.R. 4510) with a provision that would prohibit Eximbank assistance to foreign projects which in turn would export to the U.S. commodities that would compete with our own domestic producers and result in a net employment loss.

This amendment was modified somewhat on the House floor and was subsequently adopted. In the other body, an amendment with a similar intent was offered by the senior Senator from West Virginia, ROBERT BYRD, and was also adopted by that body. I am pleased to say that while a conference was never held on H.R. 4510, the compromise bill before us this afternoon contains prohibition language similar in scope to what was previously adopted in the context of H.R. 4510.

Mr. Speaker, with unemployment levels still at a very high level in many of our basic industries it makes little sense for the Eximbank to provide assistance to foreign projects that will in turn export like and similar commodities into the United States and as such, further aggravate our domestic unemployment problem. Yet, we have witnessed the Bank time and time again engage in such transactions, the most outrageous of which have involved coal, copper, and steel projects.

The intent of the prohibition provision of this legislation is to insure that never again will the Eximbank provide assistance to projects such as the El Cerrejon Coal Mine in Colombia. This project received \$850 million in Eximbank assistance and will soon be the largest surface coal mine in the world. Already, coal from El Cerrejon is infiltrating U.S. electric utility markets and displacing U.S. export coal on the international market.

It is time we cease the shortsighted policy of the Bank in transactions such as this which are so clearly against the best interest of the Nation. I can assure the Eximbank that I will closely monitor its implementation of this legislation. 132 Cong. Rec. H8047-01, 1986 WL 784510 (Cong.Rec.)

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Mr. BYRD. [Congressional Record — Senate Proceedings and Debates of the 99th Congress, Second Session Friday, September 26, 1986] Mr. President, I am pleased to see that this reauthorization of the Export-Import Bank includes the amendment which I offered to that legislation.

Exim has supported more than \$12 million in West Virginia coal exports since October 1, 1985. I am gratified that the Bank is supporting one of our most competitive exports, because coal is vital to many jobs in my State, and in several other States.

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But I have been deeply concerned about the direction of some of Exim Bank's lending. In particular, I have called to my colleagues' attention the case of the El Cerrejon-pronounced El Sarahone-mine in Colombia, South America. The Export-Import Bank provided a loan of \$200 million to support development of that mine, even though the coal it produces will compete directly with U.S. coal.

The amendment I introduced on July 21, 1986, and which is included in this legislation will go a long way toward putting an end to Exim financing for production of foreign commodities-including coal, steel, chemicals, fertilizer, and others-that would compete with U.S. products and which cause lost jobs in this country. This amendment will prohibit loans which would result in a surplus of a commodity or would compete with U.S. commodity production unless Exim weighs the short- and long-term benefits to employment and industries in this country and determines that the benefits of the loan outweigh the harm to U.S. firms and workers. This is a tough standard, but a realistic one. Congress will closely watch its operation.

Now more than ever, we must expand our exports. We are losing our lead as the world's greatest exporting nation. In the most recent month for which trade figures are available-July-we imported twice the dollar value of our exports. This is totally unacceptable, and it is cheapening the quality of life for our people.

I commend the members of the Banking Committee, and Senators PROXMIRE, GARN, and HEINZ in particular, for their work on this legislation and their help in assuring the success of my amendment. I am grateful for the support of Senators FORD and ARMSTRONG and my many other colleagues who supported this important amendment. I believe it will give the Bank a very clear signal of the intent of Congress. The Fertilizer Institute has indicated that the pendency of this legislation caused Exim Bank to reconsider a loan that would have resulted in competition with U.S. commodities. I trust the passage of this legislation will guarantee continued vigilance by the Bank.

Mr. PROXMIRE. Mr. President, I rise to support the enactment of H.R. 5548, a bill to amend and renew the charter of the Export-Import Bank. That charter will expire on September 30, next Tuesday. This bill will, among other things, renew the Bank's charter for 6 additional years. . . .

Section 11 of H.R. 5548 is a provision I heartily endorse. Senator BYRD originally offered this provision on the floor and I worked to ensure that it is in this compromise bill because it is such a good provision. It prohibits the Bank from making any loans or guarantees that will result in the production abroad of any commodities that will compete with U.S. production of the same or similar commodity if such production will cause substantial injury to the U.S. producer of that commodity. The prohibition does not apply where, in the judgment of the board of directors of the bank, the short- and long-term benefits to industry and employment in the United States are likely to outweigh the injury to U.S. producers of the same, similar, or competing commodity.

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That section should be read in conjunction with section 12 of H.R. 5548 which contains a provision I authored and which was in the bill passed by the Senate in July. Section 12 requires the Bank to consider and address in writing the views of parties or persons who may be substantially adversely affected by the loan or guarantee prior to taking final action on it. We expect that this section will ensure that the cost-benefit analysis done in section 11 is in writing and incorporates the views of those domestic workers, or farmers, or companies, who might be adversely impacted by the Eximbank's loans or guarantees. As I said prior to the Senate's passage of section 12 in July "I hope the administration will take this position very seriously and will positively seek out and give a day in court to those adversely affected * * *." It is important that Americans not be injured by the actions of their own Government and this provision is intended to protect them from inadvertent actions by the Export-Import Bank. 132 Cong. Rec. S13773-01, 1986 WL 793420 (Cong.Rec.)

1988 – An Adjustment to Section 2(e) With Little Explanation

In response to the controversy over economic impact and several other issues that emerged during the 1986 reauthorization hearings, the Bank was only reauthorized for two years in 1986. When Congress took up the Bank's reauthorization in 1988, economic impact was not the subject of the vigorous floor debates and competing amendments that had characterized the 1986 process. Instead, several minor refinements were made to Section 2(e) along with one significant modification, the addition of subsection 2(e)(3), which was done with no explanation provided in the legislative history as to its source (1988 changes indicated by underlining and mark-through).

Section 2(e) Limitation on assistance which adversely affects the United States -

(1) In general - The Bank may not extend any direct credit or financial guarantee for establishing or expanding production of any commodity for export by any country other than the United States, if-

(A) the Bank determines that--

(i) the commodity is likely to be in surplus on world markets at the time the resulting commodity will first be sold [~~productive capacity is expected to become operative~~]; or

(ii) the resulting production capacity is expected to compete with United States production of the same, similar, or competing commodity; and

(B) the Bank determines that the extension of such credit or guarantee will cause substantial injury to United States producers of the same, similar, or competing commodity.

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(2) Exception - Paragraph (1) shall not apply in any case where, in the judgment of the Board of Directors of the Bank, the short- and long-term benefits to industry and employment in the United States are likely to outweigh the short- and long-term injury to United States producers and employment of the same, similar, or competing commodity.

(3) Definition - For purposes of paragraph (1)(B), the extension of any credit or guarantee by the Bank will cause substantial injury if the amount of the capacity for production established, or the amount of the increase in such capacity expanded, by such credit or guarantee equals or exceeds 1 percent of United States production.

The recollection of the PPG staff is that the addition of subparagraph (3) was not in response to any fact-finding effort by Congress or determination that substantial injury to a U.S. producer had been identified in a specific instance where the 1 percent of United States production threshold had been crossed. Instead, it was attributed to the use of that threshold in a PPG economic impact report that had been provided to the staff of the Senate Banking Committee. The use of the 1% threshold in that report was described as a *de minimus* level of potential new foreign production of an Exportable Good that was so small that it could be safely assumed that it was highly unlikely that any substantial injury to U.S. producers could occur at that level. It was not described as reflecting any empirical work or conclusion on the matter by the PPG staff, or as having been presented to congressional staff as having empirical support.

The placement of a specific numerical threshold in the statute does address two issues that were referenced in the floor debates during the 1986 reauthorization, as well as what the PPG staff has described as a recurring degree of frustration in Congress relative to the Bank's handling of economic impact cases. The two issues that the threshold addresses are the difficulty encountered by the Bank's staff in making determinations of whether a proposed Ex-Im Bank supported transaction would in fact cause substantial injury to U.S. producers, and the perception in Congress that the transactions where U.S. producers were most outraged to find their foreign competition benefiting from Ex-Im Bank supported financing had been approved based on the Bank's staff's recommendations without independent consideration of adverse economic impact by the Board.

The reauthorization of the Bank in 1988 and the amendments to Section 2(e) of the Bank's Charter were undertaken as part of a much larger Omnibus Trade and Competitiveness bill [Pub.L. 100-418] that addressed many issues that were perceived as contributing the U.S. trade deficit, which may in part explain the limited attention given to the specific actions affecting the Bank's Charter in the legislative history. The limited history that does exist derives from the reports in each house of the results of the reconciliation process:

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[Congressional Record – Senate, Proceedings and Debates of the 100th Congress, Second Session, Tuesday, April 19, 1988] B. Comparative Injury Determinations: The Conference Agreement requires the Export-Import Bank to be concerned about extending loans or guarantees for production of certain commodities when the product is first to be sold on the world market if it causes harm to U.S. producers. The Conference Agreement defines substantial injury if the loan guarantee for the production of a certain commodity will expand production in excess of 1 percent of the U.S. production of that commodity.

