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The Soviet Union's Participation in the Agriculture Department's 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 the Department of Agriculture's (USDA) export credit guarantee programs and the Soviet Union's participation in those programs. The nature and importance of the U.S.-Soviet agricultural trade relationship is the focus of attention at this time because the Soviets have reportedly requested the extension of $1.5 billion in export credit guarantees for this year in addition to the $1 billion they have already received. If approved, loan guarantees to the Soviet Union would represent almost one-half of the total made available to all countries this year, an unprecedented single country share. Furthermore, a number of critics have raised concerns over the deterioration in the Soviet Union's creditworthiness. If this deterioration is sufficiently great, the request for additional credit guarantees could be problematic in light of provisions of the Food, Agriculture, Conservation, and Trade Act of 1990. These provisions prohibit the Secretary of Agriculture from issuing export credit guarantees to any country that the Secretary determines cannot adequately service such debt. The act also prohibits the issuance of export credit guarantees for foreign aid, foreign policy, or debt rescheduling purposes.

You asked us to provide testimony on (1) the USDA's former and present efforts to determine the ability of individual countries to repay loan guarantees extended to them, and (2) a proposed amendment to section 202 of the Agricultural Trade Act of 1978 that would allow the President to provide agricultural export credit guarantees when they are in the national interest, regardless of the creditworthiness of the borrower and foreign aid/foreign policy restrictions.

BACKGROUND

For the past 2 decades the Soviet Union has been a major customer for U.S. bulk agricultural commodities. From 1986 to 1990, the United States exported about $9.8 billion in agricultural commodities to the Soviet Union.[1] This trade relationship has been aided by a series of U.S.-Soviet long-term grain agreements and further strengthened by the Soviet Union's participation in the USDA's Export Enhancement Program. In addition, in January 1991, $1 billion in export credit guarantees under USDA's General Sales Manager program (GSM-102) was advanced to the Soviet Union. Annual sales have varied in response to a variety of factors, including fluctuations in Soviet agricultural production, the nature of the U.S.-Soviet political relationship (i.e., the 1980-81 partial grain embargo following the Soviet invasion of Afghanistan), and competition from other exporters of agricultural commodities.

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[1]According to FAS' estimates, as of December 1990, other countries, including Australia, Austria, Canada, France, Germany, Italy, Korea, Saudi Arabia, and Spain had provided approximately $4.7 billion in agricultural credits or aid to the Soviet Union.

The Soviet Union's underlying need for agricultural imports has been largely driven by the systemic problems of its agricultural sector. An ineffective agricultural reform strategy, coupled with intractable economic, social, political, and ethnic problems, has left Soviet agriculture in disarray, with no visible signs of major improvement. The Soviet Union is the world's largest producer of wheat and a major producer of a number of other crops. In 1990, record, or near-record, levels of grain, sugar beets, meat, and milk were produced, yet the food crisis persisted. The Soviets have serious problems in processing, packaging, storing, and distributing their agricultural commodities. Despite various initiatives to reform Soviet agriculture, little progress has been made.

USDA'S ASSESSMENTS OF CREDITWORTHINESS

The USDA's Foreign Agricultural Service's (FAS) Trade and Economic Information Division prepares a credit risk analysis for each country to which USDA extends export credit guarantees. From the early 1980s through fiscal year 1990, this division prepared country profiles for FAS that were mainly qualitative in nature, analyzing a country's economic, financial, and political strengths. During this time, there were no well-established procedures for including countries in the GSM programs. During the 1980s, the guarantee programs were influenced more by market development potential and foreign policy considerations than by credit risk concerns.

In 1989, USDA concluded that its credit risk analysis procedures did not provide the information necessary to make informed decisions. They noted that there was a belief that the analysis allowed for too much subjectivity. A decision was made to develop a more objective procedure, to base it on common commercial practices, and to build in more quantitative analysis.

To put more emphasis on evaluating financial risk, the division began developing new credit risk analysis procedures in January 1990 and started using them in May 1990 for fiscal year 1991 GSM decisions. In developing these new procedures, the division drew upon resources and examples from many organizations, including the International Monetary Fund, the World Bank, the Organization for Economic Cooperation and Development, and the U.S. Export-Import Bank.

The division now analyzes credit risk in the following manner. Initially, analysts issue a preliminary rating for each country based on two consensus risk ratings of major international banks and the country's economic, political, and social history. They then adjust this rating using the most current information in these areas. Based upon these considerations, as well as the country's repayment history and ability to access foreign exchange, analysts recommend how much credit to allocate to each country.

About 50 countries have been assessed under the new procedures for fiscal year 1991. Using this new risk analysis method, USDA decided that some countries should be moved into concessional food aid programs rather than GSM programs.

When USDA has conducted a risk analysis on a country that it wishes to include in the GSM program, it forwards a proposal to the National Advisory Council on International Monetary and Financial Policies (NAC). The NAC is an interagency committee that advises U.S. government agencies involved in making foreign loans. NAC membership consists of the Secretaries of the Treasury (who also serves as the chair), State, and Commerce; the U.S. Trade Representative; the Chairman of the Board of Governors of the Federal Reserve System; the President and Chairman of the Board of Directors of the U.S. Export-Import Bank; and the Director of the International Development Cooperation Agency. A staff committee comprised of economists and other agency professionals handles routine NAC business.

