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Leasing Services

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PREFACE

In 1991 the United States International Trade Commission initiated its current Industry and Trade Summary series of informational reports on the thousands of products and services imported into and exported from the United States. Each summary addresses a different industry area and contains information on U.S. and foreign producers, trade barriers, and industry trends. Also included is an analysis of the basic factors affecting trends in consumption, production, and international trade.[1]

This report on leasing services covers the period 1989 through 1993 and represents one of approximately 250 to 300 individual reports to be produced in this series during the first half of the 1990s. Listed below are the individual summary reports published to date on services industries.

USITC publication number	*Publication date*	*Title*
2456	November 1991	Insurance
2569	October 1992	Advertising
2594	February 1993	Legal Services
2638	June 1993	Commercial Banking
2864	March 1995	Leasing Services

[1] The information and analysis provided in this report are for the purpose of this report only. Nothing in this report should be construed to indicate how the Commission would find in an investigation conducted under statutory authority covering the same or similar subject matter.

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INTRODUCTION

This summary covers leasing services as they relate to the leasing of tangible personal property, generally in the form of new or reconditioned equipment; this summary does not cover services associated with the leasing of real property. Leasing services are provided by a variety of firms, including banks, insurance companies, original equipment manufacturers, and independent firms that specialize in leasing. Because of the significant differences between the players in the industry (e.g., manufacturers vs. banks) and wide variations in the level of involvement of individual firms in providing such services, there is no clearly defined "leasing services" industry as there is in the case of certain other services industries (e.g., accounting services and architectural services industries). Tangible personal property leasing almost always involves a written contract by which the owner of property (the lessor) grants to another (the lessee) the right to possess, use, and enjoy the property for a specified period of time in exchange for periodic payment of a stipulated price, generally referred to as rent.[1]

Leasing may in many instances be more advantageous than an outright sale to both the lessor and the lessee. For example, for a manufacturer-lessor, in the case of a multi-year lease, it may serve as the equivalent of a sale and lead to "sales" that would not have been made but for a lease transaction. As discussed later, it may also have tax benefits for the lessor. For a lessee, leasing may serve as an alternative to seeking new bank loans (and adding to balance sheet debt) to finance new equipment purchases; and for new or highly-leveraged firms with high borrowing costs and limited access to capital, it may serve as the least expensive way to acquire equipment. For lessees requiring equipment for only part of its useful life, leasing eliminates the task of having to dispose of the equipment as well as the risk that, because of technological developments or changed market conditions, the equipment will have a less-than-anticipated residual value.

This summary describes in broad form the basic legal and financial framework of leasing in various national markets; the adverse effects of economic recession on leasing; current market conditions in the U. S., European, and Japanese leasing industries; international attempts to create more standardized leasing contracts; the growing importance of leasing in less developed countries; and the comparative importance of leasing in international trade.

[1] For a definition of the term "lease," particularly as it pertains to the lease of tangible personal property, see *Black's Law Dictionary*, 6th ed. (1990), p. 889.

Dimensions of the Market and the Theory of Leasing

The global market for leased equipment was about $323 billion in 1992. The United States was the largest national market at roughly $120 billion.[2] It is estimated that about 32 percent of all new capital equipment put into service in the U.S. economy is under lease, including computers, motor vehicles, rail cars, sophisticated medical equipment (such as body scanners and electronic resonance machines), aircraft, and telecommunications satellites.[3] The size of the 10 largest national leasing markets globally is shown in table 1. Table 2 indicates the 10 largest leasing firms globally and their volumes of business. All these firms are based in the United States, Europe, or Japan. The two largest firms are headquartered in the United States.[4]

Leasing rests on the distinction between the legal ownership and the day-to-day use of an asset. This distinction often permits differing tax and accounting advantages to accrue to owners and users of equipment or property, and is the historical basis of the leasing industry. For example, a lessor (owner of equipment) may desire tax offsets that can be gained from depreciation schedules on equipment it owns. A lessee (user of equipment), conversely, may need to finance new equipment. Tax laws in many countries permit the rental payments for leases to be deducted from taxable income as business expenses. In contrast, interest payments on loans from banks and other traditional sources may not be deductible expenses.[5] Similarly, money paid by lessees for leasing equipment does not have to be reported in annual financial accounts in the same way as money borrowed from banks. The latter are considered debts for accounting purposes, while the former are merely regularly incurred rental payments. Thus, leasing is often an off-balance-sheet type of financing.

[2] *World Leasing Yearbook, 1994*, Euromoney Publications, London, U.K., p. 3. U.S. figures refer only to equipment leasing, including vehicles. Some global figures, especially for the European market, also include real estate leasing.

[3] Ibid.

[4] The leasing arm of the Ford Motor Company, Detroit, has never made public its leasing volume or asset figures on a global basis. The leasing firm called USL Capital is one part of Ford Financial Services, the Ford Motor Company's global financial arm, and covers only a part of Ford's domestic leasing services. USL Capital's FY 1993 leasing figure was listed as $2 billion. Additionally, Ford Credit Europe PLC (United Kingdom) listed its European leasing business in FY 1993 as $2.5 billion. Thus, if the worldwide leasing business of Ford Motor were publicly known, it would likely be among the five largest companies in the global leasing industry.

[5] Alternatively, interest tax depreciation rate schedules may be lower, or slower to take effect, than leasing ones.

Table 1
Ten largest national leasing markets, ranked by volume, 1992

Rank order	Country	Annual volume	Growth 1991-92	Percentage of new capital equipment under leasing
		(Billion dollars)	*Percent*	
1	United States	120.30	0.0	32.0
2	Japan	62.67	(11.7)	7.5
3	Germany	31.67	15.0	16.6
4	France	14.22	(14.4)	14.6
5	Italy	12.76	(30.5)	11.5
6	United Kingdom	12.28	(31.0)	18.6
7	Republic of Korea	8.45	28.0	20.0
8	Spain	6.36	(28.6)	17.5
9	Canada	4.81	27.7	11.0
10	South Africa	4.44	16.0	(1)
	Total[2]	277.96	(3)	(3)

[1] Not available.
[2] Total global annual volume for the 50 largest national markets was $323 billion.
[3] Not applicable.

Source: *World Leasing Yearbook, 1994,* Euromoney Publications, London, U.K.

Table 2
Leasing: World's 10 largest leasing companies, by annual business volume, FY 1992-93

Rank	Company and national domicile	FY93	FY92	Change
		(Billion dollars)		*(percent)*
1	GE Capital (U.S.)	13.8	11.1	24.3
2	General Motors Acceptance Corp. (U.S.)	12.7	(1)	(1)
3	Orix Corporation (Japan)	7.9	6.5	21.5
4	Lombard North Central/ National Westminster Bank (U.K.)	5.8	5.4	7.4
5	Societe Generale (France)	5.1	6.0	-15.0
6	Daimler-Benz (debis) AG (Germany)	4.8	4.4	9.1
7	Credit Lyonnais (France)	3.9	4.5	-13.3
8	KG Allgemeine Leasing GmbH & Co. (Germany)	3.6	3.4	5.9
9	AT&T Capital Corporation (U.S.)	3.5	3.3	6.1
10	GEFT - Leasing GmbH (Germany)	3.0	3.5	-14.3

[1] Not available.

Source: *Asset Finance & Leasing Digest,* London, issues of Apr., June, and July/Aug. 1994.

Because tax and accountancy rules are unique to each nation, international cross-border trade in equipment leasing tends to be confined to a few large firms specializing in highly expensive ("big-ticket") equipment such as aircraft or satellites. There is, however, relatively little cross-border leasing trade in volume terms. Rather, international trade in leasing generally entails creating subsidiary companies in foreign jurisdictions, and leasing equipment to foreign nationals through these affiliates. For example, the finance arms of major equipment manufacturers such as IBM use leasing to strengthen their sales in all markets, domestic and international. However, leasing to foreign firms is usually done by the company's subsidiary in the foreign market, not the home office.

Categories of Leases

Equipment leasing has a lengthy history in Europe, but did not become widespread in the United States until after World War II. It was not until the 1960s that leasing began to be recognized as a distinct division of the financial services industry in the United States.

There are many types of leases, each drawn to meet specific needs. A lease separates two distinct sets of rights to an item: ownership and use. The user of leased equipment or property has all the rights and

obligations of ownership with two important exceptions: (1) the lessor retains legal title to the property, and (2) under U.S. and many other national tax laws, the lessor retains the right to use or control any depreciation deductions for the equipment as a business expense.

Two categories of leases predominate, both of which have an important subset.[6] *Operating leases* keep ownership rights with lessors, and give exclusive user rights to lessees, for a specified term. The lessor buys the equipment using its own sources of capital. At the end of the term, the lessor takes back the equipment. Operating leases are thus "true leases" as defined by tax authorities. The lessor can deduct depreciation of equipment over the term of the lease in the manner provided in local tax law. The lessee can deduct rental payments from taxable income as a business expense, as well as avoid having to incur debt or tie up working capital for the initial purchase of equipment. An operating lease also helps a lessee company minimize balance sheet debt, by reporting only the rental payments on leased equipment. The reduced debt may enhance the lessee company's ability to raise financing for other purposes as well as improve the company's attractiveness to investors.