[Congressional Record - House of Representatives, Proceedings and Debates of the 100th Congress, Second Session, Wednesday, April 20, 1988] AMENDMENTS TO SECTION 2(E) OF THE EXPORT-IMPORT BANK ACT OF 1945:

A. Time for Determining Supplies

House bill

The House bill contains no provision.

Senate amendment

Section 1106(a) of the Senate amendment amends the Export-Import Bank Act of 1945 to provide that the Export-Import Bank shall be concerned about extending loans or loan guarantees for production of certain commodities in foreign countries when the product is first to be sold on the world market rather than when production capacity is expected to become operative.

Conference Agreement

The House recedes to the Senate.

B. Making Comparative Injury Determinations

House bill

The House bill contain no provision.

Senate amendment

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Section 1106(b) of the Senate amendment requires the Export-Import Bank when making a determination of injury to specify both the long and short term injury to U.S. producers and to U.S. employment.

Conference Agreement

The House bill recedes to the Senate.

C. Definition of Substantial Injury for Export-Import Bank Determination

House bill

The House bill contains no provision.

Senate amendment

Section 1106(c) of the Senate amendment provides that the extension of any credit or guarantee by the Export-Import Bank will result in substantial injury if that credit or guarantee is responsible for the establishment or expansion of production equal to or in excess of 1% of U.S. production.

Conference Agreement

The House recedes to the Senate.

Comparison of Section 2(e) of the Ex-Im Bank Charter as Enacted in 1986 and Following 1988, 2002 and 2006 Amendments, with Statutory References

A. As enacted in 1986

(2)(e) Limitation on assistance which adversely affects the United States

(1) In general - The Bank may not extend any direct credit or financial guarantee for establishing or expanding production of any commodity for export by any country other than the United States, if--

(A) the Bank determines that--

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(i) the commodity is likely to be in surplus on world markets at the time the resulting productive capacity is expected to become operative; or

(ii) the resulting production capacity is expected to compete with United States production of the same, similar, or competing commodity; and

(B) the Bank determines that the extension of such credit or guarantee will cause substantial injury to United States producers of the same, similar, or competing commodity.

(2) Exception

Paragraph (1) shall not apply in any case where, in the judgment of the Board of Directors of the Bank, the short- and long-term benefits to industry and employment in the United States are likely to outweigh the injury to United States producers of the same, similar, or competing commodity.

B. 1988 Amendments][Added [~~Deleted~~]

(2)(e) Limitation on assistance which adversely affects the United States

(1) In general

The Bank may not extend any direct credit or financial guarantee for establishing or expanding production of any commodity for export by any country other than the United States, if--

(A) the Bank determines that--

(i) the commodity is likely to be in surplus on world markets at the time the resulting commodity will first be sold [~~productive capacity is expected to become operative~~][1988]; or

(ii) the resulting production capacity is expected to compete with United States production of the same, similar, or competing commodity; and

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(B) the Bank determines that the extension of such credit or guarantee will cause substantial injury to United States producers of the same, similar, or competing commodity.

(2) Exception

Paragraph (1) shall not apply in any case where, in the judgment of the Board of Directors of the Bank, the short- and long-term benefits to industry and employment in the United States are likely to outweigh the short- and long-term [1988] injury to United States producers and employment [1988] of the same, similar, or competing commodity.

3) Definition [1988]

For purposes of paragraph (1)(B), the extension of any credit or guarantee by the Bank will cause substantial injury if the amount of the capacity for production established, or the amount of the increase in such capacity expanded, by such credit or guarantee equals or exceeds 1 percent of United States production. [1988]

X. As Currently In Effect After 2002 and 2006 Amendments [Added [~~Deleted~~]]

(2)(e) Limitation on assistance which adversely affects the United States

(1) In general

The Bank may not extend any direct credit or financial guarantee for establishing or expanding production of any commodity for export by any country other than the United States, if--

(A) the Bank determines that--

(i) the commodity is likely to be in surplus on world markets at the time the resulting commodity will first be sold; or

(ii) the resulting production capacity is expected to compete with United States production of the same, similar, or competing commodity; and

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(B) the Bank determines that the extension of such credit or guarantee will cause substantial injury to United States producers of the same, similar, or competing commodity.

In making the determination under subparagraph (B), the Bank shall determine whether the facility that would benefit from the extension of a credit or guarantee is reasonably likely to produce a commodity in addition to, or other than, the commodity specified in the application and whether the production of the additional commodity may cause substantial injury to United States producers of the same, or a similar or competing, commodity. [2006]

(2) Outstanding orders and preliminary injury determinations [2002]

(A) Orders [2002]

The Bank shall not provide any loan or guarantee to an entity for the resulting production of substantially the same product that is the subject of-

(i) a countervailing duty or antidumping order under title VII of the Tariff Act of 1930; or

(ii) a determination under title II of the Trade Act of 1974.

(B) Affirmative determination [2002]

Within 60 days after the date of the enactment of this paragraph, the Bank shall establish procedures regarding loans or guarantees provided to any entity that is subject to a preliminary determination of a reasonable indication of material injury to an industry under title VII of the Tariff Act of 1930. The procedures shall help to ensure that these loans and guarantees are likely to not result in a significant increase in imports of substantially the same product covered by the preliminary determination and are likely to not have a significant adverse impact on the domestic industry. The Bank shall report to the Committee on Financial Services of the House of Representatives and the Committee on Banking, Housing, and Urban Affairs of the Senate on the implementation of these procedures.

(The Bank shall establish procedures under which the Bank shall notify interested parties and provide a comment period [of not less than 14 days (which, on request of any affected party, shall be extended to a period of not more than 30 days)][2006] with regard to loans or guarantees reviewed pursuant to subparagraph (B) or (D).

(D) Consideration of investigations under title II of the Trade Act of 1974 [2002]

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In making any determination under paragraph (1) for a transaction involving more than \$10,000,000, the Bank shall consider investigations under title II of the Trade Act of 1974 that have been initiated at the request of the President of the United States, the United States Trade Representative, the Committee on Finance of the Senate, or the Committee on Ways and Means of the House of Representatives, or by the International Trade Commission on its own motion.

(E) Anti-circumvention [2006]

The Bank shall not provide a loan or guarantee if the Bank determines that providing the loan or guarantee will facilitate circumvention of an order or determination referred to in subparagraph (A).

(3)(~~2~~) [2002] Exception

Paragraphs (1) and (2) [2002] shall not apply in any case where, in the judgment of the Board of Directors of the Bank, the short- and long-term benefits to industry and employment in the United States are likely to outweigh the short- and long-term injury to United States producers and employment of the same, similar, or competing commodity.

(4) (~~3~~) [2002] Definition

For purposes of paragraph (1)(B), the extension of any credit or guarantee by the Bank will cause substantial injury if the amount of the capacity for production established, or the amount of the increase in such capacity expanded, by such credit or guarantee equals or exceeds 1 percent of United States production.

(5) Designation of sensitive commercial sectors and products [2006]

Not later than 120 days after the date of the enactment of this Act, the Bank shall submit a list to the Committee on Banking, Housing, and Urban Affairs of the Senate and the Committee on Financial Services of the House of Representatives, which designates sensitive commercial sectors and products with respect to which the provision of financing support by the Bank is deemed unlikely by the President of the Bank due to the significant potential for a determination that such financing support would result in an adverse economic impact on the United States. The President of the Bank shall review on an annual basis thereafter the list of sensitive commercial sectors and products and the Bank shall submit an updated list to the Committee on Banking, Housing, and Urban Affairs of the Senate and the Committee on Financial Services of the House of Representatives of such sectors and products.

(6) Financial threshold determinations [2006]

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For purposes of determining whether a proposed transaction exceeds a financial threshold under this subsection or under the procedures or rules of the Bank, the Bank shall aggregate the dollar amount of the proposed transaction and the dollar amounts of all loans and guarantees, approved by the Bank in the preceding 24-month period, that involved the same foreign entity and substantially the same product to be produced.

(7) Procedures to reduce adverse effects of loans and guarantees on industries and employment in United States [2006]

(A) Consideration of economic effects of proposed transactions [2006]

If, in making a determination under this paragraph with respect to a loan or guarantee, the Bank conducts a detailed economic impact analysis or similar study, the analysis or study, as the case may be, shall include consideration of--

- (i) the factors set forth in subparagraphs (A) and (B) of paragraph (1); and
- (ii) the views of the public and interested parties.

(B) Notice and comment requirements [2006]

(i) In general

If, in making a determination under this subsection with respect to a loan or guarantee, the Bank intends to conduct a detailed economic impact analysis or similar study, the Bank shall publish in the Federal Register a notice of the intent, and provide a period of not less than 14 days (which, on request by any affected party, shall be extended to a period of not more than 30 days) for the submission to the Bank of comments on the economic effects of the provision of the loan or guarantee, including comments on the factors set forth in subparagraphs (A) and (B) of paragraph (1). In addition, the Bank shall seek comments on the economic effects from the Department of Commerce, the Office of Management and Budget, the Committee on Banking, Housing, and Urban Affairs of the Senate, and the Committee on Financial Services of the House of Representatives.