During NAC sessions, the members discuss proposals from each of their perspectives, including issues such as foreign policy, financial risk, and trade considerations. The NAC votes on the proposal, with each member's vote recorded on a poll sheet. An official NAC recommendation must carry a majority vote. The NAC makes recommendations that are only advisory in nature. USDA does not have to abide by a NAC recommendation. The NAC sends its recommendation, in the form of an "Action Notice," back to USDA, which has the option of following or ignoring it. However, USDA typically accepts NAC recommendations unless either Treasury or State is not in the majority. In those cases, USDA reconsiders the proposal before making its decision.

While the general procedures are as outlined above, they are not followed in every case. The NAC recommended approval of the $1 billion in credit guarantees to the Soviet Union only after a decision in December 1990 on the issue had been publicly announced by the administration.

CURRENT LAW MAY IMPEDE THE PROVISION OF ADDITIONAL CREDIT GUARANTEES TO THE SOVIET UNION

The Food, Agriculture, Conservation, and Trade Act of 1990 includes an inherent conflict. On the one hand, the act requires that not less than $5 billion in GSM-102 credits be made available in each year through 1995. On the other hand, restrictions included in the act may impede the ability of USDA to find $5 billion a year worth of eligible country participants. The act amends the Agricultural Trade Act of 1978 by prohibiting (1) the issuance of export credit guarantees in connection with sales of agricultural commodities to any country that the Secretary of Agriculture determines cannot adequately service the debt associated with such sale and (2) the use of export credit guarantees for foreign aid, foreign policy, or debt rescheduling purposes.

Over the past year, major international banks have drastically downgraded their ratings of the Soviet Union's ability to repay its external debt. The sharp drop-off in the Soviet Union's ratings has occurred more rapidly in 1 year, than did similar ratings for any other country since 1983 except for Kuwait at the time it was occupied by Iraq. According to a paper recently prepared by the Central Intelligence Agency and the Defense Intelligence Agency for the Technology and National Security Subcommittee of the Joint Economic Committee,

> "To finance their burgeoning import bill, the Soviets nearly doubled their total borrowing from the West from 1987 to 1989. In late 1989 they also began to run up an unprecedented backlog of late payments to Western suppliers. With these arrears coming on top of mounting domestic political and economic turmoil, the Soviets found Western banks unwilling to provide new loans last year. To alleviate the resulting credit crunch, the USSR has drawn down cash reserves in Western banks, stepped up gold sales, and obtained financial assistance from Western governments. Nonetheless, its hard currency position remains weak."

The paper also states that

> "The Soviets will also face a rising debt service burden in the form of interest charges and scheduled payments of principal on medium- and long-term debt. Some short-term credits that Western lenders have been refusing to roll over also will have to be repaid, and the pressure to eliminate arrears in payments to Western firms will be great."

If due to the Soviet Union's severe economic deterioration, the Secretary of Agriculture determines that the Soviet Union cannot adequately service the debt that would arise from receiving an additional $1.5 billion in agricultural credit guarantees, no new credits could be extended. The foreign policy and foreign aid restrictions would also prohibit extending additional credits to the Soviet Union if such credits could not be justified based on the risk analysis, even if the President believed that it would be in the national interest.

However, a determination by the Secretary that the Soviet Union would not be able to adequately service its debt is not necessarily preordained. Export credit guarantees issued to the Soviet Union are still less risky than the average guarantee issued to other countries. Reflecting this lower risk, the Soviet Union's debt is now traded in the secondary market at a price that is substantially higher than the average price of the debt of other countries in the GSM programs.

PROPOSED CHANGES TO CURRENT LAW

Amendments to the current law have been proposed. One of the proposed amendments would add a provision allowing the President to provide agricultural credit guarantees when he believes they are in the national interest, irrespective of the 1990 act's creditworthiness restriction. Another amendment would contain a similar provision and also provide a similar waiver to the foreign aid/foreign policy restrictions.

If the current legislation is amended to make credit guarantees available to high-risk countries irrespective of their ability to repay, it would return the program to the situation that existed before the enactment of the reforms in the Food, Agriculture, Conservation, and Trade Act of 1990. Such amendments would cause the programs to be more closely tied to foreign policy objectives. The use of the programs for this purpose will increase their cost to the taxpayer and thus allow export credit guarantees to be used as foreign assistance.

The benefits of the programs in terms of the development and retention of important U.S. markets, as well as the furtherance of U.S. foreign policy objectives, may justify the added costs of such a change. However, this change would create the potential for costly initiatives such as occurred with Iraq. Our November 1990 report[2] documents how using the GSM programs for foreign policy purposes proved very costly when Iraq stopped making payments due on outstanding guaranteed loans of $2 billion. In this connection, in our most recent report, titled Loan Guarantees: Export Credit Guarantee Programs' Long-Run Costs Are High, (GAO/NSIAD-91-180, Apr. 19, 1991), we estimated that long-run costs of the programs will be about $6.7 billion, or 60 percent of the $11.2 billion in loan guarantees and accounts receivable outstanding as of May 1990.

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[2] International Trade: Iraq's Participation in U.S. Agricultural Export Programs (GAO/NSIAD-91-76, Nov. 14, 1990).

Furthermore, we projected costs will be even higher if the level of outstanding loans and guarantees continues to grow and the average risk of new guarantees is not substantially reduced.

ALTERNATIVES TO EXEMPTIONS FROM CURRENT RESTRICTIONS

You also asked us to include in our testimony possible alternatives to the current export guarantee programs. We have not had the opportunity to fully develop possible alternatives for the consideration of the committee at this hearing. However, we would be happy to discuss some of our initial ideas during the question and answer period.

Mr. Chairman and Members of the Subcommittee, this concludes my prepared statement. I will be happy to answer any questions you might have.