An important subset of operating leases is the *leveraged lease*. Lessors provide an equity portion of the equipment cost (usually from 20 percent to 40 percent), with the remainder borrowed by the lessor from third parties, such as investment banks or insurance companies. These equity holders own the equipment at the end of the lease, and derive tax benefits from ownership. Such leases are usually long term and are used for big-ticket equipment such as aircraft, ships, mainframe computers, and telecommunications satellites. Lessees obtain equipment with little or no immediate cash outlay; the lease is financed by their promise to pay rent over a given period.

The second major lease category is the *capital lease*. Here the lessee actually assumes the benefits and risks inherent in the ownership of the property, but not the actual title. The lessee does this by assuming all the maintenance and servicing responsibilities of the leased equipment, and fully expects to gain actual ownership of the equipment at the end of the lease term. The most important subset of capital leases is the *direct financing or finance lease*. It accounts for about 60 percent of U.S. leasing activity, and is really a conditional sales contract. The lessee is responsible for maintenance, taxes, and insurance for the leased equipment, and takes formal title to the equipment at the end of the lease. The lessee may thus deduct equipment depreciation and interest payments for the lease from taxable income, but unlike an operating lease, may not deduct rental payments as a business expense.[7] Lessors make profits from the financing portion of the lease, and the lease is a full-payout, non-cancellable agreement. Table 3 summarizes these leasing formats.[8]

Importance of Residual Values

As a general rule, operating lease lessors generate significant profits only if they are able to lease the same equipment a second or third time. The value left in a piece of equipment at the end of a lease is known as its residual value. The residual value determines if the same piece of equipment can be re-leased, or sold for a profit. "Profits are in the residuals" is a maxim of the leasing industry. Thus, the initial successful estimation of the realistic residual value of equipment is crucial to the financial success of lessors. Indeed, the most common cause of failure in the leasing industry is overoptimistic residual valuations by lessors.[9] Residual values can change rapidly, both up and down, due to technological change, interest rate changes, or other factors. For example, the residual value of leased computers may fall sharply with the introduction of new, more powerful equipment. On the other hand, lessors of airline equipment who in the 1960s had ordered newer, more fuel-efficient, and quieter aircraft, received an unexpected windfall in the leasing of such equipment in the 1970s after the surge in world oil prices and the implementation of stricter airport noise-reduction requirements. Conversely, those lessors who purchased cheaper, older model planes, such as noisier, less fuel-efficient Boeing 707s, lost money as these planes soon had much lower resale or re-lease value.[10] One industry authority estimates the residual value of various types of leased equipment to be, on average of original value, as follows:[11]

Computer systems	5 to 10 percent
Commercial aircraft	10 to 15 percent
Trucks and buses	15 to 20 percent
Rail cars	20 to 25 percent
Specialized manufacturing equipment	12 to 15 percent
Other industrial equipment	15 to 25 percent

[6] *U.S. Equipment Leasing Market*, The Breckling Company, Cleveland, OH, 1992.

[7] Ibid.

[8] For a learned explanation of U.S. accounting rules as they apply to leases, and extensive definitions of various leases, see Jan R. Wilson, *GAAP Guide 1994, A comprehensive restatement of all current promulgated Generally Accepted Accounting Principles*, New York: Harcourt Brace & Company, 1994, pp. 28.01-28.63.

[9] *Equipment Leasing Today*, Apr. 1994.

[10] The Breckling Company, 1992.

[11] Ibid.

Table 3
Summary of major leasing types

Lease type	Percent used in U.S. market, 1993[1]	Benefits derived by lessor	Benefits derived by lessee	Owner of equipment when lease expires	Duration
Operating lease	16	• Owns equipment. • Can deduct depreciation from taxes.	• Can deduct rental payments of equipment from taxes. • Avoids use of large sums of capital for initial purchase of equipment.	Lessor	Often short term
Leveraged lease	11	• Lessor provides 20-40 percent of finance for equipment purchase. • Receives tax benefits from ownership of equipment via depreciation allowances or investment tax credits.	• Same as for operating lease.	Lessor equity holders	Often long term
Capital lease Direct finance lease	60	• Profits made from financing terms. • Full pay out, non-cancellable agreement. • Lessee responsible for maintenance, taxes and insurance. • Lessee agrees to use equipment for 75-90 percent of its estimated economic life. • Tax efficient.	• A conditional sales contract, rather than a true lease. • May deduct equipment depreciation from taxes. • Avoids use of large sums of capital for initial purchase of equipment.	Lessee	

[1] Remainder accounted for by other types of leases.

Source: *U.S. Industrial Outlook, 1994*, U.S. Department of Commerce, and *1993 Survey of Industrial Activity*, Equipment Leasing Association of America, p. 7.

Varieties of Leasing Companies

There are three basic types of leasing companies.

Captive lessors, also known as vendors, are equipment manufacturers who have leasing subsidiaries to support the marketing of the parents' products. Examples include IBM Credit Corporation for computers; Xerox Credit Corporation for office machines; both Ford (Motor) Financial Services and General Motors Acceptance Corporation (GMAC) for automobile, truck, and bus leasing; and Caterpillar Financial Services Corporation for heavy construction equipment. Many captive lessors also have become major third-party sources of finance for leveraged leases of equipment not made by their parent companies. Such firms include AT&T Capital, ADP Credit Corporation, Chrysler Financial Corporation, McDonnell Douglas Finance Corporation, and Pitney-Bowes Credit Corporation.

Independent lessors are exclusively third-party lessors. The group is highly diverse, ranging from financial service firms, to leasing specialists, to the financial subsidiaries of industrial corporations. About one-third of independents are "full-service" lessors, which lease a wide range of equipment. The largest leasing company globally, GE Capital, is an independent lessor. It is not tied to leasing only its parent company's products, but leases a wide range of other equipment. It is a major profit center in its own right. Other notable independents among the top U.S. lessors include Comdisco, Bell Atlantic Tricon, and USL Capital.[12]

Bank lessors in the United States were permitted by regulators to enter the leasing market as early as 1963, but generally have been slow to do so because leasing competes with their traditional commercial loan activity. Consequently, banks that have leasing operations generally keep their leasing volumes under $50 million, a small fraction of their loan activity. Still, until 1991 when economic recession saw banks significantly reduce their level of leasing activity, the leasing arms of banks were the second largest third-party lessors, with about 20 percent of the overall U.S. leasing market.[13] In Europe, banks dominate the leasing market, and in Japan they have a predominant, if somewhat indirect, role.

Other Reasons for Leasing

Although tax and accounting rules strongly influence leasing transactions, other factors have become increasingly important in some national jurisdictions. For fast-growing, small, and medium-sized companies, for example, industry observers point out that generating sufficient cash flow to make the lease payments may be considerably easier than obtaining conventional bank lending, which is contingent on a firm's assets or capital base. Other benefits of leasing for the lessee may include:

- *Availability.* In many countries with underdeveloped capital markets, leasing may represent the easiest and most economical means for acquiring new equipment; medium- to long-term financing may not be readily obtained or available on suitable terms.
- *Facilitates equipment modernization.* Leasing provides a means by which a firm in need of state-of-the-art equipment, such as a computer system, can trade up to newer equipment on a regular basis without incurring the risk of an unexpected decline in residual value or the hassle of disposal; at the same time the lessor may be in a better position to economically recycle the original equipment, through sale or a new lease, to another company that has a lower technological threshold.
- *Coverage.* Leasing can provide the equivalent of up to 100 percent financing, whereas bank loans typically provide much less and often require security guarantees as well.
- *Cost.* The overall cost of leasing can be less than conventional bank financing. Although gross interest costs in a leasing contract may be higher, banks often require more collateral, more documentation, other compensating assurances from borrowers, and generally take much longer to process applications.
- *Cash flow.* The pattern and size of lease payments can be tailored to the specific needs of the lessee.[14]

In summary, leasing offers companies an alternative method of financing equipment they need. Leasing tends to be highly specialized and is increasingly dependent on lessors providing their clients not only equipment, but also expertise in wider auxiliary services.

U.S. INDUSTRY AND MARKET PROFILE

There are at least 2,000 to 3,000 firms involved directly in leasing (or indirectly as investors in lessor companies) in the United States.[15] They range in size from individual investors, to small companies, to multibillion-dollar manufacturers, to major financial institutions. Statistics, however, are difficult to compile

[12] USL Capital is a subsidiary of Ford (Motor Company) Financial Services. See footnote 4.

[13] The Breckling Company, 1992.

[14] Jonathan Hakim, ed., "Equipment Leasing," International Finance Corporation Occasional Papers, Capital Markets Series, Washington, DC, 1986.

[15] Individual car leasing, for example, is generally financed through the major automobile manufacturers, not showroom dealers.

because it is hard to track and categorize the many types of equipment leasing transactions. Table 4 profiles the 10 largest U.S. lessors and indicates the widely divergent average valuation of their leasing transactions.

