United States General Accounting Office

GAO

Report to the Ranking Minority Member, Committee on Agriculture, Nutrition, and Forestry, U.S. Senate

February 1995

FORMER SOVIET UNION

Creditworthiness of Successor States and U.S. Export Credit Guarantees

GAO/GGD-95-60

GAO

United States
General Accounting Office
Washington, D.C. 20548

General Government Division

B-253793

February 24, 1995

The Honorable Patrick Leahy
Ranking Minority Member
Committee on Agriculture,
Nutrition, and Forestry
United States Senate

Dear Senator Leahy:

This report responds to your request that we assess the creditworthiness of the former Soviet Union and its successor states in the context of the U.S. Department of Agriculture's Office of the General Sales Manager (GSM)-102 agricultural export credit guarantee program.

As you requested, unless you publicly announce its contents earlier, we plan no further distribution of this report until 30 days after its issue date. At that time, we will send copies to the Secretaries of Agriculture, State, and the Treasury and other interested congressional committees. Copies will also be made available to other interested parties on request.

Please contact me on (202) 512-4812 if you or your staff have any questions concerning this report. Other major contributors to this report are listed in appendix IV.

Sincerely yours,

Allan I. Mendelowitz

Allan I. Mendelowitz, Managing Director
International Trade, Finance,
and Competitiveness

Executive Summary

Purpose

The U.S. Department of Agriculture's (USDA) Office of the General Sales Manager (GSM)-102 export credit guarantee program's mission is intended to help maintain and further develop U.S. agricultural markets overseas. However, the Food, Agriculture, Conservation, and Trade Act of 1990 (P.L. 101-624), also known as the 1990 Farm Bill, prohibits the issuance of export credit guarantees for agricultural commodities to any country that the Secretary of Agriculture determines cannot adequately service the debt associated with a GSM-102 sale. Since early 1991, USDA has provided more than $5 billion in GSM-102 export credit guarantees to the former Soviet Union (FSU) and its successor states.

The Ranking Minority Member of the Senate Committee on Agriculture, Nutrition, and Forestry asked GAO to assess the creditworthiness of the successor states in the context of the GSM-102 program. GAO analyzed their creditworthiness from a variety of perspectives, including debt burden, external financing requirements, liquidity, secondary market valuations of FSU debt, and country risk analyses. In addition, GAO (1) considered the general economic and political environment in the FSU and its successor states; (2) reviewed how the Soviet debt crisis developed and the relationship between debt problems, on the one hand, and economic reform and creditworthiness on the other; (3) examined how USDA assessments of creditworthiness and market considerations affected USDA's decisions on providing the FSU/successor states with credit guarantees; and (4) considered the exposure of the GSM-102 portfolio to default by the FSU and its successor states.

Background

"Creditworthiness" concerns a country's ability and willingness to service its current and future foreign debt obligations. The debt-servicing requirement in the 1990 Farm Bill does not include a general creditworthiness standard. Rather, it requires that the Secretary of Agriculture determine whether a prospective borrowing country is capable of adequately servicing the debt associated with a specific, proposed GSM-102 sale to that country before issuing a credit guarantee. However, there is a close relationship between a country's general creditworthiness and its ability to service particular debts.

According to one estimate, at the end of 1993 Russian and FSU debt combined totaled about $87 billion. Of the 15 states that succeeded the Soviet Union, Russia is the most important because it initially accepted responsibility for 61 percent of the former Soviet debt and more recently assumed responsibility for all FSU debt. The other states are Armenia, Azerbaijan, Belarus, Estonia, Georgia, Kazakhstan, Kyrgystan, Latvia, Lithuania, Moldova, Tajikistan, Turkmenistan, Ukraine, and Uzbekistan.

Under the 1990 Farm Bill, the GSM-102 program is intended to develop, expand, or maintain U.S. agricultural markets overseas by facilitating commercial export sales of U.S. agricultural commodities. Under the program, USDA's Commodity Credit Corporation (CCC) may guarantee loans with terms up to 3 years, enabling countries that are short of U.S. dollars to buy U.S. agricultural exports. During 1991-93, USDA, through CCC, provided export credit guarantees to the Soviet Union and two successor states at a time when these states were experiencing hard currency shortages. USDA did so because the Soviet Union was considered a critical market for U.S. agricultural exports, according to USDA officials and documents. The Soviet Union received $3.74 billion in credit guarantees. After its dissolution, and through September 30, 1993, Russia and Ukraine received credit guarantees equal to $1.06 billion and $199 million, respectively.

Results in Brief

Most, if not all, of the FSU successor states are not creditworthy, and all should be considered at least high risk from a creditworthiness perspective. Most of the states have had severe debt burden and severe liquidity problems. Russia's already serious debt burden has been compounded by its agreement with official creditors to accept responsibility for all FSU debt. Several independent evaluations of the risk of engaging in financial transactions with the successor states and the secondary market's valuation of the FSU debt indicate that the successor states lack creditworthiness.

The states are also high-risk entities because of their difficult economic and political situations. Their economies are in disarray, and political instability is a serious problem in several of the states. These conditions are not favorable for foreign investment, which is considered essential if the states are to be capable of meeting their financial needs.

Arrears on FSU debt have continued to grow since 1989—notwithstanding debt deferral, debt rescheduling, and other foreign assistance provided by creditor nations. Additional debt relief and foreign aid seem necessary if Russia is to succeed in paying off the FSU debt. Western creditor nations have indicated a willingness to provide more debt relief and other assistance, but much of this aid remains contingent on Russia's implementing additional and difficult macroeconomic and structural adjustment reforms. Whether, and when, Russia can or will implement such reforms are open questions.

During the period when USDA provided more than $5 billion in export credit guarantees to the FSU, Russia, and Ukraine, USDA's own evaluations indicated that these states were very risky in terms of their ability to repay GSM-proposed debt. However, USDA did not conclude that the states were incapable of adequately servicing the debt associated with the proposed guarantees. According to the Assistant General Sales Manager, decisions on the credit guarantees involved balancing creditworthiness considerations against market development opportunities.

As a result of the large amount of credit guarantees provided to the FSU and its successors and their poor creditworthiness, the GSM-102 loan portfolio is heavily exposed to default. Large defaults have already occurred on FSU and Russian debt, requiring substantial dollar outlays by the U.S. government.

GAO's Analysis

Overall Creditworthiness Is Low

Since 1989, substantial arrears have accrued on the FSU debt—in spite of debt relief, debt rescheduling, and other assistance provided by creditor nations. For example, arrears on official FSU debt were $500 million at the end of 1989, $11.8 billion at the end of 1992, and $8 billion through the first half of 1993. GAO's analysis of historical and forecast data indicates that all of the successor states, as a group, were severely indebted in 1992 and projected to remain so through 1997. All except a few small states had severe liquidity problems in 1992, and most successor states are projected to experience severe liquidity problems through 1997.

Russia's agreement, in April 1993, to accept responsibility for all of the FSU's debt burden has reduced the debt burden of other successor states but added to Russia's burden. At the same time, a number of the other states have been hurt by a reduction in transfers previously received. The latter include fiscal transfers from the FSU's budget and subsidies associated with the underpricing of Russia's energy and raw material exports. Some states have fallen into serious arrears with Russia and a few other successor states as a result of trade deficits.

Several organizations that assess the financial, economic, and/or political risk involved in lending to various countries of the world have rated Russia and the other successor states as very risky. For example, in March 1994 Euromoney ranked 11 of the 15 successor states in the bottom quartile of all countries that it evaluated. The secondary market for trading bonds and loans of developing countries has steeply discounted FSU debt. According to data provided to GAO by Chemical Bank, between July 1992 and March 1994, the price of FSU loans in the secondary market averaged 26.8 cents on the dollar.

Economic and Political Environment Undergoing Dramatic Change

The area bounded by the FSU has experienced extraordinary change in recent years. The successor states are currently in varying stages of transition to what many hope will be genuine democratic polities and free market economies. However, the latter outcomes are not assured. Economic decline in many of the successor states is comparable to or greater than that experienced by the United States during the Great Depression. Economic and political reforms are underway but have a long way to go. Russia experienced a serious constitutional crisis that culminated in a brief but violent attempt to overthrow the Yeltsin government in late 1993. Five other former Soviet republics (Armenia, Azerbaijan, Georgia, Moldova, and Tajikistan) have been convulsed by violent ethnic and civil strife and intraregional conflict.

Looking to the future, many analysts have suggested a wide spectrum of possible outcomes for the FSU—ranging from successful implementation of free market and democratic reforms to restoration of an authoritarian and anti-Western Russian empire. To the extent that the political and economic situation appears subject to crisis and/or widely divergent outcomes, foreign investment in the successor states is likely to be adversely affected. Total foreign investment in Russia, according to a Commerce Department official, is not more than $4 billion, a small amount relative to Russia's overall needs.

Need for Debt Relief and Economic Restructuring

In 1992, the International Monetary Fund (IMF) estimated that in 1992 alone Russia might have an external financing requirement of $20 billion to $25 billion, and the other successor states would require about $20 billion. According to an estimate by the Wharton Econometric Forecasting Associates Group (WEFA), the successor states would require more than $20 billion in debt relief and other financial assistance each year from 1993 through 1997.

In spring 1992, western creditor nations indicated a willingness to reschedule FSU debt and to provide Russia with substantial amounts of other assistance—provided that Russia adopted a significant economic reform program and demonstrated meaningful progress toward stabilizing its economy. However, during 1992 Russia fell significantly short of its goals for restructuring its economy and did not reach agreement with the IMF on an economic reform program that would lead to a standby loan agreement. (A standby agreement is established when a borrowing country agrees to meet certain economic performance criteria in return for receiving an IMF loan.)

In April 1993, representatives of the United States and 18 other western creditor nations found it necessary to reschedule about $15 billion of FSU and Russian debt payments already in arrears or coming due in 1993. At the same time, the Group of Seven industrialized nations agreed to provide substantial amounts of other types of financial assistance. However, much of the debt relief and foreign assistance were again contingent on the Russian government's adopting and implementing an ambitious and comprehensive macroeconomic and structural adjustment program.

During 1992 and 1993, creditor nations and international institutions offered to provide $40 billion in financial assistance (not including debt relief) to Russia, but only $23 billion was delivered. According to the IMF, much of the assistance was not forthcoming because Russia had failed to stabilize its economy. Most of the actual assistance was in the form of export credits (i.e., $18 billion), and much of this amount was short-term trade credits that had to be repaid in 1 to 3 years. Over the medium term, short-term trade credits (including USDA's GSM-102 export credit guarantees) can aggravate rather than ease a country's debt-financing problems.

In June 1994, creditor nation governments rescheduled another $7 billion of FSU debt and indicated that more comprehensive debt rescheduling was still necessary. As of October 1994, Russia had not reached final agreement with its commercial creditors on rescheduling $24 billion in debt that had been accumulating since late 1991. And Russia still had not achieved a standby agreement with the IMF. Some analysts have expressed concern that IMF-type economic reforms could lead to prolonged and massive unemployment, thus increasing the risk of possible political upheaval.

Credit and Market Development Risk

On several occasions between August 1990 and September 1992, USDA offices with primary responsibility for assessing the risk of proposed GSM credit guarantees recommended that guarantees not be provided or be limited to much smaller amounts than were subsequently made available to the FSU. However, other program officials saw the FSU and its successor states as a major market for U.S. commodities and were concerned that if guarantees were not made available, there might be adverse impacts on U.S. farm prices and on the cost of U.S. commodity support programs. From a creditworthiness perspective, they argued that the states had a good record in servicing U.S. agricultural debt and that FSU natural resources offered a good means for earning foreign exchange over the longer run. In addition, the Assistant General Sales Manager said USDA believed that the FSU would give preferential treatment to GSM-102 debt; otherwise, the FSU risked losing continued access to GSM credit guarantees. The manager noted that food was a priority item, since without adequate food supplies, political stability could be threatened.

