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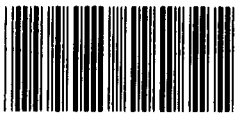

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Iraq's Participation in the Commodity Credit Corporation's GSM-102/103 Export Credit Guarantee Programs

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Research, and Foreign Agriculture
Committee on Agriculture
House of Representatives

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Mr. Chairman and Members of the Subcommittee:

We are pleased to be here today to discuss Iraq's participation in the Department of Agriculture's Export Credit Guarantee Program and Intermediate Export Credit Guarantee Program, referred to as the GSM-102 and GSM-103 programs, respectively. The GSM-102/103 programs are managed and operated by the Foreign Agricultural Service (FAS).

Under these programs, the Agriculture Department's Commodity Credit Corporation (CCC) guarantees that U.S. exporters or their assignees, such as financial institutions, will be repaid for a credit sale made to a foreign buyer in an eligible country. If the buyer defaults, the exporter can file a claim with the CCC for the loss. Under GSM-102, CCC guarantees repayment for credit sales of 3 years or less; under GSM-103, CCC guarantees repayment for credit sales of more than 3 but less than 10 years.

Over the past several years we have completed a series of reviews on the management of these programs for you and other subcommittee chairs. On November 14, 1990, we issued a report to Congressman Charles E. Schumer, Chairman, House Task Force on Urgent Fiscal Issues, entitled International Trade: Iraq's Participation in U.S. Agricultural Export Programs, (GAO/NSIAD-91-76, Nov. 14, 1990). Our testimony summarizes this report and (1) provides information on the development of Iraq as a U.S. agricultural export market and the extent to which Iraq has benefited from its inclusion in the

GSM programs since 1983 (see app. I); 2) examines agricultural, trade, and foreign policy considerations that influenced decisions to continue offering guarantees to Iraq under the GSM programs despite a growing concern about Iraq's creditworthiness; and 3) discusses the Justice Department's investigation of the Banca Nazionale Del Lavoro's (BNL) unauthorized and unreported loans to Iraq, a portion of which were guaranteed by CCC under the GSM programs, and a subsequent administrative review by the Department of Agriculture.

IRAQ'S PARTICIPATION IN THE GSM PROGRAMS

Export credit guarantees approved for Iraq under the GSM programs increased from about $400 million in fiscal year 1983 to about $1.1 billion in each of fiscal years 1988 and 1989. Another $500 million was approved for fiscal year 1990, bringing the total export credit guarantees approved to almost $5 billion. Support for Iraq also included a precedent-setting innovation: Iraq was permitted to receive export credit guarantees for both the exported agricultural commodities and their shipping costs.

On August 2, 1990, the President announced a trade embargo on Iraq, including a prohibition on granting credits for the purchase of U.S. agricultural commodities. At that time, CCC had about $2 billion in export credit guarantees covering loans to Iraq.

When the GSM programs were first offered to Iraq in 1983, the United States and Iraq were working on reestablishing diplomatic relations, which had been severed in 1967. Also during this time, Iraq was in the middle of its 8-year war with Iran, and the United States was seeking ways to assist Iraq. In addition, the U.S. farm sector was experiencing a surplus of many commodities. Despite some short-term credit problems, Iraq seemed likely to once again become a cash market and a significant market for U.S. agricultural commodities.

COUNTRY RISK ANALYSIS

FAS chooses for participation in the GSM programs those countries that have the potential to become commercial purchasers of U.S. agricultural commodities but cannot currently make such purchases without credit guarantees. Part of the process in determining program funding levels is a risk assessment that examines a country's economic, financial, and political conditions.

Agriculture's country risk analysis for Iraq in 1988 indicated that its economic situation had improved somewhat in 1987 and was expected to continue to get better in 1988. However, it was noted that Iraq faced severe economic difficulties because of its ongoing war with Iran. Furthermore, from the mid-1980s on, Iraq had pursued a policy of rescheduling old debt and remaining current only on debt owed to those countries willing to extend new credits.

Despite concerns over such actions, FAS concluded that the risk facing the Commodity Credit Corporation from Iraq's credit initiatives was likely to remain minimal.