Barriers to entry in the leasing industry are minimal, especially at the small-ticket end of the market. Basically, anyone who can buy a piece of equipment can go into the leasing business. Adding to the ease of entry, there is no formal government regulation of leasing sectors.[16] As a result of low barriers to entry, the industry is highly fragmented; no single lessor has a market share of more than 5 percent and the top 38 firms account for only 30 percent of the market. About 13 firms exceed $1 billion worth of business per annum (i.e., the value of equipment leased in a given year), while at the opposite end of the scale perhaps 1,000 firms write annual business in the $1 million to $50 million range.[17] It is estimated that approximately three-quarters of all U.S. leases are for less than $100,000.[18] As noted, the industry has contracted severely during the past 4 years due to economic recession. Niche marketing, employing lessors' core competencies, and added-value services are recognized by many in the leasing industry as keys to survival.

Leasing employs an estimated 20,000 to 40,000 people in the United States. This is, however, only a rough approximation; it depends on definitions (e.g., what proportion of a bank's staff is devoted to leasing) and to what degree part-time staff are counted in smaller leasing companies.[19] During the recent economic recession, many employees were laid off or lost jobs as leasing firms went out of business. The use of improved technology, including new computer software, also has reduced the demand for leasing professionals. The number of people needed to handle a $50 million sales volume 10 years ago, for example, was greater than the number of people needed to handle a $250 million sales volume today.[20]

Largest U.S. Companies

GE Capital, the Connecticut-based financial services arm of the General Electric Company, is the largest leasing firm in the world. GE Capital was launched in 1932 to facilitate sales of General Electric's refrigerators, but today leases a wide range of products, from aircraft and computer systems to electrical power plants and railway cars. GE Capital and other non-financial firms have become major players in financial markets, and significant competitors to large banks.[21] Fortified by the top credit rating of its industrial parent, and raising funds only from capital markets, GE Capital has survived, indeed benefitted from, the global economic recession of recent years. GE Capital has more than doubled its assets since 1988, pushing them well over $150 billion, and its annual profits amount to nearly $2 billion.[22]

The second largest U.S. leasing company, the General Motors Acceptance Corporation (GMAC), is the financial arm of General Motors. It made public the scope of its worldwide activities for the first time in 1994, reporting a leasing volume of $12.7 billion.[23] The next largest U.S. company, AT&T Capital, trails at a distant third with $3.5 billion.[24]

End Use for Leased Equipment

Figure 1 shows the distribution of types of equipment leased in the United States. The figure reflects a decline in leased aircraft between 1992 and 1993, from 15 percent of all leased equipment to 12 percent, due to the financial difficulties of several commercial airlines. This continues a trend seen since 1991, when aircraft leasing represented 23 percent of all leased equipment. Computer equipment leasing dominated for the second year in a row, capturing approximately 23 percent of the volume of all 1993 leasing activity — about the same percentage as in 1992. Within computer sub-sectors, the trend away from the leasing of mainframes continues, whereas growth is seen in the leasing of small systems, peripherals, and software. Leasing of office machines increased in 1993, representing 10.7 percent of total leasing volume.

Restructuring in Aftermath of the Tax Reform Act of 1986

The U.S. Tax Reform Act of 1986 eliminated or reduced many of the investment tax credits and

[16] Financial institutions are regulated, but not particularly for their leasing activities.

[17] USITC staff interviews with industry representatives, Washington, DC, Jan. 1993.

[18] The Breckling Company, 1992.

[19] USITC staff interview with the Equipment Leasing Association, Washington, DC, Jan. 1993.

[20] Leasing professional recruiter Ron Caruso, as quoted in *Equipment Leasing Today*, Nov./Dec. 1993, p. 23.

[21] GE Capital is also the nation's largest issuer of commercial paper, the largest supplier of private-label credit cards for department stores, and the largest private insurer of home loans. Through its ownership of Employers Reinsurance, GE Capital is the second largest U.S. non-life reinsurer. In 1993 it purchased two other insurance companies, GA Corporation and United Pacific Life, each with $6 billion in assets. It owned the securities firm Kidder Peabody until 1994, and also paid more than $2 billion to acquire the Chicago-based Kemper Insurance Company.

[22] *The Economist*, Apr. 30, 1994, Survey on International Banking, p. 13.

[23] *Asset Finance & Leasing Digest*, London, Apr. 1994, p. 10.

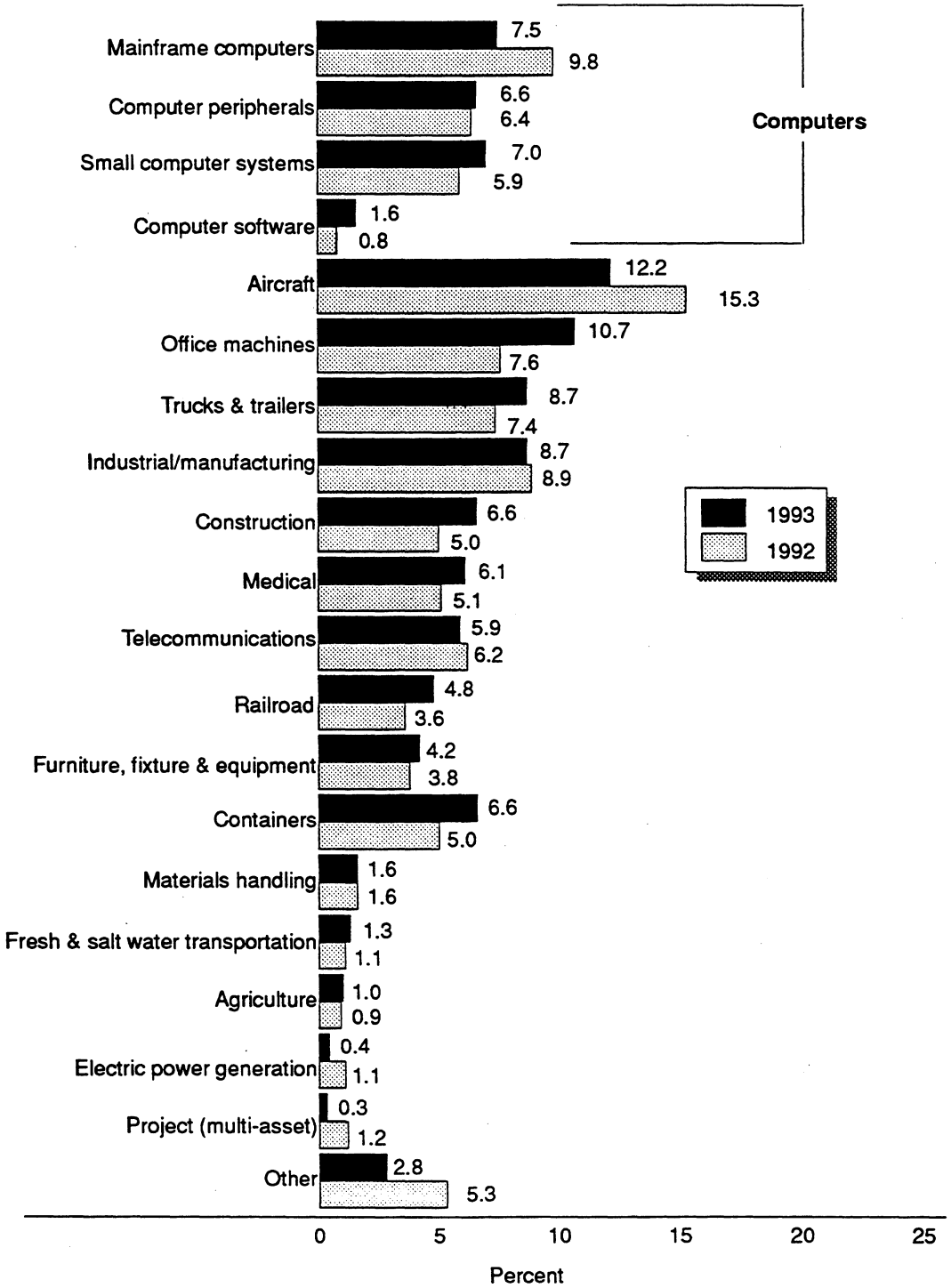
[24] See footnote 4, however, on the Ford Motor Company.

Table 4
Ten largest U.S. leasing companies, ranked by annual volume, 1993

Company	Equipment specialty	Gross value of leasing	Annual volume	Annual no. of leasing contracts	Average transaction size in dollars
		Billion dollars			
GE Capital Corp. Stamford, CT	Aircraft, trailers, computers, cars, cogeneration facilities, electronics, medical	38.8	13.8	30,000	350,000
General Motors Acceptance Corp., Detroit, MI	Autos, vehicles	15.2	12.7	717,500	17,680
AT&T Capital Corp. Morristown, NJ	High technology and transportation	6.2	3.5	477,825	NA
IBM Credit Corporation Stamford, CT	Computers	6.2	2.2	NA	NA
USL Capital (Ford Motor subsidiary) San Francisco, CA	Manufacturing, aircraft, rail vehicles, computers, communi-cations	4.9	2	NA	NA
Caterpillar Financial Services Corp. Nashville, TN	Earthmoving, engines, lift trucks	3.5	2	17,121	115,000
Mercedes Benz Credit Corp., Norwalk, CT	Vehicles and equipment made or distributed by Daimler-Benz	4.8	1.8	31,300	55,000
Comdisco Inc., Rosemont, IL	Computers, medical	3.9	1.7	6,200	50,000
Citicorp North America Inc. Harriston, NY	Railcars, aircraft, trucks, computers, materials handling, telecommunications	3.5	1.4	44,350	NA
Hewlett-Packard Finance Sunnyvale, CA	Computers	1.2	1.1	15,000	70,000

Source: *Asset Finance & Leasing Digest,* Apr. 1994.