While the GSM statute prohibits USDA from extending credit guarantees to any country the Secretary determines cannot service the debt, the statute does not require that a country be considered generally creditworthy in order to receive GSM credit guarantees. Furthermore, the statute does not provide any guidance as to what is an acceptable level of risk in evaluating whether countries can adequately service proposed GSM debt. Consequently, countries that USDA program officials assess as high risk can be approved for credit guarantees. Moreover, the statute does not place any limit on the amount of guarantees that can be provided each year to high-risk countries in aggregate or individually. Consequently, USDA can provide large amounts of guarantees to high-risk countries, making the GSM-102 portfolio subject to a potentially high rate of default.

GSM-102 recipient countries vary significantly in terms of their risk of defaulting on loans. However, CCC does not adjust the fees that it charges for GSM-102 credit guarantees to take into account the riskiness of borrowers. According to USDA officials, doing so might reduce the competitiveness of GSM-102 exports. In addition, the 1990 Farm Bill restricts CCC from charging a fee for any GSM-102 credit guarantee in excess of 1 percent of the amount of the credit. This restriction was first enacted in 1985 in response to an administration proposal to charge a 5-percent fee. Some Members of Congress were concerned that such a fee would adversely affect GSM-102 exports. However, if CCC fees included a risk-based component, this could be used to help offset the cost of defaults to U.S. taxpayers. The U.S. Export-Import Bank considers country risk as well as the repayment duration of loans in determining its fees, which range as high as $5.70 per $100 of loan guarantee coverage.

GSM-102 Portfolio Exposure and Costs to Taxpayers

At the end of January 1993, principal owed by the FSU, Russia, and Ukraine on GSM-102 guaranteed debt equaled about $3.6 billion. On the basis of an analysis of several independent ratings of the financial, economic, and political risk associated with lending to the various GSM-102 recipient countries, GAO estimated that the FSU and its successor states accounted for about 59 percent of the GSM-102 portfolio's risk at that time—even though they accounted for only 44 percent of the outstanding principal.

In the latter part of 1992, Russia began to default on payments for GSM-102 debt, causing USDA to suspend Russia's GSM-102 program. By the end of September 1993, net defaults on FSU and Russian debt totaled nearly $1.1 billion, and CCC had paid out more than $1 billion to settle claims of banks that had made the loans. On September 30, 1993, the United States completed an agreement to reschedule about $1.1 billion of GSM-102 debt. Under the agreement, Russia paid approximately $444 million in unrescheduled arrears by the end of 1993. During fiscal year 1993, USDA programmed about $1.4 billion in subsidized and donated food assistance to Russia and other successor states, helping to offset the loss of GSM-102 credit-guaranteed food imports.

During early 1994, Russia again fell into default on GSM-102 debt. During February, USDA agreed to reschedule $344 million in payments due during January 1 through April 30. In early June, USDA agreed to reschedule another $517 million in payments due during May 1 through December 31, 1994. Following the June rescheduling, Russia owed about $2.9 billion in principal on GSM-102 debt for the FSU and itself. Based on analysis of country risk ratings and secondary market ratings, GAO estimated that about $2 billion-$2.2 billion of this amount was at risk of default.

Recommendations

This report contains no recommendations.

Matters for Congressional Consideration

If Congress concludes that Russia or other successor states are too risky to receive additional GSM-102 credit guarantees, and if Congress concludes that continued agricultural exports to the states serve important U.S. economic and national security interests, Congress may wish to consider authorizing additional foreign aid to finance the sale of the food. Such additional authorization of foreign aid to finance food exports to the states could then be weighed against other priorities for U.S. foreign economic assistance

To reduce future exposure of the GSM-102 portfolio to default, Congress may wish to consider limiting the total amount of credit guarantees that can be issued each year to high-risk countries and the amount that can be provided to any single high-risk country. In addition, Congress may wish to consider (1) amending the statutory provision that precludes CCC from charging a fee in excess of 1 percent of the amount of the credit guarantee and (2) requiring the corporation to include a risk-based charge as part of its overall fee for GSM credit guarantees. Such fees could help offset the cost of potential defaults to taxpayers and equalize the value of the guarantees across all client countries.

Agency Comments

USDA commented on a draft of this report. In general, it said that the draft accurately presented the subject matter and USDA views expressed to GAO during the review. Most of USDA's comments are summarized and evaluated in chapter 6 and reproduced in appendix III. Other comments are incorporated in the report as appropriate.

USDA disagreed with GAO's draft conclusion that all of the FSU successor states were not creditworthy and said that its analysis had identified several states as being creditworthy. GAO recognizes that creditworthiness evaluations involve a multidimensional analysis of a variety of factors and some subjective judgment. As a result, evaluations by different parties may not always fully agree. Consequently, GAO restated its conclusion to say that most, if not all, successor states to the FSU are not creditworthy. USDA also disagreed with GAO's use of the secondary market for valuing FSU debt in assessing risk involved in lending to the FSU. USDA said it did not believe the secondary market is a reliable indicator of the value of FSU debt. GAO continues to believe that the secondary market is an appropriate method for valuing FSU debt. Chapters 5 and 6 include additional analysis supporting the use of this method.

USDA did not express any view regarding GAO's suggestions on how Congress could reduce future exposure of the GSM-102 portfolio to default. USDA agreed with GAO's suggestion that if Congress concludes that additional GSM-102 guarantees are not appropriate for Russia at this time, it might consider authorizing additional foreign aid to finance export sales.

Contents

Figures

Abbreviations

ASCS	Agricultural Stabilization and Conservation Service
CCC	Commodity Credit Corporation
CCCD	Commodity Credit Corporation Operations Division
CIA	Central Intelligence Agency
CIS	Commonwealth of Independent States
C&MP	Commodity and Marketing Programs Division
EEP	Export Enhancement Program
ERS	Economic Research Service
FAS	Foreign Agricultural Service
FSU	Former Soviet Union
FY	Fiscal year
G&FD	Grain and Feeds Division
GDP	gross domestic product
GNP	gross national product
GSM	General Sales Manager
G-7	Group of Seven nations
ICRG	International Country Risk Guide
IMF	International Monetary Fund
mbd	million barrels per day
mmt	million metric tons
NAC	National Advisory Council on International Monetary and Financial Policies
NIS	Newly Independent States
PDD	Program Development Division
P.L.	Public Law
STF	Systemic Transformation Division
TEID	Trade, Economics, and Information Division
USDA	U.S. Department of Agriculture
USSR	Union of Soviet Socialist Republics
VEB	Vnesheconombank
WEFA	Wharton Econometrics Forecasting Associates

Introduction

Two Department of Agriculture (USDA) programs—the Office of the General Sales Manager (GSM)-102 and GSM-103 export credit guarantee programs—are intended to promote the export of U.S. agricultural commodities. The programs' goals—under the 1990 Food, Agriculture, Conservation, and Trade Act,[1] also known as the 1990 Farm Bill—are to develop, expand, or maintain U.S. agricultural markets overseas by facilitating commercial export sales of U.S. agricultural commodities.[2] However, the statute also provides that the Secretary of Agriculture may not issue credit guarantees in connection with sales of agricultural commodities to any country that the Secretary determines cannot adequately service the debt associated with such sale. The law also prohibits issuing the credit guarantees for foreign aid, foreign policy, or debt-rescheduling purposes.

More than $16 billion in export credit guarantees were provided by the GSM-102/103 programs during fiscal years (FY) 1990 through 1992. The former Soviet Union (FSU) and two of its successor states, Russia and Ukraine, received 43 percent of the guarantees that were made available in fiscal year 1992. During fiscal year 1991 and fiscal year 1992, the FSU obtained more GSM credit guarantees than any other country in the world.

In deciding whether to extend GSM export credit guarantees to any country, USDA considers the prospects for developing and maintaining U.S. markets in that country, on the basis of our review of USDA documents and interviews with agency officials. Before providing guarantees, USDA also assesses the country's overall creditworthiness. Creditworthiness, in the context of this report, concerns a country's ability and willingness to service or make timely payments on its current and future foreign debt obligations.

Assessing the creditworthiness of nations generally involves a technical analysis of economic and financial indicators of the risk of nonpayment due to insufficient foreign currency and the likelihood that political or other nonfinancial events may disrupt payments. Some of the factors that affect creditworthiness are a country's level of indebtedness relative to its economic and financial resources, the ability of the country's government to effectively manage the domestic economy, and the general economic

[1] P.L. 101-624.

[2] GSM-102, the Export Credit Guarantee Program, allows foreign buyers to purchase U.S. agricultural commodities from private U.S. exporters, with U.S. banks providing financing with terms up to 3 years. GSM-103, the Intermediate Export Credit Guarantee Program, is similar to the GSM-102 program, except that terms of credit generally have a repayment period exceeding 3 years, but no more than 10 years.

and political situation in the country. Creditworthiness also involves temporal considerations. For example, some debtors may be judged not creditworthy over the short run due to a lack of readily available foreign exchange but may be considered capable of servicing their debts if additional time is allowed for them to organize and marshal their resources.

GSM Export Credit Guarantee Programs

The Department of Agriculture's GSM-102 and GSM-103 programs are aimed at facilitating the export of U.S. agricultural commodities to developing countries and middle-income countries with hard currency[3] shortages. They are intended to help importing nations make a transition from concessional financing[4] to cash purchases, as well as to maintain import levels during periods of financial difficulties.

Under the two programs, the U.S. government agrees to pay U.S. exporters or their assignees—U.S. banks or U.S. subsidiaries of foreign banks—in the event that a foreign buyer defaults on its loan obligation. By reducing the risk involved in selling U.S. agricultural products, USDA encourages exporters to explore new foreign market opportunities.

The USDA's Commodity Credit Corporation (CCC), which administers the GSM programs, attempts to share some of the credit risk with the exporter or the exporter's assignee (a bank or other financial institution). It does so usually by guaranteeing 98 percent of the value of the sale plus a portion of the interest payable. The exporter or the exporter's assignee is at risk for 2 percent of the principal and a portion of the interest payable. However, CCC has flexibility to adjust the amount of guarantee coverage it provides. USDA considers the GSM programs to be fully "commercial" in that they assist sales that are made by the private sector, and the interest rates are at "prevailing market levels." However, there is an important element of concessionality in the programs because recipient countries could not make the purchases without credit and loan guarantees. Furthermore, if the countries were able to obtain financing on commercial markets, they would have to pay a premium above the rates that they obtain from the GSM programs, since a U.S. government guarantee reduces the risk to the lender.

[3]Hard currencies, such as U.S. dollars or German marks, are those currencies typically accepted by a wide range of nations as mediums of exchange for international trade. Hard currencies are also used by countries to settle their foreign debts.

[4]Concessional financing occurs when the interest rates are below market rates and/or the repayment terms are considerably longer than those that can be obtained on the commercial market.

Debt-Servicing Requirements and Possible Budgetary Impacts

Section 202(f) of the 1990 Food, Agriculture, Conservation, and Trade Act prohibits the Secretary of Agriculture from issuing export credit guarantees in connection with sales of agricultural commodities to any country that the Secretary determines cannot adequately service the debt associated with such a sale. The provision was established in response to a situation that developed in the late 1980s and early 1990 when creditworthiness considerations were minimized for foreign policy objectives in order to provide Iraq with GSM export credit guarantees. Following the allied response to Iraq's invasion of Kuwait in 1990, Iraq defaulted on outstanding guaranteed GSM loans. As of August 17, 1994, CCC had received claims from 10 banks regarding Iraq's defaults. These claims totaled about $2.2 billion, and CCC had paid claims to nine of these banks, totaling $1.7 billion.