Agriculture's risk analysis documents for fiscal years 1989 and 1990 rated Iraq as a high-risk market for granting substantial credit guarantees, yet Agriculture continued to approve credit guarantees through fiscal year 1990. It seems that the U.S.' desire to develop agricultural trade and to build a strategic relationship with Iraq[1] outweighed the apparent financial risks involved and discounted evidence of Iraq's human rights violations.

USDA STAFF CONCERNS DISREGARDED

In the summer of 1988, Congress was considering legislation that would have imposed sanctions on Iraq for its use of chemical weapons against its Kurdish population. Both Agriculture and State opposed these sanctions. In a September 13, 1988, letter to the Chairman of the House Foreign Affairs Committee, a senior State Department official reported that Iraq had used chemical weapons in its campaign against the Iraqi Kurdish population but noted that the United States attached great importance to its bilateral relations with Iraq. This official also noted that the United

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[1]The Food, Agriculture, Conservation and Trade Act of 1990 (P.L. 101-624), signed into law on November 28, 1990, includes a provision stating that agricultural export credit guarantees should not be used for foreign policy purposes.

States had more to gain from maintaining a cooperative relationship with Iraq than from isolating the country.

Coincident with congressional efforts to impose sanctions against Iraq, Agriculture was seeking approval to reallocate $36.5 million in fiscal year 1988 export credit guarantees to Iraq from existing credit lines approved for other countries. Prices of U.S. commodities had increased significantly, and without additional export credit guarantees Iraq would have been unable to meet its import requirements for the rest of the year. Some Agriculture staff members expressed strong concern over Iraq's human rights atrocities as well as CCC's vulnerability should Congress impose sanctions on Iraq. In a September 22, 1988, memo to the CCC General Sales Manager about a press release announcing over $30 million in additional loan guarantees to Iraq, eight senior Agriculture staff members warned:

> "However, we also note the strong likelihood that Iraq will not make scheduled payments for these purchases if the United States proceeds with economic/political sanctions against Iraq, as is currently being strongly considered in Congress. Until the specifics of this move toward sanctions are better known, we believe that the immediate issuance of this press release would constitute an inordinately high financial risk to the Corporation, with potential for program repercussions from Congressional reaction."

Despite these concerns, the reallocation was approved by the General Sales Manager because (1) Iraq was current on its payments under the GSM programs; (2) without additional credits, Iraq could not have maintained its import requirements, given the higher commodity prices; and (3) the State Department's official position at that time was that no evidehce existed linking the Iraqi government with the gassing of the Kurds. Ultimately the proposed sanctions were not enacted, partly due to foreign policy interests and pressure from U.S. agricultural trade groups.

INTERAGENCY DELIBERATIONS ON IRAQ'S PARTICIPATION IN GSM

FAS approved a program level of $1 billion in GSM-102 credit guarantees and $50 million in GSM-103 guarantees for Iraq for fiscal year 1989 based on Iraq's long-term ability to pay and on the market potential for U.S. agricultural exports. When the National Advisory Council on International Monetary and Financial Policies (NAC)[2] considered this funding level in August 1988, two members opposed the large size of the program and stated that $600 million was a reasonable credit limit for Iraq, given its huge

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[2]The National Advisory Council on International Monetary and Financial Policies is an interagency group that gives advice and recommendations to government agencies, such as Agriculture, on international financing matters including Agriculture's decisions to extend GSM credit guarantees. Council members include the Departments of the Treasury, State, and Commerce; the Federal Reserve Board; the U.S. Export-Import Bank; the International Development Cooperation Agency; and the U.S. Trade Representative.

deficit and its policy of bilateral rescheduling of debt. Another NAC member favored the $1 billion level and suggested the possibility of increasing it.

During 1988 and 1989, warning signs were increasing concerning Iraq's creditworthiness. According to an April 1989 analysis by one NAC member, Iraq had rescheduled or refused to repay most payments owed to foreign creditors. Only those creditors providing larger amounts of new money were being repaid. Because of Iraq's policy of rescheduling old debt while at the same time taking on new debt, it was predicted that Iraq's debt would continue to grow at a faster pace than its income, thus preventing Iraq from being able to service its debt. According to an internal Agriculture briefing document, by August 1989 only the United States and Great Britain were offering credit to Iraq.