Figure 1
Distribution of U.S. annual leasing volume by equipment type, 1992 and 1993[1]



[1] This figure has several limitations. For example, neither brokered leasing business nor automobile leasing is included due partially to the makeup of the membership of the Equipment Leasing Association, which compiles the information, as well as other factors. The numbers do reflect, however, available data for broad categories of leased equipment in the United States. Due to rounding, figures exceed 100 percent.

Source: *Survey of Industry Activity 1993*, Equipment Leasing Association of America, June 1994.

accelerated depreciation allowances that made equipment leasing an attractive financial option.[25] As a result, the leasing market underwent a fundamental restructuring. Many lessors either withdrew from the market or merged with other companies. Others were more aggressive and continued to be profitable by exploiting their technical expertise, knowledge of specialized equipment, financial sophistication, and by offering additional peripheral services. The leasing market continues to benefit, however, from the existence of the U.S. Alternative Minimum Tax (AMT), which requires all companies to pay some tax. The AMT can sometimes be avoided by using operating leases.[26]

Current State of Market

Economic recession hinders the equipment leasing business. As U.S. economic activity decreased during 1989-1992, businesses tended to conserve capital or avert new costs by delaying investments in new or additional equipment. Margins tightened on all transactions. Some lessees went out of business, leaving lessors with excess equipment whose residual value had decreased due to low demand. Independent lessors had trouble raising capital; many small lessors withdrew from the market. Captive lessors, conversely, used favorable leasing finance rates to stay in business or increase their parent firm's market share, thus effectively discounting equipment prices and depressing further residual values for used equipment. The leasing arms of both banks and manufacturers, lacking acceptable levels of financial return on leasing, or with trouble in the core business, were motivated to retrench. Thus, for example, when Westinghouse Credit lost nearly $1 billion in 1990, it was liquidated by its parent company.[27] Only one U.S. bank, Citicorp, remains among the top 10 U.S. leasing companies. Until late 1994, on the international side, U.S. banks became more notable for their withdrawal from foreign leasing markets than their bullish expansion of previous years. An example is Chase Manhattan's sale of its small-ticket portfolio to Spanish-based Hispamer in 1991. Chase became more of a packager than a lessor.[28] Packagers are brokers who arrange leveraged leases for other investors.

Table 5 indicates the broad adverse effects of recession on the U.S. leasing market. After typical 8 percent to 15 percent rates of expansion in the early 1980s,[29] U.S. leasing activity nosedived in 1990 and has been relatively flat since.

On the customer side, some big-ticket lessees are in considerable difficulty. An example is the airline industry.[30] Table 6 indicates the importance of leasing to the U.S. commercial airlines. The U.S. and global aviation markets were badly hurt in recent years by the fall-off in business due to the global recession, the 1992 Gulf War, continued ticket fare wars (precipitated partially by airline carriers in Chapter 11 bankruptcy status), and regulatory factors. Carriers cancelled or postponed equipment orders, leaving both aircraft manufacturers and aircraft lessors with excess capacity. The Ireland-based GPA Group, for example, was the global leader in aircraft leasing in 1992, but was forced to restructure.[31] In late 1993 GE Capital bought 45 of GPA's aircraft for $1.35 billion and took over management of the firm's fleet. The operation was put under the umbrella of GE Capital Aviation Services, which, with over 900 aircraft on lease globally, made it a powerhouse in both operating and finance aviation leasing.[32]

New regulations affecting aircraft noise have compounded the aircraft leasing industry's difficulties. U.S. law, for example, will require that most noisier "Stage II" aircraft be replaced by quieter Stage III planes in 1999.[33] While some of the older aircraft can be sent to emerging markets with fewer noise restrictions, only 10 percent of the global airline fleet is

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[25] Intense leasing activity, for example, was encouraged by the introduction of the so-called "Safe Harbor" provisions of the 1981 tax law. Similarly, international trade in leasing was promoted when lessors/lessees could take advantage of tax breaks for leasing in more than one country, a process known in the leasing industry as "double-dipping."

[26] This is possible because rental payments for equipment financed through such leases are not defined as tax preference items in the U.S. tax code. These items would add to ordinary taxable income, and thereby increase AMT obligations. The Breckling Company, 1992.

[27] *The Economist,* Apr. 30, 1994, Survey on International Banking, p. 13.

[28] *Asset Finance & Leasing Digest,* Apr. 1994, p. 12.

[29] U.S. Department of Commerce, *U.S. Industrial Outlook,* various years.

[30] In late 1992, global aircraft lessors had 2,155 aircraft under lease and made investments in excess of $17 billion for aircraft acquisitions worldwide, either by buying new aircraft or refurbishing older ones. In the United States, 58 percent of domestic operating aircraft are leased. At the same time, given expected high growth rates in Asia and Latin America, the International Civil Aviation Organization expects that 11,000 more aircraft will be acquired worldwide, at a value of some $800 billion, by the year 2010. Although leasing can assist the financing of this boom, the global restructuring of airlines makes lessors wary. In August 1994, for example, 30 aircraft lessors met to discuss the threat by the Brazilian airline, VARIG, to stop making leasing payments on its fleet. The lessors were concerned that other airlines could make such threats to a lessor, in the knowledge that many other lessors would be interested in the business offered. Lessors thus worried that they might be picked off one by one. Lessors wanted to make it clear to airlines that they intended to cooperate to a much greater degree, consistent with anti-trust rules, to manage such threats.

[31] See *The Economist,* Mar. 6, 1993, p. 5.

[32] *Equipment Leasing Today,* Apr. 1994, p. 23.

[33] Ibid.

Table 5
U.S. equipment leasing trends, 1988-94

Items	1988-89	1989-90	1990-91	1991-92	1992-93[1]	1993-94[2]
			Percent change			
Equipment[3]	11.3	-0.8	-3.3	1.2	2.8	3.0
Business investment in all equipment[4]	5.0	6.2	-3.3	1.2	2.8	3.0

[1] Estimate.
[2] Forecast.
[3] International Trade Administration (ITA) estimates of original cost of equipment leased during each year, based on survey data from the Equipment Leasing Association of America.
[4] Private nonresidential investment in producers' durable equipment.

Source: U.S. Department of Commerce, Economics and Statistics Administration, Bureau of Economic Analysis. Estimates and forecasts by U.S. Department of Commerce, International Trade Administration.

Table 6
U.S. commercial airline fleet leases, 1990

Airline	Fleet	Leases
	— *(Number of planes)* —	
Operating airlines:		
Alaska Air Group	113	93
America West Airlines	108	[1]60
American Airlines	552	315
Continental Airlines	340	245
Continental Commuter Subsidiaries	102	93
Delta Airlines	475	210
Northwest Airlines	[1]320	[1]160
Southwest Airlines	106	[1]50
Trans World Airlines	207	135
United Airlines	462	203
Air Wisconsin	40	17
USAir Group	454	207
USAir Commuter Subsidiaries	116	60
Subtotal	3,395	1,848
Operations suspended:		
Eastern Airlines	185	91
Midway Airlines	84	70
Pan American World Airways	144	116
Subtotal	413	277
Total	3,808	2,125

[1] Estimated by the Breckling Company.
Source: The Breckling Company, Cleveland Heights, OH, 1992.

located in such countries. A glut of older aircraft has resulted. Thus, Boeing 747-100s were selling in early 1994 for as little as $2 to $3 million as scrap, when only two years earlier they might have been sold or re-leased for $10 to $12 million.[34] Overall, between 1991 and 1993, aircraft values fell some 20 percent to 25 percent.

Outlook

In January 1994, leading U.S. business leasing officers gathered to discuss the future of the U.S. industry.[35] Broadly, they agreed on the trends discussed below.

As the economy improves, industry leaders believe that leasing markets likely will expand. The equipment leasing industry will continue to account for 32 percent of the new equipment market. Banks will reenter the leasing marketplace as cash-flush competitors to independent and captive lessors. Banks also will be buyers of bundles of contracts originated by other

[34] Ibid.

[35] See Equipment Leasing of America meeting, as reported in *Equipment Leasing Today*, Apr. 1994, pp. 6-11.

lessors (securitization). Conversely, independent leasing companies, which are primarily small-ticket and middle-market lessors, will face the most significant challenges in the industry. These challenges include maintaining relationships with funding sources and reducing the relatively high administrative costs inherent to small- and middle-ticket leasing.