Section 202 (f) requires USDA to determine whether a country is capable of servicing the debt that would result from providing export credit guarantees for agricultural commodities. If a determination is negative, the provision prohibits USDA from making credit guarantees available to that country. USDA advised us that before making any loan guarantee commitments, it assesses the creditworthiness of intended recipients of guaranteed sales and uses the information in deciding whether to provide guarantees to specific countries.

In contrast to a direct loan, a credit guarantee does not involve dollar outlays to either the lender or the borrower when the loan is made. Nonetheless, budgetary outlays are required for loan guarantees when defaults occur and claims are made. To better account for the costs of federal credit programs, the Federal Credit Reform Act of 1990[5] required, beginning with fiscal year 1992, that the President's budget reflect the costs of the loan guarantee programs. To this end, new loan guarantee commitments can be undertaken only if appropriations of budget authority are made to cover their costs, including estimated payments by the government to cover defaults and delinquencies.

The act exempted all then-existing CCC credit guarantee programs from the appropriations requirement. However, CCC advised us that it is establishing what it calls an "allowance reserve" to cover its estimate of possible defaults on GSM loans. As of June 30, 1992, CCC had approximately $9.04 billion outstanding in GSM-102 and 103 guarantees on loan principal and $4.51 billion in accounts receivable from loan guarantee payouts on delinquent GSM-102 and 103 guaranteed loans. In a December 1992 report,

[5]P.L. 101-508.

we estimated the cumulative costs of the programs at about $6.5 billion, or 48 percent of the total $13.55 billion, if the programs had been terminated on June 30, 1992.[6]

Foreign Policy Considerations

In the past, decisions to provide GSM loan guarantees to countries were influenced by foreign policy considerations. Principal recipients of guarantees were often countries that had significant foreign policy relationships with the United States.[7] However, the 1990 Farm Bill stipulated that GSM export credit guarantees could not be used for foreign aid, foreign policy, or debt-rescheduling purposes. So, for example, if the Secretary of Agriculture determines under the debt-servicing requirement that a country cannot adequately service the debt that would arise from receiving agricultural export credit guarantees, no credits are to be extended—even if the president believes that such an extension would be in the national interest.

Despite the problems that arose from the Iraqi loan guarantees, as cited earlier, many Members of Congress have expressed the view that GSM credit guarantee decisions should take account of foreign policy and national interest considerations. For example, in May 1991 the Senate approved a nonbinding resolution (S. Res. 117) recommending that the administration extend another $1.5 billion in agricultural credit guarantees to the Soviet Union—assuming the administration found the country could service the debt—if certain foreign policy objectives would also be realized.[8]

In 1991, attempts were made to provide more flexibility in granting export credit guarantees; amendments to the 1990 Farm Bill were proposed that would have allowed the president to provide guarantees when he believes they are in the national interest, regardless of the debt-servicing requirement and foreign aid/policy restrictions. However, these amendments were subsequently withdrawn. Similarly, the administration's

[6]Loan Guarantees: Export Credit Guarantee Programs' Costs Are High (GAO/GGD-93-45, Dec. 22, 1992). In its financial statement for the period ending September 30, 1991, CCC estimated a percentage cost for its GSM programs of 30.9 percent. Our estimate differed from theirs because ours (1) was based on more current information and (2) used "mark-to-market techniques" so that the value estimates were more closely tied to secondary market prices rather than an analyst's subjective judgment. See chapter 5 for a discussion of secondary market prices.

[7]GAO/GGD-93-45.

[8]As an example of foreign policy objectives, the resolution urged the administration not to extend guarantees unless it secured clear and binding assurances from the then-Soviet government that the government would not use the guarantees to support the military, security, or Communist Party apparatus at the expense of helping the Soviet people.

1992 bill for authorizing assistance to the former Soviet republics[9] included a provision allowing the Secretary of Agriculture to take into account major economic reforms underway in those states in making a determination about the ability of the states to repay debt associated with GSM sales. However, this provision was struck from the bill that Congress passed in October 1992.

USDA officials told us that although the 1990 Farm Bill prohibits the Secretary of Agriculture from issuing export credit guarantees for foreign aid or foreign policy purposes, the law does not mean that such assistance cannot simultaneously serve foreign policy objectives. They noted that during congressional hearings held in late 1991 and in related briefings provided by USDA to congressional staff, the principal congressional focus with regard to agricultural credit guarantees was on keeping U.S. food moving to the FSU rather than on the risks associated with providing the guarantees.

GSM-102 and GSM-103 Sales by Country and Commodity, 1990 Through 1992

Table 1.1 provides information on GSM program sales by country for fiscal years 1990, 1991, and 1992. As shown, total GSM-102 credit guarantees were $4.6 billion in fiscal year 1990, $5 billion in fiscal year 1991, and $6.1 billion in fiscal year 1992. The GSM-103 program accounted for about $1 billion in guarantees during fiscal years 1990 through 1992. The table also shows that whereas the FSU received no GSM credit guarantees in fiscal year 1990, it was the major recipient in fiscal year 1991. In fiscal year 1992, the FSU and Russia, collectively, received more guarantees than any other nation.

[9]The former Soviet Union, or Union of Soviet Socialist Republics (USSR), included 15 republics: Armenia, Azerbaijan, Byelorussia, Estonia, Georgia, Latvia, Lithuania, Kazakhstan, Kirghizia, Moldavia, Russia, Tadzhikistan, Turkmenistan, Ukraine, and Uzbekistan.

Table 1.1: GSM-102/103 Export Credit Guarantee Commitments by Countries, FY 1990-92 (by Percent Distribution and Total Dollar Commitments)

	GSM-102				GSM-103	GSM-102 & –103
Country	**1990**	**1991**	**1992**	**Total 1990-92**	**Total 1990-92**	**Total 1990-92**
FSU/successors[a]	•	38%	43%	29%	•	27%
Mexico	33%	25	22	26	2%	25
Algeria	16	13	9	12	28	13
Korea	12	10	8	10	•	9
Pakistan	6	2	4	4	•	4
Iraq	11	•	•	3	•	3
Venezuela	2	2	3	2	2	2
Morocco	•	•	•	•	25	2
Colombia	3	1	1	2	•	2
Turkey	3	1	1	2	•	2
Tunisia	1	•	1	1	14	1
Egypt	4	•	1	2	•	1
Ecuador	3	1	1	1	•	1
Jordan	1	•	•	•	14	1
Trinidad & Tobago	1	1	1	1	•	1
Sri Lanka	•	1	•	•	1	1
Others	4	3	5	4	5	4
Total	**100%**	**100%**	**100%**	**100%**	**100%**	**100%**
Total commitments ($ in billions)	**$4.6**	**$5.0**	**$6.1**	**$15.7**	**$1.0**	**$16.8**

Legend: • = no guarantees were committed.

Note 1: Countries are listed in descending order based on percent share of GSM-102/103 guarantees committed (i.e., offered) by CCC during 1990-92. Actual exports may be less than commitments.

Note 2: Percentages may not add to 100 due to rounding.

[a]In fiscal year 1992, 30 percent of GSM-102 guarantees went to the former Soviet Union, 11 percent to Russia, and 2 percent to Ukraine.

Source: USDA's Foreign Agricultural Service (FAS). Percentages calculated by GAO.

Table 1.2 depicts the distribution of GSM-102 and 103 sales by type of commodity for fiscal years 1990, 1991, and 1992. As the table shows, wheat, yellow corn, and soybeans and soybean meal accounted for the majority of sales.

Table 1.2: Value of GSM-102/103 Exports by Major Commodities, FY 1990-92

Dollars in millions

Commodities	1990	1991	1992	1990-92	Percent
Wheat	$1,204.2	$797.8	$1,756.9	$3,759	27%
Yellow corn	860.9	1,372.0	1,090.6	3,324	24
Soybeans	289.2	482.3	652.0	1,423	10
Soybean meal	252.1	426.6	651.8	1,331	9
Grain sorghum	243.6	271.1	386.6	901	6
Cotton	202.3	210.8	240.6	654	5
Rice	223.4	44.5	55.0	323	2
Soybean oil	123.4	65.6	98.4	287	2
Tallow	104.3	63.4	64.3	232	2
Wood pulp	79.7	59.4	57.1	196	1
Lumber	114.5	49.3	23.8	188	1
Barley	91.2	6.6	46.9	145	1
Sunflowerseed oil	35.8	25.3	78.9	140	1
Beans, dry edible	96.6	•	25.2	122	1
Wheat flour	73.0	3.8	33.4	110	1
Milk, nonfat dry	25.3	4.6	56.0	86	1
Poultry meat	1.3	25.1	52.2	79	1
All other	318.0	234.1	173.4	725	5
Total	**$4,338.9**	**$4,142.6**	**$5,543.0**	**$14,024**	**100%**

Legend: • = none

Note 1: Individual commodities selected and listed in descending order based on total sales from fiscal year 1990 to fiscal year 1992.

Note 2: Data are based on commodities registered for export by CCC. Export registrations may be less than CCC guarantees offered.

Note 3: Commodity value as a percent of total value for all commodities.

Note 4: Dollars and percentages may not add to totals due to rounding.

Source: USDA'S Foreign Agriculture Service (FAS). Percentage calculations by GAO.

USDA Criteria for Assessing Creditworthiness

Within USDA, the Trade and Economic Information Division (TEID) of the Foreign Agricultural Service (FAS) is responsible for analyzing the ability and willingness of countries that have requested GSM-102 export credit guarantees to meet their current and future external debts, including potential GSM debt.

TEID evaluates creditworthiness in terms of whether a country is able and willing to service its current and future foreign debt obligations. Access to sufficient hard currency is seen as the key to whether a country is capable of servicing debt (principal and interest payments). TEID notes that external debt can be serviced through revenues derived from a country's current account,[10] from foreign exchange received from debt and investment inflows, or from a drawdown of a country's existing stock of foreign exchange reserves. Important factors that affect a country's ability to service its debts, TEID says, include the status of the current account balance; the volume of trade; the variability in current receipts; the size of international reserves; the country's access to capital account inflows, either from net direct investment, foreign borrowing, or foreign aid; and the country's ability to reduce its imports of goods and services.

TEID's approach also includes a review of the general economic and political situation of countries. If a country's economy is in a steep decline, its ability to earn foreign exchange from exports may be severely impaired. If the political system is unstable or if a country is subject to external threats to its sovereignty, concerns may arise about the country's willingness or ability to meet its future debt obligations.

The 1990 Farm Bill provision restricting when GSM-102 credit guarantees can be extended does not include a general creditworthiness standard. Rather, it requires that the Secretary of Agriculture determine whether a prospective borrowing country is capable of adequately servicing the debt associated with a specific, proposed GSM-102 sale to that country before issuing a credit guarantee. However, if a country is experiencing problems in servicing its debts or is likely to in the near future, any particular debt obligation (including a GSM loan), in our view, could result in default.

A country with low creditworthiness may be able to adequately service the debt associated with a particular GSM-102 sale if the country is willing to assign a priority to repayment of that debt (i.e., to not treat other creditors equally). In fact, USDA officials told us that the U.S. decision to extend substantial export credit guarantees to the FSU during 1991 was partly based on the assumption that the Soviet government would give preferential treatment to GSM-102 debt. U.S. officials reasoned that food was a high-priority item. Without adequate supplies of food, political stability could be threatened. Moreover, Soviet and, subsequently, Russian

[10]The current account consists of commodity exports, reexports and imports, services (such as tourism, banking, insurance, and transportation), profits earned abroad, and interest. It also includes unilateral transfers, such as grants of foreign aid or gifts. A current account deficit indicates that a country is spending more abroad than it is earning abroad.

leaders knew that if they fell into arrears on payments for GSM-102 guaranteed sales, the GSM-102 program would be suspended. Thus, they had an incentive to keep current on GSM-102 debt repayments if they wanted to secure future GSM credit guarantees.[11]

However, even if a borrowing country is willing to give preferential treatment to particular debts, creditor nations must pay close attention to its creditworthiness more generally. For example, if a prospective borrower country has low creditworthiness and its problems worsen, it may find it necessary to reschedule its debts. Under the normal rules of international debt restructuring, all official creditors (i.e., creditor country governments) are to be treated equally. Therefore, particular debts should not receive preferential treatment.