FAS risk assessment documents noted that Iraq was effectively tying repayment of past debt to continued participation in the GSM export credit guarantee programs. Despite such problems, FAS believed that it had little choice but to continue the programs because it feared that by stopping or severely reducing the programs, the important Iraqi market would be lost and Iraq would refuse to pay its past CCC-guaranteed loans.

FAS proposed an additional $30 million in GSM-102 credit guarantees for Iraq for fiscal year 1989 and $1 billion in GSM-102 guarantees

for fiscal year 1990. It submitted this proposal to the NAC in September 1989. Because of preliminary findings from the BNL investigation and the discovery of possible improprieties in the Iraqi GSM programs, two members of the NAC requested that discussion of the GSM programs for Iraq be delayed pending the outcome of the investigation.

In October 1989, before the Iraqi delegation came to Washington to negotiate its fiscal year 1990 GSM level, Agriculture resubmitted its $1-billion GSM proposal to the NAC. FAS officials explained that Iraq had thus far proved to be a good credit risk for CCC, that no evidence of wrongdoing by the Iraqi government had been found in the BNL investigation, and that lack of positive action on the GSM programs would induce Iraq to make its agricultural purchases elsewhere.

One member of the NAC supported the $1-billion level, noting that Iraq had great strategic importance to the United States. Further, in NAC discussions about the fiscal year 1990 allocation, this member saw no reason to disapprove the fiscal year 1990 program. Although some uncertainty did inevitably exist, clear-cut Iraqi government involvement in any wrongdoing regarding BNL was not evident. This member recommended going ahead with a fiscal year 1990 allocation to Iraq, seeing "...no financial difficulties looming where CCC guarantees would be called ...."

However, that member was more negative in other forums where there were discussions of a different issue that could have left CCC guarantees vulnerable. In a February 1989 published report on human rights violations occurring in calendar year 1988, and in congressional testimony, that member characterized Iraq's human rights record as "abysmal" and "unacceptable." Yet in the NAC, that member chose not to present this point of view, instead allowing discussions to center on commercial concerns and bypass human rights issues.

Two NAC members opposed the $1-billion level. One of these members had previously stated that a $600 million-$700 million limit was more appropriate; now this member was unwilling to support any program for Iraq unless assurances were given that the problems brought to light by the BNL investigation were being addressed.

As an alternative, FAS later proposed a two-tranche approach, with an initial $400-million allocation and the remainder to be offered if no improprieties involving Iraq surfaced in the BNL investigation. Although other members of the NAC approved the $400-million level, two members voted no.

In meetings with FAS officials in October 1989, Iraqi officials rejected FAS' $400-million offer, saying that this level was not sufficient to meet its import needs and that they did not want further guarantees to be linked to the outcome of the BNL

investigation. Agriculture officials representing the FAS and the Office of the General Counsel went on a fact-finding trip to Atlanta in October 1989 to review the preliminary findings in the BNL case and their possible relevance to the GSM programs. They concluded that there was no reason to delay Iraqi participation. In November 1989, Agriculture officials traveled to Iraq and offered $500 million, with additional guarantees contingent on not finding evidence of Iraqi complicity in the BNL scandal. Iraq agreed to the $500 million, but again would not accept conditions on further guarantees. In effect, the fiscal year 1990 allocation was limited to $500 million, half of the preceding year's allocation.

By February 1990, Iraq had exhausted nearly all of its 1990 GSM allocations and requested an additional $573 million. Although FAS recognized that there was considerable risk involved in granting more credits to Iraq, it also believed that there was tremendous opportunity for increased agricultural exports. However, FAS knew there would be strong interagency opposition to a proposal for further credit guarantees for fiscal year 1990 while questions remained unanswered regarding alleged program irregularities involving BNL and Iraq.