In addition, industry officials think that equipment leasing companies will continue to seek niche markets and will, increasingly, bundle services with new leasing contracts. Profit margins on equipment leasing are diminishing; profits are made by companies with specialized expertise in niche markets, and by those able to offer "cradle to grave" value-added services to equipment deals. For example, computer system lessors will offer staged hardware or software upgrades, or maintenance services, as well as the leasing of computer equipment. Vehicle lessors, particularly for fleet customers, may offer maintenance contracts, insurance, or other services. The current trend toward already large companies further expanding, and smaller companies further downsizing, will continue. Increased technological sophistication will encourage the accomplishment of more business with proportionally less staff.

Last, U.S. leasing officials think that globalization of the market will increase slowly. Customers are expanding facilities internationally. These customers want to build relationships with leasing companies that are willing and able to meet their leasing needs abroad as well as at home. Additionally, differing national taxation and accounting requirements will continue to complicate international trade in leasing services, although such trade will increase at a modest pace. In public policy terms, legislation on taxes, bankruptcy laws, financial regulation for banks and non-banks, environmental liability, and accounting regulations will continue to affect the leasing industry strongly. Potential revisions to U.S. health care financing, for example, may have adverse effects on sophisticated medical equipment leasing, due to the perceived necessity to rationalize the number of hospitals and facilities wishing to offer highly sophisticated levels of medical care, and the need to cut back on the costs of expensive medical technology equipment.

EUROPEAN LEASING MARKETS

Unlike the United States, most of Europe's top leasing companies are affiliated with banks. This reflects the wider business opportunities permitted banks in many European countries compared to the United States (e.g., universal banking); different tax, accounting, and regulatory laws regarding leasing/banking within Europe; fewer captive lessor companies; and less penetration by independent lessors of the European market.[36] As in the United States, however, banks are wary of allowing leasing to compete unduly with their primary role of lending money to commercial businesses. Also like their U.S. counterparts, European banks tend to be the most conservative lessors, with the most rigorous credit requirements and the greatest ability to repossess leased equipment if the need arises. Because banks dominate European leasing, and because of this conservatism, economic recession adversely affected leasing even more severely in Europe than in the United States; the leasing market remained open only to the best credit risks as the demand for new equipment decreased.

Mitigating this factor, however, was the uneven spread of the recession in Europe over time. Germany did not begin to feel the recession's bite until about three years after the United Kingdom. Also, reduced bank leasing was partially offset by captive lessors as European industrial companies used attractive leasing terms to entice prospective lessees.

Figure 2 demonstrates the growth in European equipment and real estate leasing over the period 1983-93. Figure 3 indicates the division of the European market by the general categories of types of equipment leased.

Differing Leasing Traditions Within Europe

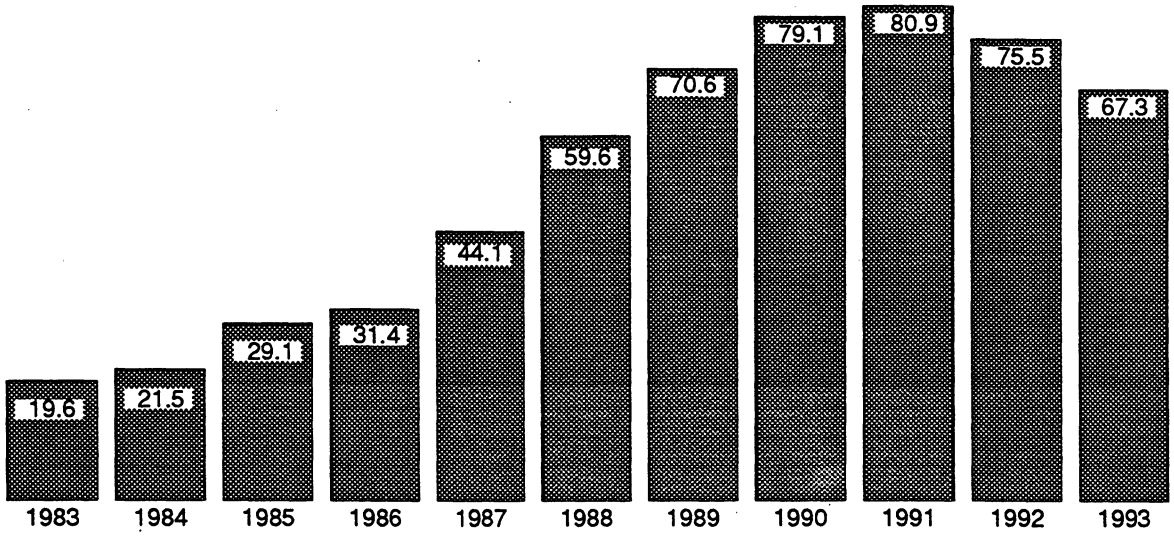
The role of leasing varies widely within Europe. This is primarily due to national differences in (1) the availability of capital for the purchase of new equipment, and (2) the tax/accounting laws that favor either leasing or purchasing new equipment. The following tabulation indicates the 1993 market penetration of leasing, as a percentage of all new equipment brought into use, in 10 European Union member states:[37]

Ireland	32.0 percent
Portugal	24.4 percent
United Kingdom	18.6 percent
Spain	17.5 percent
Germany	16.6 percent
France	14.6 percent
Italy	11.5 percent
Denmark	11.0 percent
The Netherlands	10.5 percent
Greece	4.2 percent

[36] Exceptions are the United Kingdom and Ireland, where independent lessors predominate. See *Asset Finance & Leasing Digest*, Apr. 1994, p. 26.

[37] *World Leasing Yearbook, 1994*, p. 3. Figures for Belgium and Luxembourg are not available.

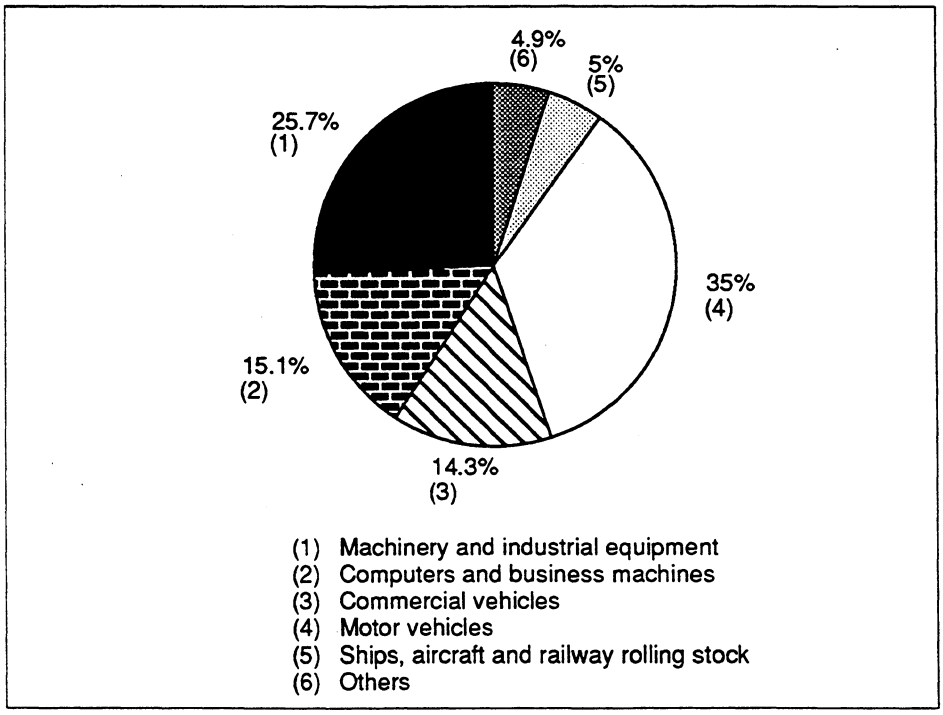
Figure 2
Growth of equipment leasing in Europe, 1983-93
***(Billion European Currency Units (ECUs))*[1]**



[1] Figures compiled by Leaseurope, a trade association of leasing companies from18 nations, based in Brussels. The organization's 1992 membership included 1,035 leasing companies from all nations of the European Union and European Free Trade Association, and Bulgaria, Hungary, Poland, Slovenia, Czechoslovakia, and Morocco. The numbers reflect data for broad catagories of leasing but have several limitations due to the makeup of the membership of Leaseurope, as well as other factors.

Source: *Leaseurope 1993 Annual Report.*

Figure 3
European leasing, by type of equipment, 1993



Source: *Leaseurope 1993 Annual Report.*

Organization of European Leasing Markets

European leasing is organized in various ways. In Germany, for example, many lessors are parts of the universal banks that mix banking, securities, insurance and other financial operations. Reportedly, one of the principal incentives for banks to establish a leasing operation in Germany is to discourage new competitors from entering the financial field. Leasing companies are not subject to any specific regulations and leasing can be undertaken without a banking license.[38] In the United Kingdom and Ireland, conversely, equipment leasing tends to be dominated by independent companies, who entered the business before the banks and have developed technical and commercial expertise. Also, leasing market conditions in Europe vary according to different national economic and financial conditions. The capital subsidy and taxation system of Ireland, for example, has tended to favor leasing over outright equipment purchases more than in many other European jurisdictions.[39]

European Computer Leasing

Leasing for computers and business machines accounted for 16.6 percent of Leaseurope's[40] members' business in 1991. The computer portion of the business has its own European trade association, which does an annual survey of its membership.[41] The association's 1991 survey indicated that its average member had been in business a little less than 10 years and employed about 60 people, of whom one-third were devoted to sales.