Exposure Guidelines

In addition to evaluating the creditworthiness of potential GSM credit guarantees, TEID establishes annual and total risk exposure guidelines to provide USDA with a yardstick for limiting its risk exposure in specific countries. The total exposure guideline for a country is TEID's recommended maximum dollar amount of GSM-guaranteed principal, rescheduled principal, interest arrears, and claims that the country should owe CCC at a given time.

Decisionmaking Process

TEID's country risk grades and exposure guidelines are used in USDA's decisionmaking process for allocating credits to requesting countries. However, TEID's recommendations about whether to extend credit and, if so, how much, are not binding on the agency. USDA considers not only the risk of providing loan guarantees but also the potential for expanding or maintaining U.S. markets overseas. A Reconciliation Committee, consisting of representatives from TEID and several other USDA offices, meets and discusses both the risk of lending to a foreign country and the prospects for developing and maintaining U.S. markets in that country. A recommendation is developed in committee. According to USDA officials, decisions about which countries should receive credit guarantees and in what amounts may be made by the Assistant General Sales Manager or the General Sales Manager, but sometimes the decisions are elevated to the level of the Under Secretary for International Affairs and Commodity Programs.

[11]During our field work in the FSU in spring 1992, Russian officials said that GSM-102 debt was receiving preferential treatment because food was a priority item. However, as discussed shortly, Russia subsequently defaulted on large amounts of the debt.

The National Advisory Council (NAC) on International Monetary and Financial Policies also provides advice to USDA on GSM credit guarantee actions.[12] USDA sends all GSM-102/103 proposals to NAC for review. Proposals are submitted after USDA has conducted its own risk analysis on a country in question. NAC's recommendations are only advisory in nature and do not necessarily reflect fiscal risk. However, we were told that USDA does not typically challenge NAC recommendations unless the Treasury or the State Department are not in the majority when a vote on a recommendation is taken.

Objectives, Scope, and Methodology

The Ranking Minority Member of the Senate Committee on Agriculture, Nutrition, and Forestry asked us to assess the creditworthiness of the FSU and its 15 successor states.[13] The FSU's 15 republics became independent states between August and December 1991, as part of the historic change that swept across the Soviet Union in the late 1980s and early 1990s. This change culminated in the collapse of the Soviet empire and the demise of the Communist Party.[14] The successor states are Armenia, Azerbaijan, Belarus, Estonia, Georgia, Kazakhstan, Kyrgyzstan, Latvia, Lithuania,

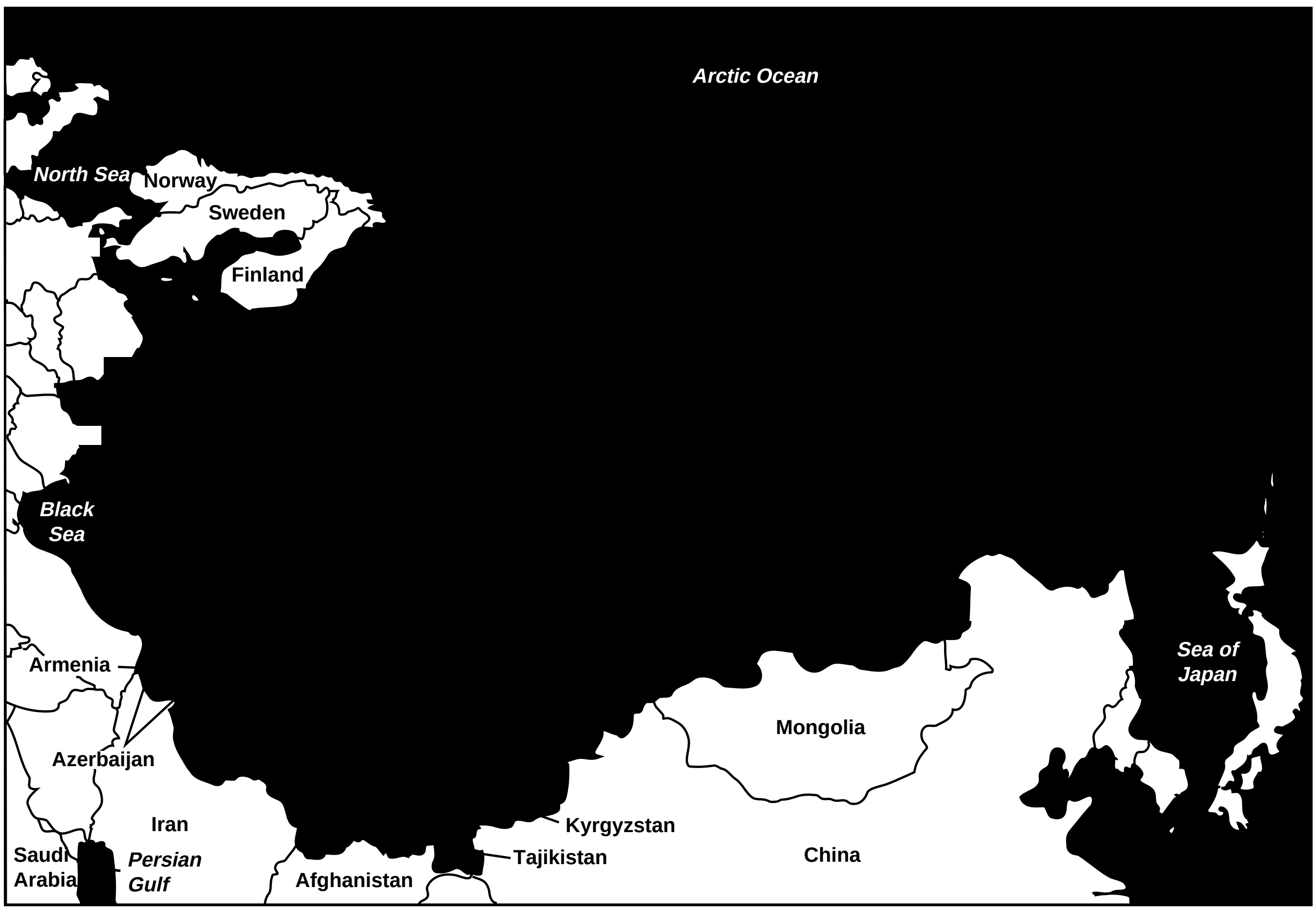
[12]NAC guides and advises U.S. government agencies involved in making foreign loans or engaged in foreign financial, exchange, or monetary transactions. Besides coordinating the actions of U.S. agencies, NAC ensures, when possible, that the actions of international financial institutions are consistent with U.S. policies and goals. However, despite its title, NAC positions are not limited to monetary and financial issues. Members are allowed to vote on the basis of their respective agency interests, expertise, and alliances. 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.

[13]The requester also asked us to assess the (1) status of agricultural reforms in the NIS; (2) relationship, if any, between GSM-102 credit guarantees and agricultural reforms; (3) whether food provided under GSM-102 credit guarantees was distributed equitably among the FSU republics prior to the dissolution of the Soviet Union; and (4) the food situation in the NIS. These issues were addressed in a separate GAO report. See Former Soviet Union: Agricultural Reform and Food Situation in Its Successor States (GAO/GGD-94-17, Nov. 19, 1993).

[14]In August 1991, some of the highest officials of the USSR's Communist Party, internal security apparatus, and the armed forces launched a coup for the purpose of forestalling signing of a new union treaty that would have radically shifted power from the central government to the republics. The coup failed. Thereafter, disintegration of the USSR's central political authority and the economy continued. In early September 1991 the central government recognized the full independence of the Baltic states of Estonia, Latvia, and Lithuania. On December 8, Russia, Ukraine, and Belarus declared that the Soviet Union no longer existed and signed an agreement to form a Commonwealth of Independent States (CIS)—for the purpose of coordinating policies on nuclear weapons and other defense issues, economic reform, banking, energy, transportation, rights of national minorities, and cultural affairs. On December 21, they were joined by eight other republics. (The three Baltic states and Georgia chose not to join. However, as discussed in ch. 4, Georgia joined in 1993.) The dissolution of the Soviet Union was formalized on December 25, 1991, when Mikhail Gorbachev resigned as President and on December 26 when the Soviet legislature dissolved itself.

Moldova, Russia, Tajikistan, Turkmenistan, Ukraine, and Uzbekistan.[15] (See fig. 1.1 for a map showing the location of the states).

Figure 1.1: Map of the Former Soviet Union and Its Successor States



Source: International Monetary Fund

Source: International Monetary Fund.

[15]In this report, the term "former Soviet Union" (FSU) includes all 15 former republics, and the term "successor states" refers to the states that succeeded the republics following the end of the Soviet Union. The term "newly independent states" (NIS), a term used by the Department of State, includes all of the successor states except for the three Baltic countries. (The United States never recognized the Soviet Union's annexation of the Baltic states in 1940.)

We analyzed the creditworthiness of the FSU and its 15 successor states from a variety of perspectives, including debt burden, gross financial requirements, liquidity, secondary market valuations of FSU debt, and country risk analyses. In addition, we (1) considered the general economic and political environment in the FSU and its successor states; (2) reviewed how the Soviet debt crisis developed and the relationship between debt problems, on the one hand, and economic reform and creditworthiness on the other; (3) examined how USDA assessments of creditworthiness and market considerations affected USDA's decisions on providing the FSU/successor states with credit guarantees; and (4) estimated the exposure of the GSM-102 portfolio to default by the FSU and its successor states.

To assess the creditworthiness of the FSU and its successor states, we (1) analyzed their debt burden and liquidity situations, using historical and forecast data; (2) considered the importance of arrears, debt relief, and International Monetary Fund (IMF) arrangements as measures of creditworthiness; (3) applied USDA/TEID criteria for measuring the relative creditworthiness of countries to the successor states; (4) reviewed secondary market prices of FSU loans and bonds; and (5) analyzed several country risk ratings of the creditworthiness of the FSU and its successor states, including preparing a composite rating for each of the states.

To examine the role of U.S. agricultural exports to the FSU and its successor states and the use of GSM-102 credit guarantees to promote such trade, we analyzed USDA data and related information on U.S. agricultural exports generally and GSM export credit guarantees more specifically. To assess the development of the Soviet debt crisis, we reviewed information on debt-servicing problems and efforts by the Group of Seven (G-7) industrialized nations[16] and international institutions to provide financial assistance to help alleviate those problems. In reviewing the economic and political situation in the FSU and its successor states, we examined data and information on economic conditions and political events during recent years and considered the views of a number of experts and U.S. government agencies. To assess the exposure of the GSM-102 portfolio to default by the FSU and its successor states, we analyzed GSM-102 data on outstanding principal owed by all GSM-102 recipients, including weighting the data according to country risk evaluations of the creditworthiness of the recipients. In addition, we used data on secondary market prices of FSU loans and country risk ratings to estimate the risk of default on external debt of the successor states. The

[16]Canada, France, Germany, Italy, Japan, United Kingdom, and the United States.

secondary market expresses the value of a country's loan as a percentage of its face value. The extent to which a loan's value is discounted in the secondary market indicates how the financial market assesses the risk of default. We estimated the default risk by subtracting a country's secondary market price from $1 and dividing the result by 100. A similar technique was used for country risk ratings.