(ii) Content of notice

The notice shall include appropriate, nonproprietary information about--

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(I) the country to which the goods involved in the transaction will be shipped;

(II) the type of goods being exported;

(III) the amount of the loan or guarantee involved;

(IV) the goods that would be produced as a result of the provision of the loan or guarantee;

(V) the amount of increased production that will result from the transaction;

(VI) the potential sales market for the resulting goods; and

(VII) the value of the transaction.

(iii) Procedure regarding materially changed applications

(I) In general

If a material change is made to an application for a loan or guarantee from the Bank after a notice with respect to the intent described in clause (i) is published under this subparagraph, the Bank shall publish in the Federal Register a revised notice of the intent, and shall provide for a comment period, as provided in clauses (i) and (ii).

(II) Material change defined

As used in sub clause (I), the term “material change”, with respect to an application, includes--

(aa) a change of at least 25 percent in the amount of a loan or guarantee requested in the application; and

(bb) a change in the principal product to be produced as a result of any transaction that would be facilitated by the provision of the loan or guarantee.

(C) Requirement to address views of adversely affected persons [2006]

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Before taking final action on an application for a loan or guarantee to which this section applies, the staff of the Bank shall provide in writing to the Board of Directors the views of any person who submitted comments pursuant to subparagraph (B).

(D) Publication of conclusions [2006]

Within 30 days after a party affected by a final decision of the Board of Directors with respect to a loan or guarantee makes a written request therefore, the Bank shall provide to the affected party a non-confidential summary of the facts found and conclusions reached in any detailed economic impact analysis or similar study conducted pursuant to subparagraph (B) with respect to the loan or guarantee, that were submitted to the Board of Directors.

(E) Rule of interpretation [2006]

This paragraph shall not be construed to make subchapter II of chapter 5 of Title 5, applicable to the Bank.

(F) Regulations [2006]

The Bank shall implement such regulations and procedures as may be appropriate to carry out this paragraph.

1986 Amendments. Subsec. (2)(e). Pub.L. 99-472, § 11, added subsec. (e).

1988 Amendments. Subsec. (e)(1)(A)(i). Pub.L. 100-418, § 3304(a), substituted “commodity will first be sold” for “productive capacity is expected to become operative”.

Subsec. (e)(2). Pub.L. 100-418, § 3304(b), added “short- and long-term” following “to outweigh the” and “and employment” following “United States producers”.

Subsec. (e)(3). Pub.L. 100-418, § 3304(c), added par. (3).

2002 Amendments. Subsecs. (e)(2) to (4). Pub.L. 107-189, § 18, added par. (2) and redesignated former pars. (2) and (3) as (3) and (4) respectively. Prior to redesignation, in par. (2), struck out “Paragraph (1)” and inserted “Paragraphs (1) and (2)”.

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2006 Amendments. Subsec. (e)(1). Pub.L. 109-438, § 7(1), at the end of par. (1), inserted: “In making the determination under subparagraph (B), the Bank shall determine whether the facility that would benefit from the extension of a credit or guarantee is reasonably likely to produce a commodity in addition to, or other than, the commodity specified in the application and whether the production of the additional commodity may cause substantial injury to United States producers of the same, or a similar or competing, commodity.”

Subsec. (e)(2)(C). Pub.L. 109-438, § 8(b), inserted “of not less than 14 days (which, on request of any affected party, shall be extended to a period of not more than 30 days)” after “comment period”.

Subsec. (e)(2)(E). Pub.L. 109-438, § 7(2), added subpar. (E).

Subsec. (e)(5). Pub.L. 109-438, § 5, added par. (5).

Subsec. (e)(6). Pub.L. 109-438, § 7(3), added par. (6).

Subsec. (e)(7). Pub.L. 109-438, § 8(a), added par. (7).

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Appendix D - Methodology and Background of this Report

Assignment Methodology

The following work was completed in support of the preparation of this Report:

- Review in detail the Bank's files pertaining to the medium-term credit insurance provided in support of the Trinidad project.
- Review of additional Bank files related to other transactions that were subjected to economic impact review during the period of January 1, 2002 to May 1, 2008.
- Review the Bank's Charter and its policies and procedures for approving transactions involving less than \$10 million of financing and for determining economic impact.
- Interviews during 2007 and 2008 of various officials regarding the methodology and interpretation of economic impact analyses, including (1) all five members of the Bank's Board of Directors; (2) the Bank's General Counsel; (3) senior Bank officials in its Policy and Analysis Division; (4) officials from other U.S. government agencies that provide comments on the Bank's draft economic impact analyses, including the Treasury and Commerce Departments, and the Office of the U.S. Trade Representative; and (5) discussions of the work supporting the 2007 OIG Report with representatives of GAO and members of the staff of the Senate Finance Committee.
- Discussion of the findings and suggestions set forth in this Report with members of the Bank's senior staff, Board and representatives of certain of the Reviewing Agencies.

This work was completed by the Inspector General with support from a senior auditor detailed to the OIG by the Office of Inspector General of the Federal Deposit Insurance Corporation.

No one interviewed during the preparation of this Report expressed satisfaction with the Economic Impact Procedures, or confidence in their efficient and effective functioning. The sources of dissatisfaction and lack of confidence varied as to cause and strength among the individuals interviewed. Comments from transaction sponsors or opponents were not obtained during the preparation of this Report. The statements and testimony of interested parties delivered to Congress regarding the Economic Impact Procedures in the Bank's reauthorization hearings held in 2006 were reviewed. That testimony and reports received from several of the individuals who were interviewed, who have interacted with transaction sponsors and opponents, presented a relatively consistent picture of dissatisfaction and lack of confidence arising from those quarters as well.

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2007 GAO Report

The 2007 GAO Report was considered and the documentation provided by the Bank to GAO upon which that report was based was reviewed. GAO conducted its work from September 2006 through August 2007 in which it reviewed: (1) the Bank's overall policies and procedures for determining economic impact; (2) the extent to which the Bank's procedures provide for the identification and appropriate analysis of projects that could potentially cause adverse economic impact; and (3) the extent to which the Bank's policies, procedures and decisions are transparent to interested and affected parties.

Overall, GAO reported that the Bank has established procedures to identify applications for projects that have the greatest potential to adversely affect U.S. industry and to conduct detailed analyses on those identified projects. GAO found challenges and areas for improvement in the screening and detailed analysis of projects for economic impact. They also found limitations in the transparency of the Bank's economic impact process. Based on its work, GAO made several recommendations in each of two areas: (1) improving the Bank's identification and analysis of applications for economic impact and (2) improving the public transparency of the economic impact process for interested and affected parties. The GAO's work was considered during the preparation of this Report, but no attempt was made to duplicate it.

Congressional Interest in the Bank's Economic Impact Procedures

The Bank's economic impact procedures have been under Congressional scrutiny for the past several years. In September 2004, Senator Charles E. Grassley sent a letter to the Bank regarding the Bank's support for the export of U.S. manufacturing equipment used in an ethanol dehydration plant in Trinidad and Tobago, questioning whether the Bank properly applied the "substantial injury" language contained in Section 2(e)(4) of the Bank's Charter. Shortly thereafter the Consolidated Appropriations Act of 2005 (PL 108-447) required that the Bank submit a report to the Appropriations Committees of the Senate and House containing an analysis of the economic impact on United States producers of ethanol of the Trinidad project.

After consideration of the Bank's response to these communications and other information, Congress directed in November 2005 that the 2007 OIG Report be prepared. Senators Grassley and Crapo later requested that the GAO review the Bank's economic impact analysis process, resulting in the 2007 GAO Report. Congress also made significant changes in the Bank's economic impact responsibility in amendments to the Charter in connection with the Bank's 2006 reauthorization (P.L. 109-438, December 20, 2006).

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Request by Chairman Jim Lambright

The OIG's inquiries in support of the 2007 OIG Report of necessity touched upon all aspects of the Bank's Economic Impact Procedures. It would not have been possible to address the narrower questions that were the subject of the 2007 OIG Report without an understanding of the broader context. Jim Lambright, the Bank's Chairman at the commencement of work on the 2007 OIG Report, requested that the OIG examine the Economic Impact Procedures more broadly. In particular, the Chairman requested that the OIG consider the findings and recommendations in the 2007 GAO Report in view of the OIG's independent review of the Economic Impact Procedures and, if deemed advisable, offer more detailed recommendations for improvements based upon them. This Report is the result of that request.

Actions Leading to Public Release of this Report

This Report was written by Michael W. Tankersley during his tenure as the first Ex-Im Bank Inspector General, with support during the preparation of the 2007 OIG Report provided by a senior auditor detailed to the Ex-Im Bank OIG by the Office of Inspector General of the Federal Deposit Insurance Corporation. This Report has been reviewed by Osvaldo Gratacos, the Acting Inspector General of Ex-Im Bank, and his comments have been incorporated in the final Report. Unlike other evaluation reports released by the Ex-Im Bank OIG in 2009 and 2010, the Office of Audits did not participate in the preparation of this Report. Substantially all of the substantive work supporting this Report was completed during 2007 and 2008, prior to the arrival of the Ex-Im Bank OIG's professional staff. The existence of the Ex-Im Bank OIG commenced in August 2007 when Michael W. Tankersley was sworn in as the first Ex-Im Bank Inspector General. The Assistant Inspector General for Audits was not employed until May 2008.

