Comments of Owen Herrnstadt, Director of Trade and Globalization, on behalf of
The International Association of Machinists and Aerospace Workers
Regarding
The Export-Import Bank of the United States
Medium-and Long-Term Domestic Content Review 2013

The International Association of Machinists and Aerospace Workers (IAM) represents several hundred thousand workers in the United States in a variety of export-related industries including aerospace, ship building and ship repair, agricultural equipment, electronics, auto parts, woodworking, defense, and transportation. IAM members produce, assemble, maintain, and service almost every imaginable product that is exported to other countries. Our members understand the importance of U.S. exports and how critical they are in creating and supporting U.S. jobs. IAM members also understand the importance of the U.S. Export Import Bank and its mission to support exports that support U.S. jobs, a mission that is not shared by most other countries' export credit agencies.

The Bank's most effective tool in supporting its jobs mission is by requiring exporters to meet its domestic content policies, in order to receive preferential financing that is not available in the private sector. The IAM strongly objects to any content review that entertains suggestions that the Bank lends greater financial support for more foreign content and foreign costs associated with U.S. exports. If the Bank were to adopt these suggestions for weakening its domestic content policies, it would be giving U.S. companies further incentives to ship more U.S. jobs to other countries. As our Nation seeks to recover from the loss of nearly three million manufacturing jobs in the past ten years, entertaining suggestions that would reward companies for using greater foreign content in their exports that receive taxpayer support is especially inappropriate.

IAM members understand the fact that producing goods and services in the U.S. creates U.S. jobs. They view claims that the Bank could support more jobs here at home, if it gives U.S. corporations greater incentives to offshore U.S. jobs by financing greater foreign content in U.S. exports, in contradiction of basic common sense. These claims are not based on empirical support and, if implemented, would cost the U.S. thousands of jobs as work for companies and their suppliers are shifted to other countries. They would also cost thousands of future jobs as other countries develop their own industries to compete with remaining U.S. operations.

Instead of weakening content requirements, the IAM believes that the Bank's domestic content policies could be much more effective if the definition of domestic content were modified to exclude items such as profit, the value of intellectual property and licensing rights, and CEO compensation, among other things. We are also troubled that the current policy permits the Bank to aggregate the domestic content of the shipment of a variety of goods, as opposed to measuring the content of individual items.

In his recent State of the Union Address, President Obama said, "Our first priority is making America a magnet for new jobs and manufacturing." Last year, he explained, "… my message is simple. It is time to stop rewarding businesses that ship jobs overseas, and start rewarding companies that create jobs right here in America."; [http://www.whitehouse.gov/the-press-office/2013/02/12/remarks-president-state-union-address; http://www.whitehouse.gov/the-press-office/2012/01/24/remarks-president-state-union-address]

A large majority of Americans agree with the President that "Made in America" is critical for our nation in building a sustainable and prosperous economic future. According to a newly released Harris poll, two-thirds say that buying American goods are very important for keeping jobs here at home. Another 75 percent agree that, "A product needs to be manufactured within the U.S." to be considered "American". http://www.harrisinteractive.com/vault/Harris%20Poll%2013%20-%20Buy%20American_3%206%2013.pdf

Given the importance of manufacturing here at home, it is ironic that on the same day that one federal agency extolled the virtues of U.S. goods, "stamped with 'Made in America'"[http://www.ustr.gov/about-us/press-office/press releases/2013/march/presidents-2013-tpa], the Ex-Im Bank issued its notice for comments on its review of domestic content policies. It also asked for comments that have been made by some businesses to reduce domestic content requirements -- giving them greater incentives to either keep or move jobs offshore. [http://www.exim.gov/generalbankpolicies/content/2013-Content-Review.cfm] It is even more ironic that the Ex-Im Bank is reviewing suggestions to weaken its domestic content policies given, as mentioned at the outset, that its purpose is to support U.S. exports that create and maintain jobs here at home.

The Ex-Im Bank's mission in supporting the creation and maintenance of U.S. jobs is clear: "The Bank's objective in authorizing loans, guarantees, insurance, and credits shall be to contribute to maintaining or increasing employment of United States workers." [12 U.S.C. Section 635(a)(1)] The Charter reinforces this mandate under Section 635(b)(1)(A):

> *It is the policy of the United States to foster expansion of manufactured goods, agricultural products, and other goods and services, thereby contributing to the promotion and maintenance of high levels of employment and real income, a commitment to reinvestment and job creation, and the increased development of the productive resources of the United States.*

The Bank fulfills its mission by providing U.S. exporters with more favorable financing than they could obtain privately, on the condition that they meet certain public policy requirements. One of these policies requires exporters to manufacture their product in the United States. The Bank's policy is simple, effective, and based on common sense: If a company wants government support for its exports, it has to produce its goods and services in the United States, not use tax payer support to finance its use of foreign goods and services.