In conducting our review, we interviewed representatives of the U.S. Departments of Agriculture, State, and the Treasury. We also conducted field work in five of the FSU's successor states (Belarus, Kazakhstan, Russia, Ukraine, and Uzbekistan) and in Paris, Bonn, and Brussels. In the latter three cities, we met with representatives of the French and German governments and the European Union.

We also reviewed U.S. legislation relating to GSM-102/103 programs, as well as other government documents and documents of the World Bank and IMF, and private sector ratings of country risk and creditworthiness. In addition, we reviewed information on violent conflicts that have affected Russia and other successor states (see app. I) and compared the debt burden of countries to debt payment problems, IMF arrangements, and debt relief agreements (see app. II).

We obtained comments from the Department of Agriculture on a draft of this report (see app. III). We summarize and evaluate most of USDA's comments in chapter 6, and some comments are addressed directly in other chapters of this report.

We did our work between April 1992 and December 1994 in accordance with generally accepted government auditing standards.

U.S. Agricultural Trade With the Former Soviet Union and Role of the GSM-102 Program

The FSU has been a major purchaser of U.S. bulk[1] agricultural exports since 1972; until 1991, it usually made such purchases with cash. However, owing to its increasing financial difficulties (see ch. 3), in the latter part of 1990 the Soviets sought export credits to finance their imports of commodities and food products. The United States responded positively. Between December 1990 and September 30, 1993, the United States offered to provide up to $5.97 billion in GSM-102 export credit guarantees to the FSU and those successor states that qualified for the program. As of September 30, 1993, $5.02 billion had been provided, $0.949 billion was no longer available to the FSU, and $3.85 billion was still owed to the United States on FSU credit-guaranteed purchases.

As a result of these sizable guarantees, the GSM-102 program has become heavily exposed to default by Russia, which has undertaken the responsibility as guarantor of the debt of the FSU. Guaranteed sales to the FSU and/or its successor states accounted for 38 percent of all GSM sales in fiscal year 1991 and 43 percent in fiscal year 1992 (including Russia and Ukraine). The FSU and its successor states now hold the largest portion of all outstanding GSM-102/103 loan guarantees. In late November 1992, Russia began missing payments due on GSM-102 debt for the FSU. By the end of September 1993, Russian defaults on FSU and Russian debt totaled nearly $1.1 billion. At that time, the United States agreed to reschedule $1.1 billion of GSM-102 debt. In January 1994, Russia again fell into default on GSM-102 loans. By early June 1994, the United States had agreed to reschedule another $882 million.

Background

As discussed in our 1993 report, the FSU was the world's largest producer of wheat and one of the world's largest producers of grains overall.[2] It was also a major producer of potatoes, sugar beets, cotton, and sunflowers. Despite its vast production of crops, however, the FSU was a net importer of food. Its imports averaged just under $20 billion per year, about half of which was for grains and sugar. The need for extensive imports continued following the dissolution of the Soviet Union in December 1991.

We found that extensive food imports were necessary because the states had been unable to efficiently harvest, store, process, and distribute much

[1]Bulk commodities include unprocessed grains and other raw agricultural products that do not require specialized transportation.

[2]Unless otherwise noted, the material in this section is from our recent report, GAO/GGD-94-17.

of what was grown.[3] Difficulties associated with each of these steps of the food production system combined to create huge losses due to spoilage after crops were initially produced. For example, approximately 25 to 30 percent of grain and 30 to 50 percent of potatoes and vegetables produced in the FSU and its successor states were lost annually because of these problems. Moreover, in absolute terms, aggregate annual grain loss of the successor states (excluding the Baltic states) was, on average, about 30 million to 40 million metric tons (mmt),[4] which was roughly equal to the size of their aggregate annual grain imports.

After 1985, the Soviet Union announced a series of initiatives to reform agriculture, ranging from making changes in land ownership laws to paying farmers hard currency for high-quality crops sold to the state in excess of original state-contracted amounts. However, for a variety of reasons, these initiatives did not produce substantive results. By 1991, the availability of basic food staples, such as potatoes, meat, and bread, was far worse than before agricultural reforms were initiated.[5] As discussed in our 1993 report, following the dissolution of the Soviet Union, agricultural reforms in the successor states proceeded slowly, with varied progress among the states. Reforms considered or undertaken in these states included the liberalizing of food prices; restructuring of state and collective farms; and privatizing of food production, wholesale and retail trade, processing, storage, and transport. However, agricultural reform has been slow, in part because successor state governments fear that rapid reform might lead to significant production shortfalls and unemployment. In turn, such disruptions could cause food shortages and discontent that would threaten the political and social stability needed by these governments to proceed with reforms. Our report also found that agricultural reforms have been impeded by (1) bureaucratic resistance from some persons with vested interests in the old central command system and (2) fear of change by workers on state and collective farms.

U.S. Trade With the FSU

Since the early 1970s, the FSU was a major customer for U.S. bulk agricultural commodities, although U.S. exports fluctuated greatly from year to year. The trade relationship was fostered by a series of U.S.-Soviet

[3]According to a USDA official, some successor states will likely continue to require some food imports, even if food handling and distribution inefficiencies are reduced. This official said, for example, that food production in Armenia and Kyrgyzstan is constrained by their mountainous topographies, necessitating food imports.

[4]A metric ton equals 1.1 tons, or 2,200 pounds.

[5]International Trade: Soviet Agricultural Reform and the U.S. Government Response (GAO/NSIAD-91-52, June 28, 1991).

long-term bilateral grain agreements. Annual sales varied in response to a variety of factors, including fluctuations in Soviet agricultural production, changes in the nature of the U.S.-Soviet political relationship, and competition from other exporters of agricultural commodities.

Table 2.1 shows U.S. agricultural exports to the FSU and its successor states as a percent of U.S. agricultural exports to the world, between 1976 and 1993 (percents were calculated on the basis of the dollar value of the exports). For the entire period, exports to the FSU and its successor states accounted for 5.5 percent (on an average annual basis) of the total value of U.S. agricultural exports to the world. For the 1991-93 period, the average annual share was 5.3 percent. Grain and soybeans/soybean products accounted for the large majority of U.S. agricultural exports to the FSU and its successor states.

Table 2.1: U.S. Agricultural Exports to the FSU/Successor States as a Percent of U.S. Agricultural Exports to the World, 1976-93

Dollars in millions

Year	U.S. exports to FSU/successor states	U.S. exports to the world	U.S. exports to FSU/successor states as a percent of exports to the world
1976	$1,558	$22,978	6.8%
1977	1,046	23,636	4.4
1978	1,756	29,382	6.0
1979	2,998	34,749	8.6
1980	1,138	41,234	2.8
1981	1,685	43,338	3.9
1982	1,871	36,627	5.1
1983	1,473	36,099	4.1
1984	2,878	37,804	7.6
1985	1,923	29,041	6.6
1986	658	26,222	2.5
1987	938	28,709	3.3
1988	2,252	37,080	6.1
1989	3,597	39,909	9.0
1990	2,271	39,363	5.8
1991	2,508	39,204	6.4
1992	2,346	42,930	5.5
1993	1,758	42,609	4.1

Source: USDA/Economic Research Service (ERS).

Table 2.2 shows U.S. corn, wheat, and soybean/soybean product exports to the FSU and its successor states as a percent of the total value of such commodity exports to the world between 1976 and 1993. The table shows that corn and wheat exports generally accounted for 10 percent or more of total U.S. exports of the same commodities.

Table 2.2: U.S. Corn, Wheat, and Soybean Exports to the FSU/Successor States as a Percent of Total Exports of Such Commodities, 1976-93

Years	Corn	Wheat	Soybeans[a]
1976-80[b]	16.6%	10.2%	3.2%
1981-85[b]	16.4	11.5	1.0
1986-90[b]	18.6	11.3	6.0
1991	25.1	13.0	12.6
1992	14.1	21.1	7.0
1993	12.5	11.1	3.0

Note: Percents calculated using the value of exports in million U.S. dollars.

[a]Includes soybeans, soybean oil, and soybean meal.

[b]Average annual percentages.

Source: GAO analysis of ERS data.

GSM-102 Sales to the FSU and Its Successor States

Beginning in the early 1970s, the FSU became more or less a permanent grain importer. Generally, through 1990, it was a cash customer when it purchased U.S. agricultural commodities.[6] However, during the last months of 1990, the Soviets sought to line up export credits to purchase needed food from countries that traditionally exported agricultural commodities to the Soviet Union. The Soviets needed such credits because they had a limited amount of hard currency reserves available to purchase food and other items and to finance their continuing trade deficit with nonsocialist countries.[7]

[6]During 1972 through 1975, CCC made available $750 million in credits to the FSU to be used to buy grains. The FSU used about $550 million of these credits. Offers of further U.S. credits ended when Congress passed the Jackson-Vanik amendment to the Trade Act of 1974 (P.L. 93-618). This amendment barred access to U.S. credit and credit guarantee programs to countries that restrict emigration. To begin offering credit guarantees to the Soviet Union in 1990, the President of the United States temporarily waived the freedom of emigration provisions contained in the amendment.

[7]According to USDA, Soviet hard currency earnings and reserves fell during the 1980s as a result of declining world oil prices. For example, the Organization of Petroleum Exporting Countries' official average sales price for a barrel of crude oil was $30.87 in 1980, $23.49 in 1986, and averaged $17.71 during 1987 through 1989. Declining world oil prices adversely affected hard currency earnings from Soviet oil exports. See chapter 3 for a discussion of how hard currency reserves became a problem in the FSU.

On December 12, 1990, the Secretary of Agriculture announced that $1 billion in GSM-102 export credit guarantees would be made available for agricultural sales to the Soviet Union. (January 1991 was the first month in which guarantees were allocated for actual commodity purchases.) The decision was made during a time of a food shortage in the Soviet Union.[8] The U.S. response to the Soviet Union's request for assistance took place in the context of growing western efforts to help the Soviet Union. As of December 1990, Canada, France, Germany, Italy, and Spain had announced about $3 billion in agricultural credits to the Soviet Union for purchases in the following months. The United States had also stated its support for the Soviet President's "perestroika" (restructuring) measures and fundamental economic reform objectives. When the GSM credits were announced in December 1990, the White House Press Secretary said they reflected the administration's desire to promote a continued positive evolution in the U.S.-Soviet relationship.[9]

In April 1991, the Soviet Union requested another $1.5 billion in GSM-102 export credit guarantees for 1991. However, the request occurred at a time of growing concern about Soviet creditworthiness. In hearings held in May 1991, the Deputy Under Secretary for International Affairs and Commodity Programs indicated to a congressional committee that under the 1985 Farm Bill[10] it was quite possible to consider the creditworthiness of a country suspect but still proceed with a full GSM program for the country because market development considerations outweighed the financial risk. However, he said, USDA believed that such an approach was no longer possible and that as a result, USDA's flexibility in operating the credit guarantee programs had been considerably limited. As discussed in chapter 1, the 1990 Farm Bill added the requirement that the Secretary of Agriculture may not issue credit guarantees in connection with sales of agricultural commodities to any country that he determines cannot adequately service the debt associated with such a sale.

During May 1991, there was extensive debate in the Senate about whether to provide additional credit guarantees to the Soviet Union. The debate focused on (1) whether the Soviet Union was creditworthy, (2) what factors should be considered in assessing a country's ability to repay GSM debt, (3) whether credit guarantees should be provided or denied to the

[8]See the next section for a discussion about whether there was a food shortage.

[9]In commenting on a draft of this report, USDA said one could argue that the main reason for Western assistance was to maintain markets.

[10]The Food Security Act of 1985 (P.L. 99-198).