IBM is the largest player in the European information technology (IT) leasing market, via the IBM Credit Corporation. Nearly 70 percent of respondents to the 1991 European IT survey ranked IBM as one of their top three lessor companies. Comdisco was in second place with 25 percent of respondents. However, market shares and company participation change rapidly. Thirty different lessor companies received at least one mention, 15 of which did not even appear in the 1990 survey. In terms of equipment vendors' volumes, IBM dominated the market absolutely. Digital Equipment Corporation (DEC) was the second largest IT lessor. Other key lessors included Hitachi, Amdahl, Siemens/Nixdorf, Olivetti, Hewlett-Packard, ICL, Unisys, and Bull.

[38] *Asset Finance & Leasing Digest*, Mar. 1992, p. 26.
[39] Ibid.
[40] Eighteen European national leasing associations make up the "Leaseurope" trade association, based in Brussels. The 1992 membership included 1,035 leasing companies from all nations of the European Union and European Free Trade Association, as well as Bulgaria, Hungary, Poland, Slovenia, Czechoslovakia, and Morocco.
[41] European Computer Leasing and Trading Association (ECLAT), Birmingham, U.K.

Economic recession has had a somewhat lesser effect on the computer leasing sector than on the overall capital equipment market because so many companies have accorded high priority to upgrading their IT systems. Rather, industry sources indicate that they tend to conserve money by purchasing used systems. This makes the computation of computer residual values more unpredictable than in the recent past.

More important to computer leasing than broad economic factors, however, are technological developments. Once state-of-the-art systems can become obsolete rapidly. Also, falling production costs can significantly reduce the value of both new and used systems.

Over the longer term, some industry observers expect that the European IT market will shake out with perhaps IBM and NEC competing at the top of the market, companies such as DEC and Hewlett-Packard in the middle, and niche companies at the lower end.[42]

Current State of Market

As in the United States, economic recession has affected adversely many European leasing markets since 1990. Germany, for example, experienced the first decline in leasing business in 20 years.[43] Overall European leasing volume fell 17 percent, from $120 billion in 1991 to $99.5 billion in 1992. Leased moveable equipment values fell 9 percent, from $66.8 billion in 1991 to $61 billion in 1992.[44] In volume terms, unprecedented declines were experienced in France (14 percent), Italy (30 percent), United Kingdom (31 percent), Spain (28 percent), Austria (10 percent), Belgium (9 percent), and Switzerland (26 percent).[45]

In France, leasing in 1993 was especially hurt by declines in corporate leasing, which fell 19.3 percent from 1992. Numerous lessee bankruptcies, bad debts, and general problems over asset security contributed to this result.[46] Operating leases showed modest growth, which heretofore has been an uncommon occurrence in France as accounting and tax rules do not provide any particular incentives to lease equipment other than electronic data processing equipment. Many leasing companies reportedly lost money.[47]

In Germany, the recession brought about fundamental changes to the leasing market. Between 1992-1994, the number of leasing companies dropped

[42] Ibid.
[43] *Asset Finance & Leasing Digest*, Apr. 1994, p. 25.
[44] *World Leasing Yearbook, 1994*, p. 38.
[45] Ibid.
[46] *Asset Finance & Leasing Digest*, July/Aug. 1994, p. 10.
[47] *The Handbook 1994/1995*, Asset Finance & Leasing Digest, p. 14.

from about 1,400 to 700.[48] In a major market reversal, car leasing in 1994 accounted for 50 percent of the German market, despite a slowdown in vehicle registrations. Capital equipment leasing fell. Some banks, often the most conservative of lessors, withdrew from the leasing market.[49] But investment in former East Germany continues at a high rate and has helped buoy the leasing market; there was a 11.5 percent increase in total investments from 1992 to 1993, helped partially by the availability of government subsidies. Importantly, captive lessors have increased their market share. BMW, for example, financed 25 percent of its new sales through leasing and Mercedes increased its leasing penetration from 9 percent in 1992 to 18.5 percent in 1993.[50]

The Italian leasing market is led by bank-owned companies and two manufacturers, Fiat and Olivetti.[51] In Italy, the 30 percent devaluation of the lira in September 1992, affecting cross-border contracts from other countries, caused an additional 25 percent fall in already soft leasing volumes. In 1993, total equipment leasing volumes fell by 22 percent.[52] "Subsidized" leasing (30 percent of the Italian market) was the only sector which improved.[53]

In Spain, the total value of leasing equipment fell by 40 percent in 1993, having fallen 23 percent in 1992.[54] Adverse tax and accounting changes for leased equipment, coupled with economic recession, reportedly accounted for the decline. The number of leasing companies fell from 101 to 88 in the first quarter of 1993, partially due to the fact that banks became eligible to become lessors in 1990, and have thus disbanded their leasing subsidiaries. Industry observers expect that the vehicle, computer, and high technology sectors will be the largest leasing growth sectors in the future.[55]

Historically, the three Benelux countries sometimes sanctioned favorable tax and accounting regulations to create advantages for local lessors doing business in neighboring countries. The recent standardization of leasing accounting treatments through EU directives is expected to close many of these loopholes. In the Netherlands, the leasing industry is dominated by the three main banking groups. In Belgium, more lessors are independent, but their products tend to be less financially sophisticated than those of the banks.[56] Although Belgium was the European center for cross-border leasing in the early 1990s, changes to its tax and accounting laws have shrunk the market considerably.[57]

Overall, major European leasing markets are seeing a continuing decline and consolidation. There is intense competition for good quality customers, with a consequent decline in margins. Lessors are focussing on reducing costs, improving customer service, and identifying profitable niches. Despite these difficulties, demand for leasing in the public sector is growing, as is the demand for operating leases, particularly in the context of captive leasing. Also, the United Kingdom economy shows signs of an upturn, and the leasing sector with it.[58]

JAPANESE LEASING MARKET

Equipment leasing in Japan began in 1963, later than in the United States or Europe. Leasing capital remains concentrated with banks, rather than with independent or captive lessors. Thus, although membership in the Japan Leasing Association totalled 407 companies in 1993,[59] roughly 54 percent of lessors are affiliated with banks (even if limited by Ministry of Finance rules), while another 18 percent are associated with manufacturers, and 12 percent with trading houses. Sixteen percent are independent or affiliated with other types of firms.[60] Banks are not permitted to engage directly in activities such as leasing, but may have subsidiary companies or related corporate entities which perform leasing. Until the mid 1980s, Japan's Ministry of Finance (MOF) limited banks' maximum participation in leasing and other near-bank activities to 10 percent, later reduced to 5 percent.[61] Still, compared with the United States or Europe, Japanese lease finance for obtaining new equipment remains limited, as reflected by the fact that in 1992 leasing had only a 7.5 percent penetration rate for new equipment, compared to 32 percent in the United States and 18.6 percent in the United Kingdom (table 1).

In terms of employment, the parent companies of the Japan Leasing Association employed about 72,000 people in 1992, but the leasing departments of those companies employed about 26,000 people. Japan's leasing industry is additionally characterized by a relatively low share in total private capital investment compared with other leading regional leasing markets;

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[48] *Asset Finance & Leasing Digest*, Apr. 1994, pp. 25-26.

[49] *The Handbook 1994/1995*, Asset Finance & Leasing Digest, p. 14.

[50] Ibid.

[51] Ibid.

[52] *Asset Finance & Leasing Digest*, July/Aug. 1994, p. 11.

[53] The Italian Government financially supports lower interest loans to lessors in some regional markets; these benefits result in lower rental rates for lessees.

[54] *Asset Finance & Leasing Digest*, July/Aug. 1994, p. 11.

[55] *The Handbook 1994/1995*, Asset Finance & Leasing Digest, p. 15.

[56] Ibid.

[57] *Asset Finance & Leasing Digest*, May 1994, p. 31.

[58] *Asset Finance & Leasing Digest*, July/Aug. 1994, p. 1.

[59] *World Leasing Yearbook, 1994*, p. 241.

[60] Ibid.

[61] *World Leasing Yearbook, 1986*, p. 167.

only seven companies are publicly listed. Also, lessors have very low equity ratios.[62] Figure 4 demonstrates the equipment sector ratios currently handled in the Japanese leasing market.