Drafts of this Report were provided to the PPG staff and senior management of the Bank at several points during 2008 and 2009, and some of the findings and suggestions in this Report that were reflected in those drafts were incorporated in economic evaluations during 2008 and 2009. The Inspector General determined not to release the Report in the Fall of 2008 after the Bank's Chairman and General Counsel were detailed to serve as senior officials of the Troubled Asset Relief Program based on his conclusion that substantive consideration of these findings and suggestions would be most constructive if undertaken by the Bank's leadership under the appointees of the new administration that would take office in January 2009. A draft of this Report and background materials, together with a short briefing, were provided to the Bank's newly appointed senior management in August 2009. Michael W. Tankersley resigned from the Office of Inspector General in October 2009.

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As a result of continuing interest in the Report's subject matter by the PPG staff, the Bank's senior management and other observers of the economic impact process, including members of Congress and the staff of the Senate Committee on Banking, Housing and Urban Development, Acting Inspector General Gratacos requested that Mr. Tankersley complete final editing of the Report and respond to his comments, a process that has resulted in the public release of this Report.

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Appendix E - Excerpts from Economic Impact Procedures – April 2007

Stage V: Analysis of the Economic Impact of Transactions by Categories

The fifth stage of the economic impact analysis consists of screens to determine whether a transaction requires a detailed economic impact analysis. The detailed economic impact analysis incorporates multiple components to determine the overall economic impact. No individual component of the analysis is determinative.

Category A: Processing Transactions Not Subject to Specified Trade Orders or Preliminary Trade Actions

....

2. Risk of Substantial Injury: Transactions that enable a foreign buyer to establish or expand foreign production by an amount that is equal to or greater than 1% of U.S. production (of the same, similar, or competing good) are subject to detailed economic impact analysis in screen 3. In determining “substantial injury”, the concept referred to as “proportionality” (i.e., where the relation of the dollar value of the Ex-Im Bank financed U.S. component to the overall cost of the transaction/project measures whether the 1% screen has been met) shall not be the only element used to avoid a full economic analysis. If a facility that would benefit from the provision of Ex-Im Bank financing is reasonably likely to produce a commodity other than, or in addition to, the commodity specified in the application, such commodity will also be subject to a substantial injury determination.

3. Detailed Economic Impact Analysis to Determine if the 2(e)(1) Prohibition is Applicable -Factors to be Evaluated:

a. Public Notice and Comment: When Ex-Im Bank determines that a transaction poses a risk of substantial injury (i.e., the resulting production is equal to or exceeds 1% of U.S. production), the Bank shall publish in the Federal Register and on its website a notice of intent, and provide a period of not less than 14 days (which, on written request by any affected party, shall be extended to a period of not more than 30 days), for the submission to the Bank of comments on the economic effect of the provision of the loan or guarantee, including comments on whether the commodity is likely to be in surplus on world markets at the time the resulting commodity will first be sold; and the resulting production capacity is expected to compete with United States production of the same, similar, or competing commodity. Concurrently, Ex-Im Bank will specifically notify relevant USG agencies and Congressional committees of the transaction and weigh carefully the analytical and policy

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views of such entities. The USG agencies and Congressional Committees to be notified include: the U.S. Department of Commerce; the U.S. Department of Treasury, the U.S. Department of State, the Office of Management and Budget, the Office of the U.S. Trade Representative, the Committee on Banking, Housing, and Urban Affairs of the Senate, and the Committee on Financial Services of the House of Representatives. The content of the notice shall include appropriate, nonproprietary information about: (i) the country to which the goods involved in the transaction will be shipped; (ii) the type of goods being exported; (iii) the amount of the loan or guarantee involved; (iv) the goods that would be produced as a result of the provision of the loan or guarantee; (v) the amount of the increased production that will result from the transaction; (vi) the potential sales market for the resulting goods; and (vii) the value of the transaction. The buyer's and the applicant's names, as well as any proprietary information, will not be released. The economic impact analysis will include a summary of the comments received. The full text of comments received by the Bank will be attached as an appendix to the Board memo.

If a material change is made to an application for Ex-Im Bank financing subsequent to the public notice, the Bank shall publish a revised notice and shall provide for a new comment period. The term material change with respect to an application includes: a change of at least 25% percent in the amount of Ex-Im Bank financing requested in the application; or a change in the principal product to be produced by the foreign buyer.

b. Oversupply and Competition: For a transaction to be eligible for denial based on economic impact, Ex-Im Bank's Charter requires that – in addition to meeting the criteria for substantial injury – the foreign buyer's resulting production must either likely be in surplus on world markets at the time it will first be sold (hereafter called oversupply) or compete with U.S. production of the same, similar or competing good.¹

i. Assessment of oversupply: Ex-Im Bank's Charter requires the economic impact analysis to address whether the foreign buyer's production resulting from Ex-Im Bank support may come on-stream during a period of oversupply. There are no generally accepted definitions of oversupply, so each transaction is analyzed on a case-by-case basis. Anti-Dumping or Countervailing Duty Orders against a product shall be factored as a consideration into any extensive economic impact analysis of a similar product elsewhere as a possible indicator of oversupply. Section 201 investigations initiated at the request of the President, the U.S. Trade Representative, the Senate Committee on Finance, the House Committee on Ways and Means or by the International Trade Commission on its own motion shall be considered by Ex-Im Bank as indicators of oversupply. Other possible indicators of oversupply that Ex-Im Bank may consider on a case-by-case basis include: (i) stagnating or falling global

¹ All analysis will be based on reasonably available data and information.

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prices and/or falling gross margins (price minus variable cost) of domestic producers; (ii) industry bankruptcy trends and/or industry unemployment trends; (iii) Trade Adjustment and Assistance (TAA) Program petitions; and (iv) preliminary Anti-Dumping or Countervailing Duty determinations; and (v) multi-lateral production limitation agreements.²

ii. Valuation of broad competitive impacts to U.S. industry: The foreign project's potential impact on U.S. industry is analyzed in a cost-benefit framework. The economic impact analysis weighs the quantitative benefits (e.g., the value of the U.S. exports, follow-on spare parts sales) and costs (e.g., the value of the displaced U.S. sales or lost market share) of the transaction. In addition to measuring whether the foreign buyer's increased production could displace U.S. production of the same, similar, or competing good in markets where the foreign buyer directly competes head-to-head with U.S. production, the economic impact analysis will also consider other secondary factors and impacts of the proposed transaction. These other factors include: concurrent additions to production capacity of the product in the U.S., buyer's country and any markets that may directly affect the prospects for current U.S. producers, the current and expected international trade flows of the product including the possibility that the foreign buyer's production may displace production from a third-country resulting in displaced U.S. production, or reduced U.S. market share. The time horizon for measuring the economic impact is the length of Ex-Im Bank support.

c. Evaluation of Quantitative and Qualitative Information: The next step in the economic impact process is the weighing of the analytical findings of the preceding steps and the qualitative information received through the notice and comment period (e.g., views from other USG agencies and affected parties) to determine the overall impact of Ex-Im Bank financing on the U.S. economy. At the conclusion of the economic impact analysis, staff makes a recommendation based on its evaluation of the various components. The Board takes all these components into account in reaching a decision.

² By policy and practice, Ex-Im Bank is directly and unexceptionally constrained by guidelines established by the Export Credit Group, a body of the Organization for Economic Cooperation and Development.

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Appendix F - Trade Flow Analysis Methodology

The Bank's trade flow analysis methodology generally involves the following steps and assumptions:

- (i) The volume of U.S. production of the Exportable Good is determined in a base year, and U.S. domestic consumption, including foreign imports, and U.S. exports of that good to specific foreign markets for that year are also identified.
- (ii) The potential annual volume of production of the Exportable Good by the foreign buyer of the exported capital equipment proposed to be supported by the Bank is identified. Manufacturer supplied information is considered by the Bank's engineering staff to confirm this quantity. Where the exported equipment is merely replacing existing equipment and no new production capacity will be created, the volume of new production associated with the Bank's supported financing is assumed to be zero.
- (iii) These production, consumption, export and import numbers are then modified to reflect anticipated trends to arrive at projected future data for the relevant future years. In some cases, for example where a market appears to be relatively static, no adjustment to historical data is made. In other cases increases or decreases may be projected from recent trends. In cases where markets are perceived to be cyclical, projected trade flows for some future years may be substantially reduced to reflect potential volatility.
- (iv) The relevant years for which projected U.S. production, consumption, imports, exports and foreign production figures are developed are assumed to begin with the year in which the Bank supported equipment will first be placed into production and to end with the term of the Bank supported financing. As a result of this assumption, changes in the duration of the Bank's financing can alter the outcome of the analysis.
- (v) It is assumed that 100% of the production of the Exportable Good will "displace" U.S. production, to the extent that the Exportable Good is reasonably capable of being exported to the U.S. or to a market to which U.S. producers have demonstrated exports. Second order competition between U.S. production and the foreign production of the Exportable Good is considered too distant and difficult to model and so is not considered. Exports to nations that U.S. producers do not export to are assumed not to have any negative impact on U.S. producers of the Exportable Good.
- (vi) The dollar value of the assumed "displaced" sales, discounted to a present value, are compared with the dollar value of the capital equipment proposed for Ex-Im Bank support and projected follow-on part or service revenues to the U.S. from the supported transaction.