Soviet Union because of foreign policy considerations, and (4) what the impact on the United States and U.S. farmers would be if guarantees were not provided and sales not made. On May 15, 1991, the Senate approved (by a vote of 70 to 28) a nonbinding resolution (S. Res. 117) that said that as the administration evaluates the Soviet request, it should consider in its evaluation such factors as whether the Soviets were able to service current debt and whether the absence of U.S. guarantees would jeopardize U.S. market development. Similarly, on May 31, 1991, 37 members of the House Committee on Agriculture sent the Secretary of Agriculture a letter that said the Secretary should consider, among other factors, the U.S. ability to access, maintain, and develop markets for U.S. agricultural products, including an assessment of whether the absence of U.S. credit guarantees would jeopardize the ability to access and develop such markets.[11]

In June 1991, the President approved the Soviet request for $1.5 billion in additional credit guarantees. Subsequently, in July 1991, USDA's Assistant General Sales Manager told us that the Senate resolution and letters that USDA had received from Members of Congress had provided helpful guidance on how to interpret the requirements of the 1990 Farm Bill. He said that without that guidance, it is not clear whether USDA would have made a determination that the Soviet Union was creditworthy. The official noted that the entire GSM program was predicated on making credit available beyond what the private sector would provide.

During the summer of 1991, increasing apprehension about the Soviet Union's creditworthiness affected its ability to obtain financing for U.S. agricultural commodities—even for purchases backed by U.S. credit guarantees. According to an official of Vnesheconombank (VEB), the Soviet Bank for Foreign Economic Affairs, U.S. commercial banks no longer felt comfortable with the 98-percent guarantee coverage that USDA typically offers. The banks, he said, wanted CCC to provide 100-percent coverage of the principal or have the exporters absorb some of the risk.

On September 24, 1991, CCC agreed to guarantee 100 percent of principal. Between then and the end of fiscal year 1993, all of the credit guarantees to the FSU, Russia, and Ukraine included 100-percent coverage of the

[11]The Senate resolution and the House letter also urged the administration to take into account (1) the country's present situation in servicing similar government-to-government credit guarantees, (2) the degree of exposure represented by the credit guarantee request as a percentage of total financing available to the country from other sources, (3) the country's repayment performance on previous debt, and (4) the national assets that may ensure an ability to repay debt.

principal.[12] In comparison, none of the other countries that received GSM-102 credit guarantees in fiscal year 1991 through March 4 of fiscal year 1994 were provided more than 98-percent coverage.

In November 1991, the White House announced that another $1.25 billion in credit guarantees was being made available, along with $250 million in food aid and technical assistance. The White House said that the President's decision would help the Soviet Union, its republics, and their peoples cope with immediate food shortages and aid in the longer term restructuring of the country's food distribution system. However, owing to concern about whether the Soviet Union would continue to exist, this commitment was not made until after Russia and the other republics agreed to "joint and several liability" for the debts of the Soviet Union.[13] In December 1991, the Soviet Union did dissolve. At that time, a considerable portion of the November GSM credit guarantees had not been allocated. CCC announced that the unused guarantees (about $650 million) would be available for sale to any of the 12 republics.[14] However, all sales for the unused guarantees went to the 12 states of the FSU as a group.[15]

In April 1992, the President announced that another $1.1 billion in credit guarantees would be made available. However, because several of the successor states (particularly Russia and Ukraine) wanted separate programs, USDA indicated that the guarantees would henceforth be made on a bilateral basis. Of the $1.1 billion announced at that time, USDA said that $600 million was being designated for Russia. The remaining $500 million would be available for Ukraine and the other states provided they met GSM-102 program qualifications. Only Ukraine received any of this commitment—$109 million. According to a USDA official, the remaining $390 million is no longer available. In September 1992, USDA announced that $900 million in new guarantees was being made available to Russia for fiscal year 1993. One month later, USDA announced a commitment of $200 million for Ukraine for fiscal year 1993. Between January and

[12]Estonia and Uzbekistan received small amounts of guarantees in fiscal year 1993 (see table 2.3) that included 98-percent coverage of the principal.

[13]Each state agreed that it would be jointly liable with the other states for the debts of the Soviet Union and that it would assume sole responsibility if the other states defaulted.

[14]As discussed in chapter 1, the Soviet Union had recognized the independence of the three Baltic states in September 1991.

[15]In February 1992, member states of the CIS and Georgia signed an agreement designating Russia as the guarantor and negotiator on behalf of all in matters related to the use of foreign credits for the purchase of food. They also agreed to use two Moscow-based foreign trade organizations to handle the food imports.

September 1993, USDA announced small amounts of credit guarantees for Estonia ($5 million) and Uzbekistan ($15 million).

Table 2.3 summarizes information on all GSM-102 commitments made to the FSU and its successor states through September 30, 1993. As the table shows, U.S.-announced guarantees totaled $5.97 billion. As of September 30, 1993, $5.021 billion had been registered for export.[16] Of this, the FSU received $3.74 billion, Russia $1.06 billion, Ukraine $199 million, and two other states a total of $20 million. The remaining $949 million in announced guarantees is no longer available because the period of time during which the guarantees could have been registered for export has expired.

[16]An export credit guarantee is considered issued when the export is registered for sale with CCC and the exporter has paid a fee for the service. The exporter registers the dollar value of what he or she thinks will be exported. Actual shipments in total may be somewhat lower than guarantees issued.

Table 2.3: GSM-102 Export Credit Guarantee Announcements and Amounts Actually Registered for Export to the FSU and Its Successor States, as of September 30, 1993

Dollars in billions

		Announcement designees			Amounts registered for export[a]			
Date announced	**Amount announced**	**FSU**	**Russia**	**Others[b]**	**FSU**	**Russia**	**Ukraine**	**Others**
Dec. 90	$1.000	$1.000	•	•	$1.000	•	•	•
Jun. 91	1.500	1.500	•	•	1.497	•	•	•
Nov. 91	1.250	1.250	•	•	1.247	•	•	•
Apr. 92	1.100	•	$0.600	$0.500	•	$0.545	$0.109	$0
Sep. 92	0.900	•	0.900	•	•	0.513	•	•
Oct. 92	0.200	•	•	0.200	•	•	0.090	•
Feb. 93	0.005	•	•	0.005	•	•	•	0.005
Aug. 93	0.015	•	•	0.015	•	•	•	0.015
Total	**$5.970**	**$3.750**	**$1.500**	**$0.720**	**$3.744**	**$1.058**	**$0.199**	**$0.020**

Legend: • Guarantees were not announced or registered.

Note: An announcement represents an expressed intention by USDA to make guarantees available to the country or countries designated up to the dollar amount specified. It does not represent a binding commitment. After making an announcement, USDA announces an allocation, which specifies commodities for which export guarantees can be obtained and the total dollar amount of guarantees available by commodity. The dollar value of commodities actually registered for export by CCC, and hence credit guaranteed, depends on the value of the commodities that a designated country chooses to purchase and whether the country meets GSM-102 program requirements for the full value of those purchases.

[a]If the amount announced exceeds the dollar value of the amount registered for export, the unused portion is no longer available. With regard to the April 1992 announcement and export registration for Russia, the difference is $55 million. CCC offered Russia direct credit terms (comparable to the terms of GSM-102 credit guarantees) for the purchase of $55 million of CCC stocks of butter. Russia actually purchased $21 million of butter under the offer.

[b]In April 1992, CCC announced $500 million for successor states other than Russia; however, Ukraine was the only state to qualify for any of these guarantees. The October 1992 commitment of $200 million was designated for Ukraine only. USDA announced a $5-million allocation for Estonia in February 1993 and a $15-million allocation for Uzbekistan in August 1993.

Source: USDA/FAS.

Fiscal Year 1994 GSM-102 Credit Guarantees

During fiscal year 1994, USDA announced the availability of GSM-102 credit guarantees for successor states as follows: Kazakhstan, $15 million; Ukraine, $40 million; Turkmenistan, $10 million; and Uzbekistan, $15 million. In each of these cases, CCC agreed to cover only 98 percent of the principal. For Kazakhstan, Turkmenistan, and Uzbekistan, USDA required that principal repayments be made every 6 months. For Ukraine, however, USDA indicated principal repayments could be made annually.

Although USDA said it would make up to $40 million available for Ukraine, only $20 million was authorized during the fiscal year.

In addition to the above states, in September 1994, USDA announced it was authorizing $20 million in GSM-102 credit guarantees for sales to private sector buyers in Russia for fiscal year 1994. The guarantees offered to Russia were significantly different from guarantees previously made available to the FSU and its successor states, including Russia. Under the terms of the announcement, the guarantees could be effective for up to 90 days only rather than up to 3 years. The offer followed a long period during which Russia did not receive any guarantees as a result of substantial defaults on its GSM-102 credit-guaranteed loan payments (see later discussion in this chapter).

Total GSM-102 guarantees offered to the successor states in fiscal year 1994 equalled $100 million, a small fraction of the amounts offered in fiscal years 1991, 1992, and 1993. (See table 2.3 and the accompanying discussion.)

Was There a Food Shortage?

In commenting on a draft of this report, USDA said it is important to clarify that there were no food shortages in the sense that the USSR did not produce enough food. Before the breakup of the USSR, USDA said, shortages and long lines existed in state stores where prices were controlled, resulting in "surplus demand" at those locations. No shortages existed in the farmer markets where prices were relatively freely set and substantially higher than state-set prices. After the breakup of the Soviet Union, USDA said, price liberalization led to higher prices, increasing the availability of food by decreasing surplus demand.

The primary problems facing the FSU in terms of food supply, USDA said, are disruptions due to military conflict and the reduced purchasing power of consumers, which has put some groups (such as the elderly and unemployed) at risk. Humanitarian assistance could address, and in many cases has addressed, these problems. USDA also said that it would not characterize 1990 as a time of food shortages. It noted that the 1990 grain crop was one of the largest in history and reiterated that the food problems in the Soviet Union were a function of controlled prices and surplus demand, not a "shortage of supply."

We do not disagree with USDA's description of what caused the food problems in the FSU but believe that our use of the term "food shortages" to characterize the situation in the FSU is consistent with what both USDA and others were saying at the time. For example, on December 12, 1990, the White House issued a fact sheet that said that the GSM-102 export credit guarantees being made available at that time were a form of food assistance that "will help the Soviet authorities address current food shortages." A Congressional Research Service report of December 3, 1990, concluded that even with bumper grain crops in the Soviet Union in the fall, food losses due to harvesting and spoilage problems and a breakdown in food processing and distribution systems had resulted in shortages of food products, particularly in the larger Soviet cities and in remote areas far from the major food producing regions.[17] Similarly, a May 1991 USDA report on Soviet agriculture used the term food shortages several times in describing food problems in the Soviet Union.[18]

GSM Sales Relative to Total U.S. Exports to the Region

Since the beginning of 1991, most U.S. agricultural exports to the FSU and its successor states have been financed through GSM-102 credit guarantees. For example, the United States exported $6.6 billion in agricultural commodities to the FSU during 1991 through 1993. Between January 1991 and September 30, 1993, CCC registered for export $5 billion in GSM-102 credit-guaranteed food.

Table 2.4 shows that the principal GSM-102 commodity exports to the FSU, Russia, and Ukraine have been grains (i.e., yellow corn and wheat) and soybeans and soybean products (i.e., soybean meal and soybean oil). The table also shows that the GSM commodity exports to the three countries accounted for a considerable portion of total GSM-102 and 103 commodity exports to the world during fiscal years 1991 and 1992.

[17]Soviet Food Shortages: U.S. Policy Options, Library of Congress, Congressional Research Service (Washington, D.C.: Dec. 3, 1990).