Japan as a Source of Global Leasing Capital

During the Japanese economy's high-growth era of the 1960s and early 1970s, leasing helped offset perpetual domestic capital shortages. By 1978, however, the reverse problem was evident: Japan had a huge foreign trade surplus and was looking for ways to reduce it. Consequently, the "samurai lease" was born. This lease was a government-sponsored international lease with special privileges under the Japanese Foreign Exchange Control Law. The Japanese Government loaned low-interest dollar funds to Japanese leasing companies through the Export-Import Bank of Japan. The lessors bought 31 aircraft worth $900 million from U.S. and European manufacturers, thus reducing the surpluses with Japan's major trading partners. The lessors then leased the aircraft to foreign airlines.[63]

Although in 1979 the second oil crisis dampened these trade surpluses, a second program, the "shogun lease," was implemented in December 1980. Japanese leasing companies were allowed to purchase overseas assets from non-residents and lease or sell them on installment to non-residents. Unlike leasing companies, Japanese banks were not permitted to do this without prior permission from the Ministry of Finance. This program, coupled with the fact that immense capital surpluses were present in Japan during the 1980s, made Japan the leader in global cross-border leasing for airplanes, property, and equipment. In the late 1980s, roughly 70 percent of all aircraft financing worldwide ultimately came from Japan.[64] In addition, Japanese leasing companies had 144 foreign subsidiaries in 22 countries by 1991, compared to 31 subsidiaries in 12 countries in 1980.[65] It was only the collapse of Japanese property market prices in the early 1990s that began to limit Japan's relatively large cross-border leasing program.

Current State of Market

The recent economic recession in Japan, as in the United States and Europe, adversely affected Japan's leasing market. Leasing firms were hurt due to the downturn of the business cycle and lower profitability in finance leasing — the leasing companies' main business. That, however, represented merely half of the problem. Lessors in Japan have long been dependent on the banks for their sources of capital. Unlike lessors in many other OECD countries, they have not been permitted to independently raise funds via mechanisms such as stock offerings or the securitization of leased assets.[66] The falling stock market and depression of property values, which caused a slackening of the rate of growth of private capital spending, have thus depressed leasing growth since the latter half of 1990. Indeed, in fiscal 1992 (April to April) the value of leasing contracts concluded in Japan declined 11.7 percent from the previous year's level.[67] The decline was the first to occur since the inauguration of the Japan Leasing Association in 1971.

The fall continued in 1993.[68] With the sole exception of medical equipment, which increased 4.3 percent, all equipment leasing sectors showed declines. The value of leasing contracts for machine tools, an item sensitive to business conditions, fell 38.6 percent, followed by industrial machinery (down 15 percent), office equipment (down 12.6 percent), and civil engineering and construction machinery (down 10.6 percent). The value of leasing contracts for information-related equipment (a large part of the leasing market) was down 9.7 percent, and other business and service industries fell 4.2 percent.[69]

The overall market effect in terms of the value of leasing contracts registered an 18.4 percent drop for manufacturing industry equipment, which included a 20.2 percent drop in the "machinery" sector. In the non-manufacturing sector, both "transportation and telecommunications" and "construction and real estate" turned in double-digit declines from the previous year, decreasing 11.8 and 10.9 percent, respectively.[70]

OTHER LEASING MARKETS

Equipment leasing is expanding in several places outside the major regional markets of North America, Europe, and Japan. The 10 largest leasing countries (table 2) already include Korea and South Africa. Other emerging markets with significant annual leasing volumes include Brazil ($4.1 billion in 1992), Australia ($3.9 billion), Hong Kong ($3 billion), Mexico ($2.5 billion), China ($1.9 billion), and Indonesia ($1.8 billion).[71]

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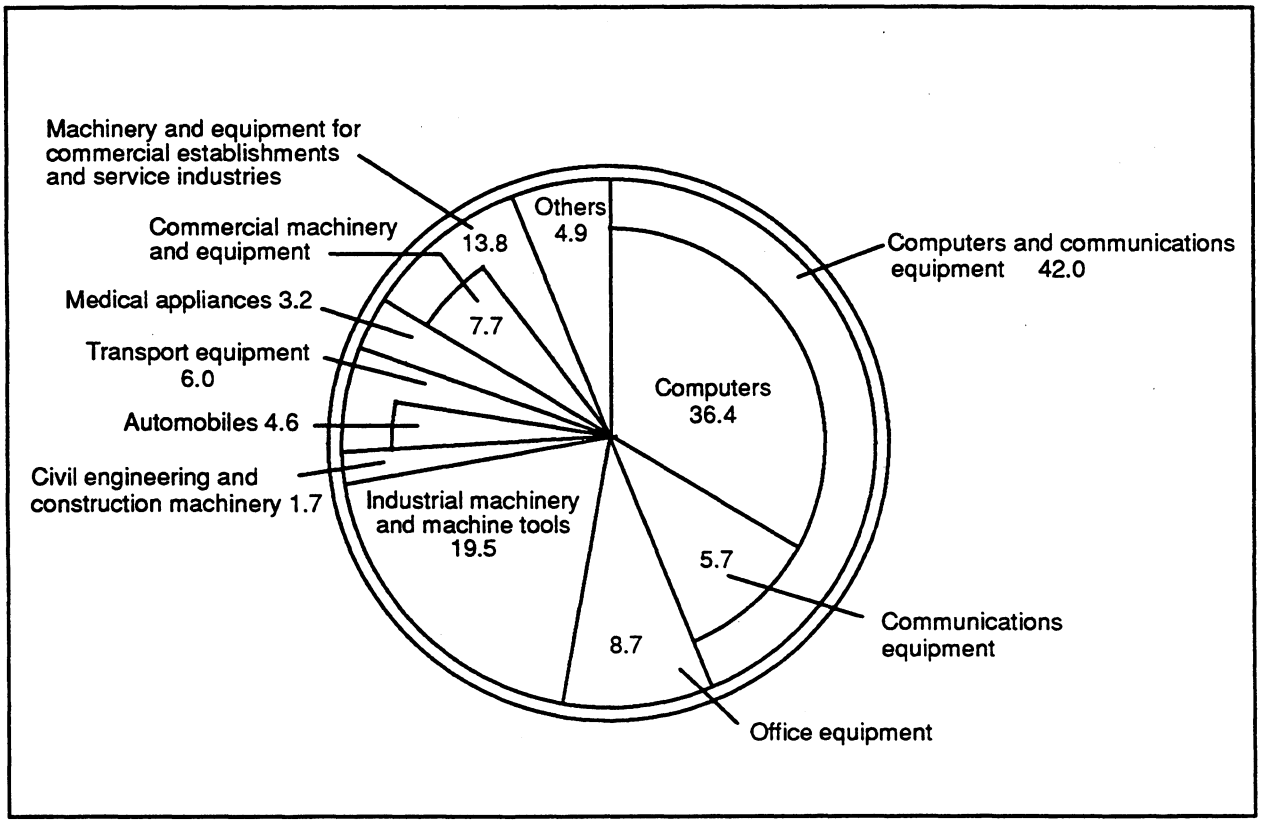
[62] Lease Japan, Japan Leasing Association, Oct. 1992, and USITC correspondence with Japan Leasing Association, Mar. 1993.
[63] *World Leasing Yearbook, 1992, pp. 238-239.*
[64] *Air Transport World,* Dec. 1992, p. 32.
[65] *World Leasing Yearbook, 1992,* p. 239.
[66] *Asset Finance & Leasing Digest,* June 1994, pp. 19-25.
[67] Ibid.
[68] *World Leasing Yearbook, 1994,* p. 233.
[69] Ibid.
[70] Ibid, p. 235.
[71] *World Leasing Yearbook, 1994,* p. 3.

Figure 4
Japan's leasing market: Types of equipment, by percentage, 1992



Source: *Lease Japan*, Japan Leasing Association, Oct. 1993.

Leasing is an attractive form of equipment finance for companies in developing countries. Companies in such countries, particularly small- to medium-sized companies, often have only limited access to conventional bank credit and little or no access to equity markets. Leasing's ability to offer 100 percent, asset-backed financing is thus crucial, regardless of tax or accounting advantages that leasing may offer.[72]

However, leasing in these emerging markets carries risks for lessors. These range from *ad hoc* government decisions about leasing, to political risks, to an inability to assess the credit worthiness of lessees, to problems in repossessing leased equipment if the lessee fails to make payments. Detailed knowledge of a country's economy, its tax and accounting regimes, and its repossession rules, are thus particularly important in leasing in emerging markets.[73]

[72] *Asset Finance & Leasing Digest*, Supplement on Emerging Markets, Sept. 1993.
[73] Ibid.

EMERGING MARKETS AND THE INTERNATIONAL FINANCE CORPORATION[74]

The International Finance Corporation (IFC) is an affiliate of the World Bank, sharing the same Board of Directors. Founded in 1956, it has 156 member countries and a mandate to help the private sector in developing countries. The IFC makes both equity investments and loans, all to the private sector, while the World Bank gives only loans and lends exclusively to the public sector, or with a government guarantee.