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- (vii) If the dollar value of the displaced sales by U.S. producers of the Exportable Good exceeds the dollar value of the supported export transaction, a negative trade flow effect is identified by the PPG staff and the transaction generally receives a negative staff recommendation due to perceived “substantial injury to U.S. producers.” If the dollar value of the displaced sales by U.S. producers of the Exportable Good is less than the dollar value of the supported export transaction, a positive trade flow effect is identified by the PPG staff and the transaction generally receives a positive recommendation.

- (viii) If the result of the analysis reflected in items (vi) and (vii) above is negative in a case in which the PPG staff identifies other data suggesting that the method overstates the likelihood of injury to U.S. producers, or in which other mitigating factors exist that strongly suggest that no injury to U.S. producers is likely (see 1.(d) below), the PPG staff has on occasion introduced modifications to the method, or recommended changes in the transaction structure, so that the results of the model are more consistent with the other data. The results produced by the revised model then allow the staff to confirm that there is not a negative trade flow effect. Examples of this include considering imports of an Exportable Good only in every other year for cyclical industries, and applying the concept of “proportionality” to consider only a small percentage of the Exportable Goods produced as displacing U.S. production where the contribution of the Ex-Im Bank supported export to the new foreign production capacity is small or indirect.

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Appendix G - 2007 OIG Report to Congress

November 5, 2007

The Honorable Spencer Bachus
House Committee on Financial Services
2129 Rayburn House Office Building
Washington, DC 20515-1306

Dear Congressman:

The Export-Import Bank of the United States (Bank) Office of Inspector General (OIG) has completed its analysis of issues related to medium-term credit insurance provided to an ethanol dehydration plant in Trinidad and Tobago (the "Trinidad Project"), and related matters. The OIG initiated this special project at the direction of the Congress. Specifically, Conference Report 109-265, dated November 2, 2005 (the "November 2005 Conference Report"), included the following language:

The conferees direct that the Inspector General shall provide a written analysis to the Committees on Appropriations and other appropriate committees, including the Senate Finance Committee, within 90 days of appointment as to whether loan guarantees provided to an ethanol dehydration plant in Trinidad and Tobago met the conditions of section 2(e)(4) of the Export-Import Bank Act of 1945 or any provision in the Bank's charter. This analysis shall include whether "value added" methodology is routinely used by the Bank to determine whether or not a proposed loan guarantee or export credit meets the statutory test found in section 2(e)(4). The Inspector General shall also make recommendations as to whether it is appropriate to use such methodology in making determinations of substantial injury.

In responding to the November 2005 Conference Report, the OIG focused its attention on the three specific issues which are analyzed herein:

- (1) Whether the medium-term credit insurance provided by the Bank in support of the Trinidad Project met the conditions of Section 2(e)(4) or any other provision of the Export-Import Bank Act of 1945 (the "Charter") (see Appendix A for relevant provisions of the Charter).

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- (2) Whether the Bank routinely uses “value added” methodology to determine whether a proposed loan guarantee or export credit meets the statutory test of substantial injury, as specified in Section 2(e)(4) of the Charter.
- (3) Whether it is appropriate for the Bank to use “value added” methodology in making determinations of substantial injury.

Results in Brief

Following is a brief synopsis of our conclusions. A more comprehensive discussion of our findings begins on page 6.

Issue 1. We have concluded that as a legal matter the Trinidad Project met the conditions of Section 2(e)(4) of the Bank’s Charter and other related provisions pursuant to procedures authorized by the Bank in the exercise of its discretion. Under these procedures, as a transaction involving less than \$10 million of financing, (i) the Trinidad Project was not evaluated by the Bank’s staff to determine whether it would result in the production of dehydrated ethanol in an amount that would equal or exceed 1% of United States production and (ii) the transaction was authorized by the Bank’s Credit Committee.

Issue 2. We have concluded that value added methodology is not routinely used by the Bank to determine whether or not a proposed loan guarantee or export credit meets the statutory test found in Section 2(e)(4) of the Charter. We identified no transactions during the period we examined of 2002 to present which have been authorized by the Bank based upon use of value added methodology. Value added methodology was used by the Bank in a 2005 report to Congress, after the Trinidad Project had been authorized (referred to herein as the “2005 Response”), to support the proposition that the Trinidad Project had not resulted in substantial injury to any U.S. producers of ethanol under the standards set forth in the Charter.

Issue 3. Based upon the limited procedures performed in support of this analysis, we have concluded that the use of value added methodology with respect to the Trinidad Project as expressed in the 2005 Response was not appropriate. In particular, the OIG does not believe that it was appropriate for the Bank in its 2005 Response to Congress to suggest that value added methodology be used to determine whether the 1 % threshold set forth in Section 2(e)(4) of the Charter had been crossed.

As noted in a recently released report prepared by the U.S. Government Accountability Office (GAO), *Export-Import Bank – Improvements Needed in Assessment of Economic Impact* (GAO-07-1071) (September 2007 GAO Report), which addressed the Bank’s economic impact procedures more generally, the determination of economic impact required of the Bank pursuant to the Charter is challenging and complex. The OIG is performing additional procedures with the objective of making recommendations to

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management regarding certain aspects of the Bank's economic impact procedures based upon further review of the conceptual basis for value added methodology, issues raised in the September 2007 GAO Report and other matters identified by the OIG in the course of preparing this analysis.

Background

In March 2004 the Bank approved the issuance of a medium-term insurance policy with a credit limit of \$9.87 million to support the export of U.S. manufactured equipment to a company in Trinidad and Tobago to be used in a new ethanol dehydration facility. The equipment supported by the Bank was to be used to produce "anhydrous" ethanol by removing water from "hydrous" fuel-grade ethanol produced in Brazil, with the intent of exporting up to 100 million gallons of anhydrous fuel-grade ethanol to the U.S. In accordance with the Bank's policies, because the amount of financing supported by the Bank was less than \$10 million, no public notice was provided in the Federal Register during the Bank's consideration of whether to provide financial support for the project, no detailed economic impact analysis was conducted to determine whether the transaction would cause substantial injury to U.S. producers of fuel-grade ethanol and the transaction was approved by the Bank's Credit Committee.

In September 2004, Senator Charles E. Grassley sent a letter to the Bank questioning the Bank's support for the Trinidad Project. In particular, Senator Grassley cited the "substantial injury" language contained in Section 2(e)(4) of the Bank's Charter. Shortly thereafter Division D of the Consolidated Appropriations Act, 2005 (PL 108-447) (2005 Appropriations Act) was enacted, which required that the Bank submit a report to the Appropriations Committees of the Senate and House "containing an analysis of the economic impact on United States producers of ethanol of the extension of credit and financial guarantees for the development of an ethanol dehydration plant in Trinidad and Tobago, including a determination of whether such extension will cause substantial injury to such producers, as defined in section 2(e)(4) of the Export-Import Bank Act of 1945 (12 U.S.C. 635(e)(4))."

In January 2005 the Bank delivered a report responding to Senator Grassley's letter and the 2005 Appropriations Act. The 2005 Response considered the question of adverse economic impact relative to the Trinidad Project from three perspectives: (1) substantial injury based on a comparison of the production capacity of the Trinidad Project as a percentage of U.S. production; (2) whether there would be an "oversupply" of ethanol on U.S. markets, which would be exacerbated by the Trinidad Project; and (3) substantial injury as measured by net trade flows, comparing the dollar value of exports being financed against the dollar value of U.S. production that might be "displaced" by imported ethanol from the Trinidad Project. The Bank's 2005 Response concluded:

- The 100 million gallon per year production of the Trinidad Project would not cause substantial injury to U.S. producers because (i) the Bank supported equipment did not produce ethanol, but only added value to an existing stock of fuel grade ethanol by reducing its water content and (ii) the exported equipment would add only 10% to the value of the final product and therefore only

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10% of the output, or 10 million gallons, should be considered as “associated” with the Bank’s support. When 10 million gallons was measured against U.S. production of 2.8 billion gallons, the resulting 0.35% of U.S. production was described in the 2005 Response as being substantially below the 1% threshold of Section 2(e)(4) of the Charter. We note that this determination represented the application of “value added” analysis and that without the application of value added analysis the annual output of the Trinidad Project would equal 3.5% of U.S. production, well above 1% threshold.

The 2005 Response stated “Since the additional value associated with this new production is less than 1% of U.S. production, the transaction does not require an economic impact analysis. However, pursuant to the requirement in the Consolidated Appropriations Act, 2005, the standard economic impact procedures are applied to this case and are presented below.”