[18]USSR Agriculture and Trade Report, USDA, Economic Research Service (Washington, D.C.: May 1991).

Table 2.4: Value of GSM-102/103 Exports to the FSU/Successor States and to the World, by Commodities, Fiscal Years 1991-92

Dollars in millions

	FY 1991		FY 1992		FY 1991-92		
Commodity	**FSU/ successors**	**World**	**FSU/ successors**	**World**	**FSU/ successors**	**World**	**Percent[a]**
Yellow corn	$947	$1,372	$799	$1,091	$1,747	$2,463	71%
Wheat	202	798	1,101	1,757	1,303	2,555	51
Soybean meal	268	427	508	652	776	1,078	72
Soybeans	108	482	131	652	239	1,134	21
Poultry meat	21	25	28	52	49	77	64
Soybean oil	•	66	43	98	43	164	27
Barley	•	7	36	47	36	54	67
Sunflower seed oil	•	25	27	79	27	104	26
Tallow	•	63	20	64	20	128	16
Almonds	9	9	5	5	14	14	100
Rice	•	45	8	55	8	100	8
Hops	2	2	5	5	7	7	100
Soy isolates	•	•	6	6	6	6	100
Chicken franks	5	5	•	•	5	5	100
All other	•	818	•	980	•	1798	0
Total[b]	**$1,563**	**$4,143**	**$2,717**	**$5,543**	**$4,280**	**$9,686**	**44%**

Legend • = no exports

Note 1: Successor states include Russia and Ukraine. Specific commodities shown include commodities that were sold to the FSU or successor states. Commodities are listed in rank descending order based on the dollar value of sales to FSU/successors for fiscal year 1991-92. The FSU and its successor states received only GSM-102 exports.

Note 2: Numbers may not add due to rounding.

[a]FSU/successors as a percent of GSM-102 and GSM-103 world exports. Percent calculations by GAO.

[b]Totals for exports to FSU/successors differ from previously discussed credit guarantees made available, since there is a lag between the two.

Sources: USDA's FAS and ERS.

USDA Assessments of FSU And successor States' Creditworthiness and Impact on Decisions About Whether to Provide Credit Guarantees

We examined USDA documents recording the results of meetings of USDA's Reconciliation Committee on whether to provide credit guarantees to the FSU and its successor states. We found that FSU and, subsequently, Russian and Ukrainian creditworthiness were assessed as very risky by the committee during the 2-year period when USDA's CCC made available more than $5 billion in credit guarantees to these countries. We also found that there was considerable disagreement between those participants whose primary concern was to assess financial risk and those responsible for assessing market opportunities. The committee sought to develop recommendations that would reconcile or balance the financial risks and market development opportunities.

The Assistant General Sales Manager or the Acting General Sales Manager chaired the committee. Other participants included representatives from several offices under USDA's Under Secretary for International Affairs and Commodity Programs. These included (1) the Financial Management Division of the Agricultural Stabilization and Conservation Service (ASCS); (2) the CCC Operations Division (CCCD); (3) the Commodity and Marketing Programs (C&MP), including its Grain and Feeds Division (G&FD); (4) the Program Development Division (PDD); and (5) the Trade and Economic Information Division.

August-December 1990

The Reconciliation Committee met on August 21, 1990, to consider a recommendation to provide GSM-102 export credit guarantees to the FSU. Members presented very strong arguments for both a $2-billion program based on market development opportunities and a limited $500-million (or less) program based on financial and political risks. The Reconciliation Committee Chairman suggested a $1-billion program as a good balance between market development and risk. However, given strongly opposing views, the committee decided to further assess the situation.

The committee met again on September 19, 1990. TEID, responsible for assessing country risk, reported that there was continued deterioration in the Soviet economic situation and a further unraveling of the political situation. It recommended a maximum exposure of no more than $500 million in credit guarantees for the Soviet Union. ASCS, responsible for establishing limits on the amount of credit guarantees that could be handled by Soviet banks, said that on the basis of bank financial risks, macroeconomic issues, and political problems, it was strongly against a GSM program higher than $280 million. It noted a rapid and major decline in Soviet creditworthiness, reports of military movements outside of

Moscow, and open discussion of a coup in the Soviet Union. Both TEID and ASCS cited a plan being circulated in the Soviet Union for changing the balance of power between central authorities and the republics, and they expressed concern about who would be responsible for repayment if republics split from the Soviet Union. ASCS said that if the Soviet plan were implemented, the Soviet banking system would be decentralized and that VEB, the only Soviet bank authorized to issue letters of credit to obtain credit guarantees, might not have sufficient hard currency to repay its obligations.

CCCD asked whether the committee could even consider anything over $500 million, given the negative financial information presented by TEID and ASCS. The Reconciliation Committee Chairman agreed that based on financial information only a smaller program was warranted. However, he reminded the participants that the purpose of the committee was not only to consider financial risks but also to reconcile these risks with market development opportunities. He said the committee had the responsibility of sending forward a recommendation that was balanced between risks and market development.

C&MP, which had urged at least a $2-billion program for the Soviet Union in August 1990, again urged a large program to meet many potential market development opportunities. It said (1) the Soviet Union represented the largest market development opportunity in the world and also had the greatest future potential, (2) there were many competitors lined up to extend credit to the Soviets, (3) any loss in U.S. market share would be severely detrimental to U.S. agricultural business and producers, and (4) loss of the Soviet market would result in higher domestic program costs for CCC now and in future years. In addition, C&MP said the Soviet Union's ability to pay should not be based solely on current market information. It noted that the country had the largest untapped resource base in the world and that even though its financial condition was bad, it was still paying its agricultural debts to the United States.

In spite of the wide differences of view, the committee recommended a $1.25-billion program for the Soviet Union—subject to certain conditions, such as releasing the guarantees in segments and securing a credit guarantee assurance letter from the Soviet federal government.[19] In

[19]A credit guarantee assurance letter makes the government of the buying country financially responsible for letters of credit issued by banks in that country to obtain credit guarantees. Thus, if a bank issuing letters of credit should default on the associated credit guarantee loan payments, the government of the buying country is legally responsible for reimbursing the U.S. government for payments the latter must make to the U.S. lending bank(s) to cover payment defaults.

addition, the committee said it wanted reviewers of its recommendation to know that there was extreme risk in its proposal and a substantial chance that CCC would have to make outlays. The committee said it felt that CCC should accept a degree of country risk that it would refuse for another country because (1) the Soviet Union was our largest export market for grains, and the health of the American farm community was directly dependent on maintaining market share in that market; and (2) in the event of a loss of the Soviet market, CCC would also make substantial outlays under domestic programs.

According to documents provided to us by USDA, the Reconciliation Committee did not meet again to discuss the Soviet situation between the time of its September recommendation and December 12, 1990. On the latter date, the Secretary of Agriculture announced that the President had waived the Jackson-Vanik amendment to the 1974 Trade Act emigration requirements in order for the Soviet Union to purchase U.S. agriculture commodities using USDA credit guarantees. The Secretary said $1 billion in guarantees would be made available to fulfill a request made by the Soviet government.

May-June 1991

In May 1991 the Reconciliation Committee met twice to consider a Soviet request for an additional $1.5 billion in credit guarantees. In a May 2 meeting, TEID advised the members that the Soviet economic and political situation was rapidly deteriorating and questioned who would repay Soviet loans if the Soviet Union did not survive. TEID said that on the basis of a "best-case" scenario, it could propose no more than $300 million in added credit guarantees. PDD said it favored postponing any further credits. Among some of the reasons it offered were that (1) section 202 (f) of the 1990 Farm Bill stipulated that credit should not be extended to countries that cannot adequately service the debt, (2) CCC exposure was already over CCC's guideline, (3) Soviet instability seemed likely to continue, (4) foreign exchange reserves would likely decline, and (5) there was uncertainty about implementation of the Jackson-Vanik amendment. ASCS recommended no new credits.

In contrast, C&MP told the committee that the Soviets could use all of the $1.5 billion in credit guarantees and that if the United States did not extend credit, it would be out of the market. C&MP warned that the U.S. reputation as a reliable supplier would suffer, and long-term trade repercussions would follow. G&FD questioned whether there was not room to work out a solution. It noted that the Soviet Union had huge resources and there had been no occasion of its delaying payment. G&FD warned that the President and the Secretary of Agriculture might be embarrassed if guarantees were not extended, since the Soviet state had an obligation to feed its people and the credit guarantees would be used to purchase grain, a fundamental staple. The meeting ended with the committee recommending that no further credit be extended to the Soviet Union for the time being. However, it said a reexamination should be initiated if, for example, Congress acted to clarify the interpretation of section 202(f) of the 1990 Farm Bill. As previously discussed, during May 1991 the Senate approved a nonbinding resolution, and 37 members of the House sent the Secretary of Agriculture a letter indicating that USDA should assess the impact on U.S. commodity exports if additional credit guarantees were not extended to the Soviet Union.

On May 28, 1991, the Reconciliation Committee met to review its previous position and to be briefed by the Chairman and the General Sales Manager on the results of a presidential mission that had visited the Soviet Union between May 17 and 26, 1991, and of which the Chairman and the manager were members. The Chairman reported there were no real signs of hunger or food shortages in the Soviet Union. The General Sales Manager told the committee that Soviet officials had advised USDA that they could not provide firm financial figures relative to Soviet creditworthiness. As a result, he said, Soviet figures had lost their credibility, and a Soviet request for additional credits would have to be viewed as a political rather than commercial request. TEID agreed. Although the committee noted that the Soviet Union had passed a new immigration law that would make the Jackson-Vanik requirement less of a problem in the future, the committee concluded that there was no basis for changing its previous recommendation not to extend further credit guarantees to the Soviet Union.

The committee's recommendation notwithstanding, on June 11, 1991, the President announced his decision to extend another $1.5 billion in loan guarantees to the Soviet Union. According to the White House Press Secretary, the President's assessment of the Soviet Union's creditworthiness was based on the following: (1) its record of never defaulting on an official loan involving the United States; (2) its positive repayment history on several hundred million dollars in loans through the 1970s, primarily from the U.S. Export-Import Bank; (3) the judgment of the USDA team that had visited the Soviet Union in May; (4) the subsequent review by the Secretary of Agriculture; (5) the administration's discussions with Soviet officials; and (6) the commitment of President Gorbachev to move toward a market economy.

In July 1991, the Assistant General Sales Manager told us that food was a priority item for the Soviet government, since without adequate food supplies political stability could be threatened. The government had an incentive to stay current on GSM debt payments, he said, because Soviet officials knew that if the government did not remain current, the GSM-102 program would be suspended.

August-October 1992

The Reconciliation Committee met on August 12, 1992, to discuss a possible fiscal year 1993 GSM-102 program for Russia. PDD recommended a $1.2-billion program. It noted that Russia had not missed a payment on any of the FSU's GSM-102 debt and that VEB and Russian officials had continually said Russia would honor all of its GSM-102 obligations. C&MP said Russia's commodity import needs greatly exceeded the $1.2-billion recommendation and that GSM-102 was essential to maintain the U.S. share of the Russian market. It warned that U.S. exports to Russia would be needed to help offset U.S. farm program costs.

TEID objected to the proposed $1.2-billion program. It advised the committee that CCC was vastly overexposed and at substantial risk of realizing large losses on the FSU and Russian programs. TEID said that Russia's ability and commitment to resume full debt servicing in fiscal year 1993 were very doubtful and that FSU debt was likely to be rescheduled following Russian negotiation of a standby agreement with the IMF.[20] TEID said it was impossible to establish a meaningful debt exposure guideline for additional credits, since Russia was not creditworthy for the size of its existing program. TEID recommended that Russia be extended other assistance of a more concessional nature. ASCS also objected to the proposed program level due to the substantial credit risk. It noted that the debt exposure level for VEB was well over the established bank limit now set by ASCS at $130 million, that VEB continued to fall behind on its interest payments to other creditors, and that VEB had been late on a number of GSM debt payments to banks. In addition, responsibility for the FSU debt on the part of each former republic had yet to be settled.

