A Conversation with Fred P. Hochberg

Strains of Globalization Buffet Trade, Financing of Export-Import Bank

Fred P. Hochberg just concluded an eight-year tenure as the chairman and president of the Export-Import Bank of the United States. He discussed the bank and the outlook for trade during an appearance at the Houston Branch as part of the Federal Reserve Bank of Dallas' Global Perspectives speakers' series.

Q. What is the Export-Import Bank?

The Ex-Im Bank was started by President Roosevelt in 1934 and does two basic things. First, it levels the playing field when U.S. companies are competing against foreign companies and need financing to close the sale. If the government of China or Germany or France is providing financing, we make sure that U.S. companies are similarly armed so that they can compete on a level playing field.

Take wide-body commercial aircraft for example. Global airlines have a choice between Airbus or Boeing—that's it. We want to make sure that when they are making a decision they are going to purchase the equipment that's right for them, not because the ex-im banks of Germany, France and the U.K. are providing financing to Airbus and we're not.

The second thing we do is fill private-sector financing gaps. About two-thirds of the lending we do is in developing economies, and that is where there is just not the financial capacity.

To stick with aircraft as the example, we have worked on financing for Ethiopian Airways. Given the state of Ethiopia's economy, and its status as one of the lowest-income countries in sub-Saharan Africa, the capital markets are not there to support those purchases. The airline is a major moneymaker for exports and trade and tourism and business, so we are filling that market gap as the company and country grow and build their credibility with private lenders.

Q. What void do you fill by providing financing?

Well, Boeing is an aircraft company; they are not in the finance business. The same goes for all of our major manufacturers. We want them investing in R&D, and building their supply chains, not financing their customers' purchases. Many people have said—and it's anecdotal—that one of the things that actually hurt McDonnell Douglas [later absorbed by Boeing] many years ago was that they were actively financing their purchases and not putting money into R&D. As a result, they ultimately had an obsolete product.

On the other end of the spectrum, 90 percent of the companies we work with are small businesses. I ran a small business, a family business [Lillian Vernon Corp.], and small businesses have a couple of strikes against them. One, they are small, so banks don't like to deal with them, and they (the banks) don't make enough money. Two, if they are exporting, their banks or insurers are frequently reluctant to provide working capital to a company with any amount of export sales, so we fill in that gap for them.

Q. The bank is part of the executive branch, yet operates under congressional oversight. How does that work?

Every four or five years, Congress gives us the authority to make loans and guarantees, and we collect revenue and put aside a loan loss reserve, like any responsible institution. Congress then says, [from] what's left over, we will let you retain about $100 million to run the place, and the rest goes to the taxpayer.

Since I have been at the bank [in 2009], we sent [to taxpayers] $3.8 billion in cash. Think of it in terms of your own business: you start with sales, subtract all costs and what's leftover is referred to as profit.

You know what they call that in the federal government? Negative subsidy.

Q. What's the biggest misconception about trade that you see right now?

I think people confuse trade with outsourcing. They have nothing to do with each other, but they confuse it with outsourcing. I wish we did not call it free trade. I wish we called it fair trade, because goods come into our market with very low tariffs, very low requirements.

When you have a trade deal, some industries and some products will become less competitive because they will have more foreign competition. So you have to have a belief that if you have fewer barriers, less friction, ultimately we will do better because we are a very innovative society. We have relatively inexpensive power, we have good rule of law, a well-trained workforce—our infrastructure could be better but it's still better than many places. So all things being equal, we will do much better.

Q. What's the Ex-Im Bank's impact in Texas?

Well, I counted it up, I visited Texas 11 times as chairman; I came to Houston nine of those times.

This is a major exporting hub. One great expertise we have as a country is our knowledge in oil and gas and energy. That is one of our strongest export categories, whether it be power, whether it be equipment used in oil and gas operations, whether it be LNG (liquid natural gas). That's why I have been here.