- Based on price trends and indicated levels of demand for fuel grade ethanol in the United States at the time and predicted in future years, ethanol would not be likely to be in “oversupply” in the United States when the Trinidad Project commenced operation in 2005.
- The result was indeterminate based on analysis of trade flows from the Trinidad Project. A positive trade flow effect was predicted if a proposed 90 million gallon cap on duty-free imports of ethanol from Caribbean Basin countries was implemented, effectively blocking the Trinidad Project’s ability to sell ethanol in the U.S. A negative trade flow effect was predicted if the cap was not implemented. This analysis also adopted a “value added” approach in quantifying the negative trade flow by considering only 10% of the anticipated production of the Trinidad Product over the seven year term of the financing. We note that had 100% of the output of the Trinidad Project been considered, the potential negative trade flow considered in the 2005 Response would have been much higher.

After consideration of the Bank’s 2005 Response and other information, Congress directed in the November 2005 Conference Report that this written analysis be submitted to Congress within 90 days of the Inspector General taking office. Senators Grassley and Crapo later requested that the GAO review the Bank’s economic impact analysis process, resulting in the September 2007 GAO Report described in more detail below. Congress also made significant changes in the Bank’s economic impact review standards and policies in amendments to the Charter in connection with the Bank’s 2006 reauthorization (P.L. 109-438, December 20, 2006). The Bank revised its published economic impact review policies in response to these developments in April 2007. The Bank’s Policy Analysis Division has undertaken an ongoing process to revise its economic impact methodology in view of these developments, and has implemented a number of changes informally, with a formal process to revise the Bank’s economic impact procedures planned following receipt of this analysis and management recommendations expected to result from the OIG’s continuing review of the Bank’s economic impact procedures.

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Methodology

To conduct our analysis of the issues raised in the November 2005 Conference Report, we performed the following work:

- Reviewed in detail the Bank's files pertaining to the medium-term credit insurance provided in support of the Trinidad Project.
- Reviewed additional Bank files related to other transactions that were subjected to economic impact review.
- Reviewed the Bank's 2005 Response and supporting documentation.
- Reviewed the Bank's Charter and its policies and procedures for approving transactions involving less than \$10 million of financing and for determining economic impact.
- Interviewed various officials regarding the methodology and interpretation of economic impact analyses, including (1) all five members of the Bank's Board of Directors; (2) the Bank's General Counsel; (3) senior Bank officials in its Policy Analysis Division; and (4) officials from other U.S. government agencies that provide comments on the Bank's draft economic impact analyses, including the Treasury and Commerce Departments, and the Office of the U.S. Trade Representative.

Further, we considered the September 2007 GAO Report and reviewed the documentation provided by the Bank to GAO upon which that report was based. GAO conducted its work from September 2006 through August 2007 in which it reviewed: (1) the Bank's overall policies and procedures for determining economic impact; (2) the extent to which the Bank's procedures provide for the identification and appropriate analysis of projects that could potentially cause adverse economic impact; and (3) the extent to which the Bank's policies, procedures and decisions are transparent to interested and affected parties.

Overall, GAO reported that the Bank has established procedures to identify applications for projects that have the greatest potential to adversely affect U.S. industry and to conduct detailed analyses on those identified projects. GAO found challenges and areas for improvement in the screening and detailed analysis of projects for economic impact. They also found limitations in the transparency of the Bank's economic impact process. Based on its work, GAO made several recommendations in each of two areas: (1) improving the Bank's identification and analysis of applications for economic impact and (2) improving the public transparency of the economic impact process for interested and affected parties.

Relevant to the first issue addressed in this analysis, GAO concluded that "The effectiveness of the \$10 million screen, introduced under Ex-Im's statutory authority, is uncertain. Ex-Im has not determined whether it removes from review those projects that could meet the statutory definition of substantial injury

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(producing 1% or more of U.S. production in an industry).” In reaching this conclusion, GAO referenced two circumstances where transactions involving financing of less than \$10 million appeared to support the production of exportable goods exceeding 1% of U.S. production, one of them being the Trinidad Project. In conducting our analysis, we considered but did not attempt to duplicate GAO’s work.

Findings and Conclusions

Question 1: *Did Bank medium-term credit insurance provided to an ethanol dehydration plant in Trinidad and Tobago meet the conditions of Section 2(e)(4) or any other provisions of the Bank’s Charter?*

OIG Response: We have concluded that as a legal matter the Bank’s extension of medium-term credit insurance in support of the Trinidad Project met the conditions of Section 2(e)(4) of the Charter and other related provisions of the Charter describing factors the Bank is required to consider in evaluating whether individual transactions will result in substantial injury to U.S. producers. Under procedures authorized by the Bank in the exercise of its discretion, as a transaction involving less than \$10 million of financing, (i) the Trinidad Project was not evaluated by the Bank’s staff to determine whether it would result in the production of dehydrated ethanol in an amount that would equal or exceed 1% of United States production and (ii) the Trinidad Project was authorized by the Bank’s Credit Committee, rather than the Board, pursuant to authority delegated to the Credit Committee by the Board. Transactions under \$10 million generally are not reviewed for their economic impact, or under other policy directives applicable to larger transactions, such as review for environmental impact.

Paraphrased, Section 2(e) of the Bank’s Charter sets forth the following key propositions:

The Bank is not authorized to extend any direct credit or financial guarantees to support the establishment or expansion of production of any commodity for export (Exportable Goods) if the resulting production will compete with U.S. production of the same, similar or competing commodity if the Bank determines that substantial injury to U.S. producers of the Exportable Good will result.

Substantial injury will be presumed to exist if the amount of new or expanded production of the Exportable Good exceeds 1% of U.S. production.

Notwithstanding the fact that the 1% threshold may be exceeded, the Board of the Bank is authorized to approve a transaction if it determines that the short- and long-term benefits to industry and employment in the United States are likely to outweigh the short- and long-term injury to United States producers and employment resulting from the transaction.

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The Bank is authorized to implement regulations and procedures as may be appropriate to carry out Section 2(e) so long as they do not contravene an express statutory requirement.

The Bank's authority to exercise discretion as an independent executive agency of the government in implementing regulations and procedures is confirmed by decisions of the U.S. Supreme Court in

Chevron U.S.A. Inc. v. Natural Resources Defense Council, Inc., 467 U.S. 837, 104 S.Ct. 2778, 81 L.Ed.2d 694 (1984) and U.S. v. Mead Corporation, 533 U.S. 218, 121 S.Ct. 2164 (2001).

Interviews with the Board and management of the Bank and review of economic impact reports in other transactions confirmed that preparing an economic impact report is a labor-intensive undertaking. The Board and staff of the Bank have for many years relied upon the \$10 million of financing threshold as a rough "rule of thumb" dividing line where it was determined that the likelihood of missing a transaction that would in fact result in substantial injury to U.S. producers was sufficiently low that it was not deemed to be an effective use of the Bank's limited resources to subject these smaller transactions to a detailed review.

The September 2007 GAO Report accepts the fundamental legality and legitimacy of the \$10 million screen, while criticizing the Bank for not undertaking to validate the \$10 million screen, a comment with which the OIG concurs. GAO identified the Trinidad Project and one other as examples of transactions approved by the Bank that would result in Exportable Goods exceeding 1% of U.S. production. At the same time, the September 2007 GAO Report noted that of the 19 cases subjected to a full economic impact report between 2003 and 2005, only two were denied.

The September 2007 GAO Report suggests that it might be possible to implement other cost-effective procedures that would identify transactions below the \$10 million threshold, such as transactions affecting smaller U.S. industries, where there was a greater risk of the resulting Exportable Goods exceeding 1% of U.S. production. In the Bank's response to the GAO report, and in discussions with the OIG relating to this analysis, the management and Board of the Bank have expressed interest and commitment to evaluate the effectiveness of the \$10 million screen and to consider other cost-effective measures to address the potential for substantial injury to U.S. producers in smaller transactions.

Question 2: Does the Bank routinely use "value added" methodology to determine whether or not a proposed loan guarantee or export credit meets the statutory test found in Section 2(e)(4)?

OIG Response: We found that the Bank does not routinely use value added methodology to determine whether or not a proposed loan guarantee or export credit meets the statutory test of substantial injury found in the Charter. We identified no transactions during the period we examined of 2002 to present which have been authorized by the Bank based upon use of value added methodology. Value added methodology was used by

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the Bank in the 2005 Response, after the Trinidad Project had been authorized, to support the proposition that the Trinidad Project had not resulted in substantial injury to any U.S. producers of ethanol under the standards set forth in the Charter.

As part of our work, we reviewed a list of transactions requiring detailed economic impact analysis between 2002 and June 2007. Of the 31 detailed analyses included on the list, a senior Bank official reported that only one, in 2006, had considered value added methodology at the draft report stage, and that the value added methodology was not reflected in the final report. We inquired as to the origin of the use of the value added methodology set forth in the Bank's 2005 Response to Congress. The Bank's use of value added methodology as expressed in the 2005 Response was identified by a senior Bank official as a logical extension of another methodology, known as proportionality, which the Bank's Policy Analysis Division has considered in a limited number of other economic impact reports but which has not been relied upon by the Board to approve any transactions subject to economic impact analysis.