Unfortunately, the Bank's current review is unbalanced and narrowly focused on suggestions for weakening domestic content, instead of strengthening its current policy. The review is preoccupied with the suggestions of some exporters who have a vested interest in maintaining and increasing their global supply chain. These exporters basically claim that in order for the Bank to be competitive with other export credit agencies, it should be more flexible in its application of domestic content. Their claim is flawed for two reasons: (1.) The Bank is already far too flexible in its application of domestic content, sacrificing its effectiveness in supporting U.S. jobs; and, (2.) The Bank continues to be highly competitive with other ECAs, setting another record- breaking year supporting transactions worth over $32 billion in export financing.

Over the years, the Bank has made several major concessions to demands that its domestic content policy be made more flexible. For example, Ex-Im already lends support for a significant percentage of foreign content and other costs related to foreign goods and services. According to the Government Accountability Office (GAO), "the Bank allows it to support up to 30 percent of the value of the export contract in local costs {*e.g., project-related costs for foreign goods and services incurred in the buyer's country*}, in addition to 15 percent foreign content {*parts and components produced outside the U.S.*}." [http://www.gao.gov/assets/590/588267.pdf]

The Bank also provides exporters with great flexibility in calculating domestic content. It permits exporters to include in their domestic content calculations costs, those associated with research and development, intellectual property and licensing rights, CEO compensation and profits. Any one of these factors could be used by an exporter to dilute the true domestic content of an export, reflected by direct costs for labor, materials, parts, components, and production.

The inclusion of these factors in calculating domestic content raises serious questions that should be included in the Bank's review:

1. How does the Bank justify including profit or CEO compensation into domestic content calculations?

2. Since the value of non-labor related research and development and intellectual property rights can reach into the billions of dollars, how can they be used to distort actual domestic content calculations?

3. How has the inclusion of profit, the value of intellectual property rights, CEO compensation and all non-labor related with research and development negatively impacted domestic employment?

In 2001, the Bank modified its method for calculating domestic content to give exporters even greater flexibility. Rather than requiring exporters to report the domestic content of each individual item in a contract, the Bank now relies on the whole contract's value, permitting exporters to report the domestic content of the contract's entire value, instead of each item in the contract. This allows Ex-Im to finance contracts that may have individual items that contain far less than 85 percent domestic content. Under this method, it is conceivable that items supported by Ex-Im financing could have little or no domestic content. This method raises several questions as well that should be answered in the Bank's review:

1. What, if any, follow-up has been given since the change in methodology ten years ago to determine if it is being abused by exporters?

2. Has there been any review to determine what and how many items included in a contract that have less than 85 percent domestic content?

3. What is the domestic content of individual items in a contract?

4. How many U.S. jobs have been negatively impacted by permitting Bank support for individual items that are below the 85 percent domestic content requirement?

The Bank also relies on self-reporting by exporters with respect to the domestic content of their goods and services. Inquiries by the Bank concerning the domestic content of materials, parts, and components from prime manufacturers and their suppliers are limited. Inquiries into sub-tier suppliers are practically non-existent. The Bank's review should raise a number of questions regarding how its self-reporting system may have a negative impact of its support for U.S. jobs:

1. How reliable are exporters in providing their own reports on domestic content?

2. Does the Bank follow-up to ensure that reports are accurate, before transmitting funds?

3. Does the Bank audit shipments to verify that reports concerning content are accurate?

4. What other methods could the Bank employ to ensure that domestic content calculations are verified before financing is approved and when a shipment occurs?

The Bank has also adopted its co-financing policy to accommodate exporters that rely on foreign parts and components:

> "One-Stop-Shop" arrangements allow products and services from two (or more) countries to benefit from a single ECA financing package. Without co-financing, the parties would have to make separate financing

arrangements with two (or more) ECAs to ensure support for exports from various countries. The country with the largest share of the sourcing and/or the location of the main contractor will generally determine which ECA leads the transaction. [http://www.exim.gov]

In addition to analyzing how its flexible standard in applying domestic content negatively impacts domestic employment, the Bank should also include in its review how its policies can be reconciled with the standards set by the Federal Trade Commission (FTC). According to the FTC:

> "A product that is all or virtually all made in the United States will ordinarily be one in which all significant parts and processing that go into the product are of U.S. origin. In other words, where a product is labeled or otherwise advertised with an unqualified "Made in USA" claim, it should contain only a de minimus, or negligible, amount of foreign content….in order for a product to be considered "all or virtually all" made in the United States, the final assembly or processing of the product must take place in the United States."
> [http://www.ftc.gov/os/1997/12/epsmadeusa.htm]

None of the questions asked by the Bank in its review, capture the concerns that are expressed above. Even more troubling, the proposals suggested by exporters that are included in the Bank's review appear to be wholly inconsistent with basic understandings of domestic content (as understood by the FTC and the general public).

