FOR most of its 80 years, America’s Export-Import Bank has laboured in obscurity, providing loans, loan guarantees and credit insurance to foreign buyers of American products from jumbo jets to quiche. All of a sudden, it is in the spotlight: Tea Party conservatives have declared it to be the embodiment of corporate welfare. Republicans are threatening to block reauthorisation of the bank when its mandate expires on September 30th.

The fight over ExIm has drawn rare attention to one of the most pervasive and enduring instruments of mercantilism in the world trading system. Export-credit agencies got their start early last century. Britain’s, established in 1919, was part of an effort to improve its balance of payments and thus return to the gold standard. America’s ExIm Bank was originally conceived as an instrument of foreign policy, to provide leverage over the Soviet Union and support for Cuba.

The global financial crisis gave such banks a new lease of life. When banks pulled back from trade finance after Lehman Brothers collapsed in 2008, governments prodded their export agencies to fill the gap to prevent a bigger fall in trade volumes. Official export credit extended by the G7 alone soared from $35 billion in 2007 to $64 billion in 2009, and has remained around those levels since (see chart below).

Subsidised loans for exports have long been recognised as a form of mercantilism, which is why rich countries struck a gentlemen’s agreement in 1978 to curb them. Signatories to the “OECD arrangement” agree to maximum loan maturities, commercially-based interest rates and minimum risk premiums for insurance. When one signatory strikes a financing deal, it notifies the others, giving them the opportunity to match the terms.

Given these safeguards, many advocates say official export credit is not really a subsidy at all but simply compensation for a market failure. Banks are reluctant to provide long-term export financing, to lend to countries with shaky political or legal regimes, or to small businesses, even more so since new capital standards have made such loans costlier. Export-credit agencies simply fill an unmet need—and their profits prove it.

These arguments are suspect. The scarcity of private financing for certain exports reflects genuine
risks that taxpayers are forced to assume. The profit earned by lenders may simply reflect the advantages that come with being part of the government. The Congressional Budget Office reckons that if ExIm’s future revenue were discounted using the interest rate paid by the Treasury (the bank’s main source of funding), it would make a profit of $14 billion over the next decade. But discounting at market rates would turn that into a loss of $2 billion. This is far less than the implicit cost of federal student and mortgage loan guarantees. But it does not suggest ExIm has found lucrative untapped opportunities.

Even if export credit is a subsidy, advocates say it is unavoidable. Any high-minded country that refuses to subsidise exports simply surrenders sales, jobs and income to countries with no such qualms. If ExIm stopped financing sales of Boeing aircraft, the argument runs, either Airbus would grab market share, or Boeing would move production to another country that did finance those sales. This line has been trotted out in recent years as a growing share of export finance takes place outside the OECD arrangement. Two factors are at work. First, many OECD members are using instruments not covered by the arrangement, such as floating-rate loans linked to Libor, and “untied” development aid that implicitly, but not explicitly, pays for the donor country’s exports, as is common with Japan’s lending.

The China syndrome

The second factor is the surge in lending by countries outside the OECD, above all China. ExIm reckons that China’s official export credit last year amounted to $45.5 billion. Adding in untied aid, project finance and other surreptitious forms of export credit boosts the total to $111 billion, more than a third of the global total. China regularly offers easier terms than the OECD arrangement would allow. Other countries feel obliged to match them, as ExIm Bank did in 2012 for a Pakistani purchase of locomotives.

Ordinarily, export subsidies are a bad bet even if used to match another country’s handouts. The resources used to provide the support must either come from distortionary taxes or borrowing, which in normal times would raise interest rates and crowd out private investment. Industries receiving the boost would also absorb capital and labour that might be more productively used elsewhere. Unless foreign subsidies create some market failure (by threatening to destabilise an industrial cluster, for instance) the least harmful course of action may be to accept the foreign government’s largesse.

At present, with the world awash in savings and interest rates stuck near zero, the case against subsidies is a little murkier. Subsidising exports may boost demand for domestic production, leaving
the country better off—unless, of course, every country does the same, in which case no one gets an advantage.

The World Trade Organisation discourages protectionism by permitting a country hurt by another's subsidies to raise tariffs in retaliation. But this is of limited use with export credits because the victim is neither the importer nor the exporter, but a third country whose exports are artificially suppressed. That country would accomplish nothing by raising tariffs.

The world would be better off without subsidised export credits. Failing that, the best solution would be for the OECD arrangement to cover more types of lending and more countries (OECD membership is not required to be a party to the agreement). Though America had hoped that by this year that China would agree to “international guidelines” on export credits, there is no sign yet. In the meantime, American companies will fight hard to keep ExIm Bank alive. They will likely succeed.

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