Question 3: In the opinion of the OIG, is it appropriate for the Bank to use "value added" methodology in making determinations of substantial injury?

Based upon the limited procedures performed in support of this analysis, we have concluded that the use of value added methodology described in the Bank's 2005 Response with respect to the Trinidad Project was not appropriate. The 2005 Response applied value added methodology to conclude that the Bank's financing should only be associated with 10% of the 100 million gallon annual production of the Trinidad Project because the exported equipment would not produce ethanol from feedstock, but instead would merely add 10% to the value of existing hydrous ethanol purchased from Brazil. The 2005 Response asserted that when 10 million gallons was considered as "associated" with the Bank's support and compared to U.S. production of 2.8 billion gallons, the resulting 0.35% of U.S. production was substantially below the 1% threshold for substantial injury set forth in Section 2(e)(4) of the Charter. The 2005 Response stated "Since the additional value associated with this new production is less than 1% of U.S. production, the transaction does not require an economic impact analysis."

Interviews with Bank staff, reviews of supporting materials for the Bank's 2005 Response and reviews of other economic impact analyses prepared by the Bank's staff confirm that the economic impact analysis expressed in the 2005 Response, and particularly the use of value added methodology, was not representative of the Bank's then existing policies and procedures for undertaking economic impact analysis.

The OIG's review of the 2005 Response and interviews with senior bank officials indicate that the work performed by the Bank's policy analysis group as set forth in the 2005 Response was not fully reflective of the work that would have been done had the Trinidad Project been presented for review as a transaction involving more than \$10 million of financing. Because of a number of issues relative to the Bank's economic impact procedures that are noted in the September 2007 GAO Report, including a lack of transparency and certain inconsistencies between the Bank's published procedures and how they were implemented in practice, it is

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difficult to draw clear distinctions between the work supporting the 2005 Response and the work that would be done for transactions involving more than \$10 million of financing. Among differences noted between the work supporting the 2005 Response and the Bank's regular economic impact review practices were:

- The value added analysis used in the 2005 letter had not previously been used by the policy analysis staff in preparing economic impact reports, and particularly had not been used in assessing whether the 1% threshold of Section 2(e)(4) of the Charter had been crossed.
- The value added analysis expressed in the trade flow portion of the 2005 Response was not among the methodologies that had been used previously to support adjustments decreasing the dollar value of trade flows from a Bank supported project deemed to "displace" U.S. production. For example, in one section of the 2005 Response, the expected volume of ethanol that would be produced by the Trinidad Project over the seven year life of the loan was calculated to be 440 million gallons. That amount was then reduced to 44 million gallons (10% of the predicted volume) in the trade flow analysis based on the 10% value added to the hydrous ethanol by the equipment supported by the Bank's medium-term credit insurance.

Also, the Trinidad Project was not considered under the procedures applicable to transactions involving more than \$10 million of financing when initially approved, and the Bank did not consider it feasible to recreate that process after the fact. As a result:

- Agencies that normally provide the Bank with market data analysis to support economic impact reports were not consulted regarding the 2005 Response.
- The Bank's analysis reflected in the 2005 Response was not reviewed by any of the agencies that typically review and comment on draft economic impact reports.
- The Trinidad Project was not published in the Federal Register, so that no comments from the public, industry or Congress were received to be taken into account in preparing the 2005 Response.
- The Board of the Bank is charged by the Charter with making the determination as to whether an adverse economic impact will result from a proposed transaction. In this instance, the Board was not consulted relative to the preparation of the 2005 Response and it does not reflect their judgment of the matter.

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The OIG has concluded that it was inappropriate to apply value added analysis as set forth in the 2005 Response in assessing whether the 1% threshold established by Section 2(e)(4) of the Charter had been crossed because that usage conflicts with Congressional intent. The Supreme Court in American Tobacco Co. v. Patterson, 456 U.S. 63, 102 S.Ct. 1534, 71 L.Ed.2d 748 (1982) instructed that in cases involving statutory construction, the starting point must be the

language employed by Congress, which assumes that the legislative purpose is expressed by the ordinary meaning of the words used. Absent a clearly expressed legislative intent to the contrary, the plain language should be controlling.

The OIG's reading of Congressional intent as expressed in the plain language of Section 2(e)(3) and (4) of the Charter and their legislative history is that Congress intends the Bank's Board, a politically accountable body appointed by the President and confirmed by the Senate, to make the difficult balancing judgments of when a given export transaction should be approved or declined in circumstances where more than a very small amount of new production of an Exportable Good will result. A determination that the Bank will not support an export transaction on economic impact grounds will injure the exporter directly and certainly. Under the Bank's Charter, this must be balanced against the economic injury that may accrue to U.S. producers if an export transaction is approved, which will generally be indirect and less certain.

Applying value added methodology to determine whether the 1% threshold of Section 2(e)(4) has been crossed, a methodology that has not been approved for such use by the Board, would undercut this important check and balance. It is important to note that the Bank's management has confirmed that value added analysis has not been used to remove transactions above the \$10 million threshold from economic impact analysis and consideration by the Board. Because the \$10 million threshold has been approved by the Board, as noted above in the response to Question 1, the legality and legitimacy of the approval of the Trinidad Project by the Credit Committee, without an economic impact analysis, is not subject to the same criticism.

The OIG has not undertaken an exhaustive legal analysis of the construction of the language used in Section 2(e)(1), (3) and (4) of the Charter. At the same time, it is plain from the words that Congress used in those provisions that the key issue linking a Bank sponsored transaction to the substantial injury that the Bank is obligated to avoid, and the determinations that Congress charged the Board with making, is assessing causation of production and causation of substantial injury:

(1) The Bank may not extend any direct credit or financial guarantee . . . if: . . . (B) . . . the Bank determines that the extension of such credit or guarantee will cause substantial injury to United States producers . . .

(4) . . . the extension of any credit or guarantee by the Bank will cause substantial injury if the amount of the capacity for production established, or the amount of the increase in such capacity expanded, by such credit or guarantee equals or exceeds 1 percent of United States production . . . (emphasis added).

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Causation is an inherently factual inquiry that depends as much or more on common sense and logic than it does on specialized knowledge of industrial processes. This is why the job of deciding economic impact cases was assigned by Congress to the Board, not to the Bank's expert staff.

The OIG has concluded that it is difficult, and may be disingenuous, to assert that the Bank's financing has caused either 0% or 10% of the production attributable to a project for purposes of applying Section 2(e)(3) and (4) of the Charter in a transaction such as the Trinidad Project, where (i) it appears that 100% of the anticipated output is intended to be exported to the United States, (ii) but for the creation of the new capacity for anhydrous fuel-grade ethanol output resulting from the Bank's support of the Trinidad Project in a country qualifying for favorable U.S. import duty treatment, the trade flow of the product was unlikely to occur, and (iii) the Bank's financing supports equipment that was integrally responsible for producing the Caribbean Basin Initiative qualified dehydrated ethanol that was the core reason for constructing the Trinidad Project. For these reasons, the OIG believes that it was inappropriate for the 2005 Response to assert that the Bank's support was either causative of none of the Trinidad Project's dehydrated ethanol production, or at most 10% of the Trinidad Project's production.

In the course of the interviews conducted in support of this analysis, the OIG encountered a range of views as to whether value added methodology, and the related analytical tool of proportionality, may have appropriate application in contexts that are factually distinct from the circumstances of the Trinidad Project. The OIG has not reached a conclusion as to whether these concepts would be appropriate for inclusion among a larger set of considerations that the Bank's staff and the Board consider as mitigating factors when evaluating an export transaction for its potential for substantial injury to U.S. producers under Section 2(e)(3) and (4) of the Charter. While proportionality analysis has been discussed among the staff of the Bank for a number of years, and has been included in a small number of draft economic impact reports, it has not appeared in any final economic impact report for any transaction approved by the Board during the period that was reviewed in preparing this analysis. Accordingly, the OIG determined not to address these concepts in detail in this analysis.

The conceptual argument underlying both value added and proportionality methodology is that there are some transactions where the portion supported by the Bank is so small relative to the entire project, and where the equipment supported by the Bank is so tangential or incidental to the production process, that it does not make sense to conclude that the Bank's support has caused 100% of any adverse economic impact that might result from the output of the project. As noted in the September 2007 GAO Report, the Bank has not defined in a clear and consistent way how and when these concepts might be appropriate to use. The Bank's management, in response to the September 2007 GAO Report, and in interviews in support of this analysis, has undertaken to perform a careful review of the use of these concepts and to work to develop written policies for their use that will support increased transparency in the future, for the benefit of the public and of other interested parties such as the recipients of this analysis.

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Additional Work to be Performed

The Inspector General is continuing its review of certain aspects of the Bank's economic impact procedures with the objective of developing recommendations to management addressing the conceptual basis for value added methodology, issues raised in the September 2007 GAO Report and other matters identified by the OIG in the course of preparing this analysis.

This analysis is not an audit and it was not prepared in accordance with Generally Accepted Government Auditing Standards. Given the limited time and scope of this analysis, it does not include any recommendations to the Bank's management.