The exporters' suggestions reflected in the review promote the fiction that foreign content is domestic content. If implemented, they would be devastating to U.S. workers and cripple the Bank's jobs mission. Many of their suggestions would give U.S. companies more incentive to ship U.S. jobs and technology to other countries and raise serious questions:

1. Consider all components from sub-suppliers who are U.S. manufacturers to be 100 percent made in the U.S., even if the components (or the materials like steel used in them) are made in China, Mexico, South Korea, Brazil, or anywhere else in the world?

2. Permit actual foreign parts and components (e.g., foreign tires and other goods) to be magically transformed into domestic content if they are incorporated into U.S. production, even if they constitute as much as 10 percent of the export's value, which in some cases could be millions of dollars?

3. Consider that U.S. ownership of a license constitutes U.S. content regardless of where the work regarding a contract is performed?

4. Accept that if the exporter contract holder's nationality is U.S., the entire contract's product will be considered to be domestic, regardless of its actual domestic content?

5. Allow a certification of "intent" to employ U.S. workers as sufficient evidence of U.S. content, regardless of whether U.S. workers will actually perform the work in the contract and regardless of whether U.S. workers already perform the work?

6. Consider that the product in the contract is domestic even though 49 percent of it is foreign?

7. Permit exporters to consider parts and components from China, Mexico, South Korea and elsewhere in the world as made in the U.S., if the same goods produced by U.S. workers would be 25 percent more expensive?

Each of these proposals is based on a fiction that foreign content is domestic content, would displace hundreds of thousands of U.S. manufacturing and service jobs, and give businesses greater incentives to ship jobs off shore.

The Bank's proposal that it permit exporters maximum financing support even when its goods have a domestic content that is 25 percent lower than required, as long as it is in the process of returning or moving export-oriented production to the U.S., would have the exact opposite result of what the Bank claims it would do: it would reward companies for previously transferring work outside the country; permit them lower domestic content even after they have already decided to move work back; presume that the exporter will continue with their U.S. production after receiving the Bank's financing; and, create unfair competition for other U.S. exporters and suppliers who have kept their production in the U.S..

Some exporters have argued that the Bank should be financing a greater percentage of foreign content in their exports so that the Bank can be competitive with other countries' ECAs. This overlooks the fundamental mission of the Bank, to support U.S. jobs—a mission that is not shared by other ECAs because their countries, unlike the U.S., have adopted national policies to create and retain jobs. It also overlooks the simple fact that other ECAs are <u>private</u> institutions which have adopted a business model that competes with the private sector and that do not share the same public policy goals as the Ex-Im Bank.

Statements that the Bank is not competitive with other ECAs should be dismissed. After all, year after year, the Bank has been found to be highly competitive with other ECA's. It's recent Annual Competitiveness Report again gave the Bank very high marks. Moreover, the Bank seems to have no problem finding demand for its loan capacity, having another record-breaking year.

Some exporters claim that lowering domestic content requirements and raising the amount of foreign content that is supported by the Bank will support U.S. jobs. They argue that this change in policy will increase export sales which will, in turn, support more U.S. jobs. There is no empirical support for this proposition. Rather, their claim is based on speculation with respect to the reasons why they lost a sale. In contrast, there is ample empirical support that if exporters are required to make products here, in return for the Bank's financing, they will do so. Indeed, the Bank claims that in 2011, its transactions supported "an estimated 290,000 American jobs at more than 3,600 U.S. companies." http://www.exim.gov/about/library/reports/annualreports/2012/

There is also ample empirical support showing that companies will move work to other countries if they have incentives to do so. These incentives may take the form of tax benefits, trade agreements, and other countries' industrial policies that encourage the transfer of U.S. production and technology in return for market access. See, http://www.epi.org/blog/signing-trade-deals-terrible-jobs-strategy/; http://www.epi.org/publication/bp201/

The Bank should take the opportunity during its domestic content review to examine how it can strengthen its current policy—not weaken it. Suggestions that the Bank reduce its content requirements and adopt a fiction that foreign parts, components and services qualify as domestic content should be dismissed. If they are adopted, they would undermine the Bank's mission to support U.S. jobs. They would also impede the President's efforts to "stop rewarding businesses that ship jobs overseas and start rewarding companies that create jobs right here in America."