As the $500 million in credit guarantees were exhausted, Iraq no longer considered commodity offers from the United States. Instead, it began purchasing commodities from Argentina, Australia,

Canada, the European Community, Saudi Arabia, Thailand, and Vietnam. Australia, Canada, and Thailand provided some new credit; the remainder of the purchases were for cash. To clear the way for further negotiations, Agriculture asked for consultations with Iraqi officials to discuss program irregularities and to review pertinent documents. These discussions were held in April 1990. Nevertheless, consideration of additional GSM guarantees was deferred because the BNL investigation was still ongoing and Agriculture's Office of the Inspector General had not yet finished its review of unresolved issues raised in Agriculture's administrative review--high pricing in certain transactions and the extent to which "after sales services"[3] had been provided in connection with GSM sales.

THE BANCA NAZIONALE DEL LAVORO INVESTIGATION

In August 1989, the Office of the U.S. Attorney for the Northern District of Georgia was notified that officials at the Atlanta branch of the Italian-owned Banca Nazionale del Lavoro had been keeping a second set of books and had advanced unauthorized and unreported loans to Iraq. This discovery led to the initiation of a grand jury investigation by the Office of the U.S. Attorney,

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[3]These services included providing nonagricultural products, such as truck parts, tires, and air conditioning equipment, some of which could have military application. FAS first advised Iraq in September 1988 that providing these services was not acceptable under the GSM program, however, Iraq continued to request such services until April 1990, when FAS obtained a written commitment from Iraq that such requests would cease.

U.S. Department of Justice, focusing on bank fraud and evasion of bank regulatory requirements. Agriculture's Office of the Inspector General joined the investigative team in September 1989, when it learned that a portion of these loans were guaranteed by CCC. By October 1989, Agriculture had initiated a separate administrative review of Iraq's participation in the GSM programs.

To date, the Justice investigation has resulted in a 347-count indictment of 10 defendants, including Iraqi government officials and 3 of BNL's Atlanta branch officials, for making fraudulent loans to Iraq totaling more than $4 billion. BNL provided about $1.9 billion of the almost $5-billion total loaned to Iraq under the GSM programs. As of August 2, 1990, when Iraq invaded Kuwait, Iraq owed BNL approximately $347 million on its GSM loans.

In closing Mr. Chairman, the GSM programs to Iraq were driven by foreign policy and agricultural trade objectives which exposed the U.S. government to substantial financial loss. During the period in which the exposure to Iraq was growing, there were significant program irregularities including the provision of after sales services, the export of non-U.S. origin commodities, and unauthorized banking practices. On a number of occasions over the past 3 years we have pointed out the need for stronger internal controls and better management of the GSM programs. Had Agriculture responded to our concerns more quickly, information on

program irregularities might have surfaced sooner and resulted in a smaller U.S. government exposure to financial loss.

Two types of changes should make the future of the programs less problematic. Agriculture is attempting to address problems GAO identified through management and regulatory reform. Furthermore the 1990 Farm Bill mandates a variety of management reforms and prohibits the use of GSM export credit guarantees for foreign policy or foreign aid purposes. Implementation of this provision, in effect, restricts program determinations to the consideration of export market opportunities and financial risk to the CCC. With decisionmaking so constrained, future financial risks should not be borne by the CCC as a result of foreign policy or other objectives that now are prohibited by law.

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This concludes my statement, Mr. Chairman. I will be happy to try to answer any questions that you and members of the Subcommittee may have.

IRAQ'S PARTICIPATION IN THE GSM EXPORT CREDIT GUARANTEE PROGRAMS

(Dollars in millions)

Fiscal year	Total guarantees approved	Guarantees to Iraq	Percent to Iraq
1983	$ 4,737.4[a]	$ 401.9	8
1984	3,431.2	513.3	15
1985	2,512.8	340.1	14
1986	2,535.1	392.9	15
1987	2,872.9	652.5	23
1988	4,504.3	1,113.2	25
1989	5,195.3	1,088.8	21
1990	4,289.5	481.2	11
Total	$30,078.5	$4,983.9	17

[a]Includes $1,028.1 million under the Commodity Credit Corporation's (CCC) Blended Credit Program, which combined direct loans with credit guarantees.

Source: CCC Guarantee Program Commitment Reports prepared by the U.S. Department of Agriculture's Foreign Agricultural Service, CCC Operations Division.