Q. Mexico is Texas' biggest trading partner, much of it cross-border manufacturing. What has that relationship meant?

One of the views has been that between Canada, the U.S. and Mexico,

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there are a half-billion people. If we can get more integrated on manufacturing, innovation and product development, we could become a much better counterweight to Asia than if we all try and go in alone.

And the barriers are really more political than they are commercial or economic.

The world is more integrated from supply chains than it has ever been, and yet countries around the world are becoming more nationalistic and more tribal and putting up more barriers. And maybe it's just simply the changes happen so fast that people are unable to absorb it at the rate of speed it's been happening. The benefits of an integrated market are spread widely. People have argued that the benefits of globalization and integration between Canada and Mexico adds about $10,000 worth of purchasing power to each American household, which is a lot.

Q. How has trade become such a hot-button issue?

The downsides [of trade] are narrowly based, because somebody loses their job or a factory closes, but part of that is also mixed up in automation. Part of that is mixed up in the fact that trade is an easy thing to blame, but I think a lot of it has to do with other factors.

There was an article about a textile mill that closed down, laying off 4,000 employees. Then Marriott Corp. decided to make all of its towels in the United States, to bring that work back. But the plant will only hire a few hundred employees. So it's not about trade; things are being automated.

Q. When you see companies that are deciding to hold off on locating a plant in Mexico and saying they are going to keep these jobs in the United States, what's your reaction?

At the end of the day, companies need to make economic decisions by which they can deliver goods to the marketplace at a price the market will pay for them.

We are actually seeing an on-shoring of many jobs. I mean, there are companies that had moved to China that are now moving back to the United States. As costs have gone up in China, and the fact that we are automating factories here, it has made more and more economic sense to actually do the work here because the labor portion that might be relatively expensive is a smaller and smaller percentage of the cost of goods.

We are going to get to a point, for example, where, if you want to order a pair of Nike sneakers, you can decide what it looks like, what the color is, and they will deliver it in 24 or 48 hours. As we get to that, we are going to have more manufacturing close to the consumer, because they are going to locate that factory next to the FedEx hub or next to the UPS hub, not 8,000 miles away and put it on a boat that takes 25 days to get here.

Q. The Ex-Im Bank operated without a full board and was thus limited to loans not to exceed $10 million for the past few years. What was the impact?

Well, we have lost a number of transactions. We have lost three satellite transactions that went to France, because France is our main competitor when it comes to satellites. And when it comes to satellite launches, we compete with France, China and Russia. So if we can't finance them, they will go to China and Russia or France.

In the satellite space, we were doing in the range of a $1 billion a year in satellite and satellite launches financing. Commercial satellites are a major U.S. industry. We have a real competitive edge, and they are very hard to finance. So we lost some satellite transactions. We lost a number of [sales of] aircraft that put Rolls-Royce engines on them instead of GE engines.

And the impact of that is very long term. I mean, it's a little bit like the Gillette razor—it's not the razor, it's the blades [that are the profit maker], and if you buy a GE engine versus a Rolls-Royce engine, you have got 20 years of maintenance that will exceed the acquisition costs. So this is having a pronounced impact.

Q. What are the prospects for global trade?

Global trade was at one point growing at about two times global GDP. So if the global GDP was growing at 5 percent, global trade was growing 10 percent. In the last few years, all of a sudden, global trade instead of growing at two times global GDP is growing at about half, and we are still trying to figure out why. My hunch would be that part of it is because the oil industry has slowed down.

We have a lot more digitization, so a lot of transactions are really happening digitally and over the internet, so there is less transfer of goods.

We are also finding that the era is over when a U.S. company could make things here, open a small sales office in Addis Ababa or Johannesburg and have a salesperson and two or three people, and that was all it needed in that country to have a foothold. If you are going to sell farm equipment, rail, power equipment, countries now say, 'Well, that's all great, but we want you to set up the manufacturing in our country.'