Since 1977 the IFC has actively promoted the establishment of leasing companies in emerging markets. The aim is to provide alternative sources of

[74] The information in this section is based on a paper prepared by Teresa Barger and Alemayehu Mengistu, International Finance Corporation, Washington, DC, and reprinted in the *World Leasing Yearbook, 1994*.

medium-term equipment finance in these nations, and thus facilitate growth in investment and capital formation. While the IFC does not preclude existing financial institutions in developing countries from offering lease financing (e.g., commercial banks), it prefers to help establish specialized leasing companies. It does so by acting as a catalyst to unite domestic investors with established leasing companies elsewhere. The IFC loans money to the new company and is willing to invest up to 25 percent equity in the new venture, as long as it is not the largest equity holder. Between 1977-94, the IFC helped establish 47 equipment leasing companies in 26 countries. In 1993, its equity investment in such companies totalled $19.3 million.[75] Loans to IFC investor companies amount to a cumulative total of $240 million.

The IFC was involved as a founding shareholder for leasing companies in 12 nations (Bangladesh, Botswana, Dominican Republic, Ghana, Jordan, Oman, Pakistan, Peru, Korea, Sri Lanka, Thailand, and Tunisia). By 1993, the IFC had divested its interests in several of these companies, and its loans had been repaid. The IFC also has supported leasing operations for local banks where specialized leasing companies could not be supported (Uruguay, Cyprus, Swaziland, Fiji). In half of the countries mentioned, the IFC-backed enterprises were the first leasing companies to be established, and led to the creation of others.

Almost all the larger, more successful leasing companies in developing nations have been joint ventures between domestic institutions and a leasing company from a developed country acting as a technical partner. Such developed country partners include Societe Generale, Credit Agricole, and Credit Lyonnais (France); Orix (Japan); US Leasing (United States); and Lloyds and Barclays (United Kingdom). The foreign partners give the local company access to technical expertise, to foreign and domestic capital markets, and to a broader range of potential clients.

The IFC has found leasing to be a highly competitive form of financing in many developing countries, especially where it enjoys tax treatment comparable to that accorded to bank lending. Currently, the IFC is establishing leasing programs in several Eastern European countries.

[75] Several equity holdings have been sold as the new companies became established, more financially secure, and mature. IFC has divested partially or fully its equity holdings, for example, in Thailand, Sri Lanka, Korea, Portugal, Pakistan, Jordan, Tunisia, Brazil, and Peru.

THE UNIDROIT CONVENTION

Unidroit is an international intergovernmental organization, based in Rome, which seeks to promote harmonization and convergence of national factoring and leasing laws.[76] After several years of discussion on leasing, it proposed in 1988 a final text for a universal uniform commercial code for international leasing transactions.[77] The proposed code would clarify and standardize leasing terminology, forms of contracts, the time when a lease takes effect, expectations of lessees and lessors if a contract is breached, and similar commercial matters. In short, the overall intent of the Convention is to promote cross-border and international leasing by clarifying commercial rules. Examples of subjects covered include the treatment of leased airliners impounded by governments, or leased shipping vessels which founder.

The Convention will enter into force following the deposit of three national instruments of ratification or accession. France became the first (and thus far only) nation to deposit a ratification instrument in October 1991. Ratification is thought to be near in Italy and Nigeria, and is under active consideration in several other countries, including several Western European nations, Canada, Russia, and China. In the United States, the Equipment Leasing Association of America and American Bar Association have endorsed the Convention and the Department of State has indicated the United States' intention to join. The process would entail the State Department preparing the necessary explanations for reviews by the U.S. Departments of the Treasury, Commerce, and Justice. Bundled with several other international commercial/trade-law agreements, the Convention would then be sent to the President for signature, and to the Senate for its advice and consent. No implementing legislation would be necessary.[78] U.S. lessors support the Convention but do not see it as a major breakthrough in the promotion of international leasing, due to the preponderant weight of national tax, accounting, and other laws and regulations that tend to inhibit cross-border international trade in leasing. The Convention is seen, rather, as likely to bring modest improvements and increased transparency to international lease

[76] This organization is known formally as the Unidroit Convention on International Factoring and International Financial Leasing.

[77] A copy of the proposed text can be found in the *World Leasing Yearbook, 1992*, pp. 42-43.

[78] USITC staff telephone conversations with the U.S. Department of State, Legal Advisor's Office, Mar. 1993 and Feb. 1995.

agreements, and assist leasing in those nations that have little leasing law on their books.

The U.S. Department of State is in the process of preparing the necessary documents to obtain the approvals of the Departments of Commerce and Justice. Assuming the process goes forward smoothly, as expected, the Department of State anticipates that the United States may ratify the Convention by late 1995 or mid-1996.[79]

INTERNATIONAL TRADE IN LEASING

Cross-Border Trade vs. Affiliate Transactions

As noted, wide variations in the tax, accounting, and legal treatment of leasing in different countries have limited the growth of cross-border transactions. As a result, leasing companies generally have tended to use foreign subsidiaries or, to a lesser extent, joint ventures or special contract firms to conduct international operations. No figures on the volume of international transactions are available. There is a general industry consensus, however, that equipment types which are appropriate for global leasing include aircraft, rail cars and other rail assets, ships, shipping containers, telecommunication equipment, and satellites.[80] Other global equipment types, especially when leased by the captive lessor firms of manufacturing companies, might include computers, medical equipment, and automatic teller machines.[81]

Lessors are more likely to explore international markets if traditional home market clients have expanded their international operations and need leasing services at new foreign locations. Lessees often prefer to establish global equipment contracts with lessors with whom they have had a prior relationship. Similarly, lessors feel more comfortable taking risks on equipment with clients they already know. Their profits often are obtained from the resale or re-lease of equipment (residuals) at the end of a lease, and previous customers have a record of reliability in returning equipment in good condition.

[79] USITC staff telephone conversations with Ralph Petta, Equipment Leasing Association of America (ELA), Feb. 1995; Ed Huddleson, General Counsel for the ELA, Feb. 1995; Chuck Mooney, University of Pennsylvania Law Professor (who helped negotiate the Convention), Feb. 1995; Karen Ghaffarkhan, Legal Advisors Office, U.S. Department of State, Feb. 1995; and Peter Pfund, Private International Law Office, U.S. Department of State, Feb. 1995.

[80] U.S. Department of Commerce, International Trade Administration, *U.S. Industrial Outlook, 1993*, (Washington, DC: GPO, 1993), pp. 53-55.

[81] Ibid.

Foreign Penetration of U.S. Markets and U.S. Leasing Abroad

As noted, Japan was the source of relatively cheap global capital throughout much of the 1980s. Japanese leasing firms benefitted accordingly and were the principal sources of capital for some big-ticket leasing markets such as airplane leasing. In general terms, Japanese lessors, with the aid of leveraged leases, and French lessors, partly aided by export leasing credit facilities, were among the first to establish foreign affiliates.[82] For example, both Japanese and European leasing firms followed their clients as their customers established subsidiary companies or won construction projects in the United States.

Starting in 1993, however, and aided by the nation's emergence from recession, large U.S. lessors have reportedly been the most aggressive in seeking international business. For example, GE Capital has expanded its position in both domestic and international markets significantly, and the General Motors Acceptance Corporation (GMAC) has used its captive status to offer favorable financing terms to GM customers.[83]

U.S. industry sources suggest that about 3 percent of the U.S. leasing market is served by direct cross-border leasing from firms abroad, and that perhaps another 14 percent to 15 percent is served by leasing subsidiaries of foreign-owned firms. This translates to about $25 billion worth of equipment leased annually.[84]

Conversely, industry officials estimate that U.S. leasing firms' penetration of the West European market is in the range of about 7 percent to 8 percent, which translates to about $8 billion worth of equipment annually. GE Capital's expansion in 1993, as well as GMAC and Ford Motor's increased activity in Europe during 1993-94 may have increased this share. The largest foreign market for U.S. lessors is Canada. There is little or no U.S. or non-Japanese penetration of the Japanese leasing market. This is attributed by U.S. industry sources to factors such as Japanese firms' access to relatively cheap capital until 1993, and keiretsu[85] relationships within the Japanese corporate structure.[86]

[82] Credit Suisse Research Group, Tokyo, 1990.

[83] *Asset Finance & Leasing Digest*, Sept. 1993, p. 12, and Apr. 1994, p. 14.

[84] USITC staff telephone conversations with the Equipment Leasing Association of America and with Mr. John Breckling, the Breckling Company, Mar. 1993.

[85] Keiretsu relationships often involve interlocking share-holding transactions between a group of "family" companies, the sharing of members of boards of directors, the use of the same bank and trading house, and other common services that make it difficult for companies outside the organization to gain access to the corporate family's business.

[86] USITC staff telephone conversations with the Equipment Leasing Association of America and with Mr. John Breckling, the Breckling Company, Mar. 1993.

Adoption and enforcement of the Unidroit Convention on International Financial Leasing, and efforts by the World Leasing Council[87] to draw up a model leasing contract for worldwide use, may modestly expand international cross-border leasing in the future. Similarly, the adoption of the North American Free Trade Agreement and the inclusion of leasing services in the General Agreement on Trade in Services (GATS) of the World Trade Organization (WTO) may also increase the likelihood of international leasing contracts by liberalizing current restrictions on capital movements and transactions. The most important factors affecting the worldwide level of leasing contracts, however, are the growth rate of the global economy, and the ability of leasing firms to regroup or restructure in the aftermath of the economic recession of the early 1990s.

[87] The Council is composed of national leasing associations.