We are also providing copies of this analysis to the Chairman House Committee on Financial Services Senate Committee on Appropriations, U.S. House of Representatives Committee on Appropriations, U.S. Senate Committee on Banking, Housing, and Urban Affairs, the U.S. Senate Finance Committee. Should you or your staff have any questions or wish to discuss the results of our analysis, please call me at (202) 565-3923

Sincerely,

//signed

Michael W. Tankersley
Inspector General

Attachments

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cc:

Senator Robert C. Byrd, Chairman, Senate Committee on Appropriations

Senator Thad Cochran, Ranking Member, Senate Committee on Appropriations

Senator Max Baucus, Chairman, Senate Committee on Finance

Senator Charles E. Grassley, Ranking Member, Senate Committee on Finance

Senator Chris J. Dodd, Chairman, Senate Committee on Banking, Housing and Urban Affairs

Senator Richard C. Shelby, Ranking Member, Senate Committee on Banking, Housing and Urban Affairs

Senator Evan Bayh, Senate Committee on Banking, Housing and Urban Affairs

Senator Mel Martinez Senator, Senate Committee on Banking, Housing and Urban Affairs

Senator Wayne Allard, Senator, Senate Committee on Banking, Housing and Urban Affairs

Congressman Dave Obey, Chairman, House Committee on Appropriations

Congressman Jerry Lewis, Ranking Member, House Committee on Appropriations

Congressman Barney Frank, Chairman House Committee on Financial Services

Emilia Disanto, Chief Investigator Senate Committee, Senate Committee on Finance

David Johanson, International Trade Counsel, Senate Committee on Finance

Gregg Richard, Legislative Assistant, Senate Committee on Banking, Housing and Urban Affairs

Joe Hepp, Professional Staff Member, Senate Committee on Banking, Housing and Urban Affairs

Kellie Larkin, Professional Staff Member, Committee on Financial Services

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Appendix A

Export-Import Bank Act of 1945, as amended

Sec. 2(e) Limitation on assistance which adversely affect[s] the United States.

(1) In general. The Bank may not extend any direct credit or financial guarantee for establishing or expanding production of any commodity for export by any country other than the United States, if

(A) the Bank determines that –

(i) the commodity is likely to be in surplus on world markets at the time the resulting commodity will first be sold; or

(ii) the resulting production capacity is expected to compete with United States production of the same, similar, or competing commodity; and

(B) the Bank determines that the extension of such credit or guarantee will cause substantial injury to United States producers of the same, similar, or competing commodity.

In making the determination under subparagraph (B), the Bank shall determine whether the facility that would benefit from the extension of a credit or guarantee is reasonably likely to produce a commodity in addition to, or other than, the commodity specified in the application and whether the production of the additional commodity may cause substantial injury to United States producers of the same, or a similar or competing, commodity.

(3) Exception. Paragraphs (1) and (2) shall not apply in any case where, in the judgment of the Board of Directors of the Bank, the short- and long-term benefits to industry and employment in the United States are likely to outweigh the short- and long-term injury to United States producers and employment of the same, similar, or competing commodity.

(4) Definition. For purposes of paragraph (1)(B), the extension of any credit or guarantee by the Bank will cause substantial injury if the amount of the capacity for production established, or the amount of the increase in such capacity expanded, by such credit or guarantee equals or exceeds 1 percent of United States production.

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Appendix H - Federal Trade Commission's Hart-Scott Method

The Federal Trade Commission (“FTC”), under the Hart Scott Rodino Antitrust Improvements Act of 1976 (“Hart-Scott”), developed a pre-transaction antitrust review applied to corporate mergers and acquisitions named the Hart-Scott Method. Under the FTC’s Hart-Scott procedures, the transaction proponents are required to make a simplified filing at least 30 days before the transaction is to close which includes: (i) a breakdown of each party’s revenues according to SIC codes and sub-codes for the most recently completed fiscal year and as they existed in an earlier year; (ii) a copy of documents describing the terms of the transaction and (iii) materials in the possession of either party that evaluate the market for their respective goods or the competitive effects of the transaction. The FTC staff then applies a simplified quantitative screen to the transaction – referred to as the “Herfindahl Index” – that compares the market share in percentages of each party based on their reported SIC code data. If the FTC has not taken formal action to request additional information or object to the transaction within 30 days of filing, the parties are allowed to proceed without further delay.

If the mathematical result of the Herfindahl Index analysis is below a specified level, further review of the transaction is passed and the 30 day waiting period is typically waved within 7-10 days of submission to the FTC. Among the factors that might suggest further FTC review are involvement of the participants in an industry known to have antitrust enforcement challenges, or where the market evaluation materials provided to the FTC suggest that the parties were contemplating obtaining undue market power or narrowly avoiding violations of the antitrust laws in the context of the transaction. If the result of the quantitative market share analysis is above the specified level or there are other concerns present, the FTC makes a “second request” for expanded information to support a detailed staff evaluation of the competitive effects of the transaction. While the high fee charged for Hart-Scott review has drawn continuing criticism, the substance of the process is generally viewed as efficient and effective by transaction participants.

The information that the FTC requests and considers at the first instance in Hart-Scott review is generally easily available to the parties. The cut-off level of the Herfindahl Index above which a second request for information can be expected is publicly disclosed. This allows parties to a potential transaction very early in the process, even before merger discussions are initiated, to efficiently evaluate the likelihood of FTC interest and detailed review, and to avoid transactions where long delays or rejection can be anticipated. Because the sort of information that the FTC specifies in its “second requests” is known, and because its analytical methods and concerns have been transparently made available to the public, transaction proponents can consult counsel and other advisors to obtain a reasonable estimation of the timing and substantive requirements to be expected from a detailed FTC review, and the likely outcome of that review. In those cases, the companies’ advisors will frequently submit a whitepaper analysis incorporating more information than the initial filing requires that addresses the FTC’s anticipated concerns. Counsel may also arrange to meet with FTC staff to discuss the case before or shortly after the initial filing. These actions also help expedite even more complex and challenging cases.

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Because the Bank has not made much of its learning on the subject of economic impact analysis available to the public, and because the facts and results of specific cases, while relying on common analytical methods, tend in the final analysis to be very fact specific to particular markets, potential transaction sponsors contemplating an application for Ex-Im Bank support have had a limited ability to analyze their own prospects of passing an economic impact review. This uncertainty has a real, and potentially large, cost to U.S. exporters and to the mission of Ex-Im Bank. Transactions that might have been approved may not be submitted to the Bank, while other transactions are submitted to the Bank that have limited chances of approval based on the Bank's analytical methods, absorbing considerable staff and proponent time and expense to then dispose of. Making more information regarding the Economic Impact Procedures available to the public, as suggested in Section C of this Report, will allow transaction proponents to more efficiently determine their prospects for approval, and will also allow them to gather relevant data to support their own analysis and to share that data with the Bank's PPG staff as part of their application process.

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Appendix I - Ex-Im Bank's Management Comments to Draft Report

See Next Page



EXPORT-IMPORT BANK
OF THE UNITED STATES

ALICE P. ALBRIGHT, CCA

EXECUTIVE VICE PRESIDENT &
CHIEF OPERATING OFFICER

September 10, 2010

Mr. Osvaldo L. Gratacós
Inspector General (acting)
Export-Import Bank of the United States
811 Vermont Avenue, NW
Washington, DC 20571

Re: Draft Evaluation Report Relating to Economic Impact Procedures (OIG-EV-10-XX)

Dear Mr. Gratacós,

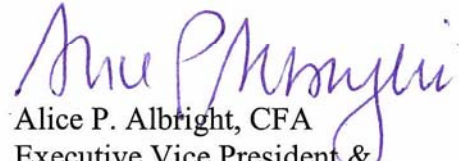
Thank you for the opportunity to review the referenced draft report. I appreciate the significant time and effort your office dedicated to this issue. The substance covered in the report reflects an in-depth understanding of both the evolution of the economic impact mandate and the complexities associated with its implementation.

Guided by the analysis and recommendations of the Bank's professional staff, the Board of Directors presently balances a variety of interests when considering the benefit of a particular transaction against its potential economic impact. It is an ongoing challenge to develop and consistently apply procedures that account for each of these diverse economic interests consistent with the Bank's mission to sustain and create jobs through export finance. The Bank's management agrees that its current economic impact procedures (including methodology) should be improved, including enhanced transparency and consistency across analyses.

Management has decided that any significant adjustment to the Bank's economic impact procedures, however, should coincide with the Bank's impending Congressional reauthorization. As the Bank begins a dialogue with Congress regarding its 2011 reauthorization, it will also initiate a full review and likely overhaul of its economic impact procedures. This public, transparent process will enable a wide range of stakeholders to provide valuable input and express any concerns they may have. The review will also carefully consider the findings and suggestions of your report as well as the recommendations addressed by the September 2007 GAO report entitled, "Improvements Needed in Assessment of Economic Impact".


The Bank's management continuously seeks to improve its policies and procedures to better fulfill its mission and is grateful for your suggestions.

Sincerely,



Alice P. Albright, CFA
Executive Vice President &
Chief Operating Officer

cc: Fred P. Hochberg
Jonathan Cordone



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