In the absence of a committee consensus, on August 28, 1992, the Committee Chairman recommended a $1.2-billion Russian program to the

[20]See chapter 5 for a discussion of IMF financial arrangements, including standby agreements, programs, and loans.

Acting Under Secretary for International Affairs and Commodity Programs. The Chairman detailed the differing views of the committee members. He noted that the proposed program might slightly reduce CCC's total exposure and indicated that if there were no fiscal year 1993 program for Russia, there would be a highly damaging impact on farm prices and resulting outlays under U.S. domestic commodity support programs.

On August 26, 1992, the Reconciliation Committee met to discuss a fiscal year 1993 GSM-102 program for Ukraine. PDD recognized continued deterioration of the Ukrainian economy but recommended a $200-million program. It said GSM-102 financing would be needed to maintain U.S. market share and that Ukraine officials had stated they would honor all of their GSM-102 obligations. C&MP estimated Ukraine's credit needs as closer to $300 million and said that the market would provide significant U.S. sales opportunities well into the latter half of the 1990s. In contrast, TEID recommended against a fiscal year 1993 program. It found Ukraine overexposed based on its fiscal year 1992 program and its share of repayments of the FSU program. It warned that unless Ukraine's record significantly improved, TEID believed Ukraine would not obtain sufficient international financing and foreign exchange earnings to pay for its imports and service its foreign debts. ASCS, which had established a bank limit of $0 for the State Export-Import Bank of Ukraine, also recommended against any further CCC credits.

In the absence of a committee consensus, in September 1992 the Chairman recommended a $150-million Ukrainian program to the Acting Under Secretary. The Chairman said he was again trying to balance financial risk against market development opportunities. He said providing credits would mark the first time that USDA had made credit guarantees available to a country whose current risk rating was below grade (i.e., not creditworthy), but he also said the proposed program would represent a minimal presence in a major market where the United States had a strong interest.

On September 14, 1992, USDA announced that during fiscal year 1993 it would provide Russia with $900 million in GSM-102 credit guarantees and $250 million in food aid. On October 19, 1992, USDA announced an allocation of $200 million in export credit guarantees to Ukraine for fiscal year 1993.

Relationship Between Credit-Guaranteed Food Imports and Agricultural Reform

As we have previously reported,[21] the progress of agricultural reform in the successor states might be hindered by the provision of export credit guarantees by the United States and other countries. Credit guarantees allow the successor states to continue to import billions of dollars of foreign grain and other food commodities. Because these commodities are generally purchased, processed, and distributed by state-owned enterprises, these structures are likely to survive longer as state monopolies than might otherwise be the case, although we were unable to quantify this effect. It is these inefficient state enterprises that successor state reformers seek to privatize or replace with alternative, nonstate structures, such as commodity exchanges and private food processors, distributors, and wholesalers. In addition, credit guarantee-assisted food imports might hinder domestic food production and the efficient processing and marketing of this food by keeping down prices offered to successor state farmers and food processors and distributors.

At the same time, however, a number of successor state officials we contacted felt that credit guarantee-assisted food imports had benefited the overall economic reform process in the states more generally. According to these officials, the food imports helped to preclude food shortages and thereby contributed to the political and social stability needed to advance the overall economic reform process.

In commenting on a draft of this report, USDA indicated that credit-guaranteed assistance has adversely affected reform in the FSU. According to USDA, although widespread dislocation in the food supply never occurred, the West continued to provide assistance (credits and food aid) to the FSU, which accepted it to the likely detriment of economic reforms (increased debt and continued state control of agricultural marketing that lowers productivity, increases waste, and possibly undercuts domestic production). According to USDA, FSU leaders figured it was in their best interest to accept western assistance since repayment, if any, would be delayed. USDA also noted that before its breakup, the Soviet Union also imported large amounts of grain rather than pay farmers more to increase domestic grain procurement and to reduce waste.

[21]GAO/GGD-94-17.

Exposure of the GSM Programs to Default on Former Soviet Union/Successor States' Debt

In the space of 2 years, the GSM-102 program quickly became heavily exposed to debt of the FSU and its successor states. As table 1.1 showed, in fiscal year 1990 there were no GSM sales to the FSU. In fiscal year 1991, GSM guaranteed sales to the FSU were $1.9 billion, which equalled 38 percent of all GSM-102 sales that year. In fiscal year 1992, the FSU, Russia, and Ukraine together accounted for $2.6 billion, or 43 percent of all GSM-102 guaranteed sales.[22] Not surprisingly, the FSU and its successor states accounted for the single largest portion of all outstanding loan guarantees from the GSM-102/103 programs combined. As of the end of January 1993, CCC had $8.8 billion in outstanding loan guarantees (principal only) from these programs.[23] Of this amount, $3.6 billion, or 40.9 percent, was accounted for by guarantees provided to the FSU, Russia, and Ukraine. When the outstanding principal owed by GSM recipient countries is weighted by the risk of countries defaulting on their debt payments, we estimate that the exposure to default by the FSU, Russia, and Ukraine is even greater. See table 5.12 and accompanying discussion in chapter 5.[24]

Table 2.5 provides the repayment schedule for the FSU's GSM-102 loans as of the end of February 1993.

Table 2.5: GSM-102 Schedule of Payments and Defaults for the FSU, Russia, and Ukraine, as of February 28, 1993

Dollars in millions

	FSU		Russia		Ukraine[a]	Total[b]	
Time Period	**P+I**	**Defaults**	**P+I**	**Defaults**	**P+I**	**P+I**	**Defaults**
1991	**$38.3**	**$0**	**$0**	**$0**	**$0**	**$38.3**	**$0**
1992	**991.8**	**141.4**	**5.7**	**4.1**	**1.1**	**998.6**	**145.5**
1st quarter	279.8	0	0	0	0	279.8	0
2nd quarter	123.5	0	0	0	0	123.5	0
3rd quarter	233.5	0	0	0	0	233.5	0
4th quarter	355.2	141.4	5.7	4.1	1.1	362.0	145.5

(continued)

[22]The country with the next largest change in the program during this period was Iraq. It accounted for 11 percent of GSM-102 exports in fiscal year 1990 and no sales in fiscal year 1991 and fiscal year 1992.

[23]These figures do not include any payments in default or claims paid by CCC. As of June 30, 1992, CCC had $9.04 billion outstanding in GSM-102/103 guarantees on loan principal for all GSM recipient countries and $4.51 billion in accounts receivable resulting from guarantee payouts on previously delinquent GSM-guaranteed loans.

[24]The discussion in chapter 5 focuses only on the GSM-102 program.

Dollars in millions

	FSU		Russia		Ukraine[a]	Total[b]	
Time Period	**P+I**	**Defaults**	**P+I**	**Defaults**	**P+I**	**P+I**	**Defaults**
1993	**1,314.3**	**196.7**	**270.1**	**4.6**	**65.4**	**1,649.8**	**201.3**
1st quarter[c]	537.1	196.8	4.6	4.6	1.1	542.8	201.4
2nd quarter	229.2	•	69.4	•	19.1	317.7	•
3rd quarter	212.2	•	111.3	•	18.3	341.8	•
4th quarter	335.7	•	85.0	•	26.8	447.5	•
1994	**1,287.0**	•	**270.6**	•	**62.9**	**1,620.5**	•
1st quarter	536.5	•	7.8	•	0.7	545.0	•
2nd quarter	223.1	•	66.2	•	18.3	307.6	•
3rd quarter	201.1	•	118.5	•	18.0	337.6	•
4th quarter	326.4	•	78.2	•	25.9	430.5	•
1995	**396.7**	•	**260.3**	•	**60.4**	**717.4**	•
1st half	393.4	•	68.8	•	17.7	479.9	•
2nd half	3.4	•	191.5	•	42.7	237.6	•
1996	**0**	•	**4.2**	•	**0**	**4.2**	•
Grand Total	**$4,028.2**	**$338.1**	**$810.9**	**$8.7**	**$189.9**	**$5,029.0**	**$346.8**

Legend: P + I = principal and interest payments.
• = not applicable.

Note 1: Numbers may not add to totals due to rounding.

Note 2: Schedule does not reflect debt reschedulings of September 1993 and June 1994.

[a]Ukraine had not defaulted on its GSM-102 payments.

[b]Totals calculated by GAO from the country row data.

[c]Through February 28, 1993.

Source: Commodity Credit Corporation.

As the table shows, combined principal and interest payments due from the FSU, Russia, and Ukraine for 1993 equaled nearly $1.65 billion; in 1994, $1.62 billion; and in 1995, about $0.72 billion. The figures do not reflect, as discussed below, USDA's April 1993 and June 1994 agreements to reschedule a considerable amount of FSU GSM-102 debt.

Since Russia is the only successor state making payments on GSM-102 debt for the FSU and since Russia accounts for nearly all credit guarantees committed since the program was converted to a bilateral mode, the GSM program is particularly vulnerable if Russia is not able or willing to make payments on GSM debt. As table 2.5 shows, Russia began defaulting on scheduled payments for both the FSU and Russia itself beginning in the fourth quarter of 1992. As a result of these defaults, USDA suspended Russia's participation in the GSM-102 program. By March 31, 1993, FSU and Russian defaults totaled nearly $648 million (see table 2.6).

Table 2.6: Status of Defaults on FSU and Russian GSM-102 Credit-Guaranteeed Loans and CCC Payouts on U.S. Bank Claims, as of September 30, 1993

Dollars in millions

	FSU			Russia		
Defaults and Claims	**As of 3/31/93**	**As of 6/30/93**	**As of 9/30/93**	**As of 3/31/93**	**As of 6/30/93**	**As of 9/30/93**
Net defaults reported by banks to CCC	$645.1	$897.9	$1,117.1	$2.6	$7.8	$10.5
Gross claims by banks submitted to CCC	517.8	771.6	1,117.0	0.3	4.0	25.2
Claims withdrawn because recovered	0	0	0	2	2	1.8
Gross claims paid by CCC	263.8	557.0	1,093.3	0.1	3.7	22.9
Claims recovered by CCC from defaulter	0.2	0.2	0.2	0.1	0.1	12.6
Claims paid by CCC and not recovered	$263.6	$556.8	$1,093.1	$0	$3.6	$10.3

Note: The status of defaults was calculated prior to the conclusion of a debt rescheduling agreement on that day.

Source: Commodity Credit Corporation.

On April 2, 1993, the United States reached a provisional agreement with Russia to reschedule approximately $1.1 billion of GSM-102 debt.[25] The agreement covered FSU principal and interest arrears, as well as payments coming due in calendar year 1993, on export contracts made in 1991. The rescheduled debt would be repaid over 7 years, with a 2-year grace period on principal repayments. Not covered by the rescheduling were $287 million in FSU arrears accumulated through March 31, 1993. Under the proposed agreement, Russia was to eliminate the arrears by June 30, 1993, and stay current on GSM-102 payments as they came due. However, rather than eliminating the arrears, Russian defaults increased. By the end of September 1993, net defaults totaled nearly $1.13 billion, and the Commodity Credit Corporation had paid out $1.1 billion in net claims to U.S. banks that had made the loans (see table 2.6.).

[25]The GSM-102 debt rescheduling was part of a broader agreement concluded between 19 creditor nations and Russia (see ch. 3 for additional discussion).

Nonetheless, on September 30, 1993, the United States and Russia concluded a debt rescheduling agreement along the lines of the April proposal. Under the agreement, Russia accepted responsibility for all of the GSM-102 debt of the FSU. The agreement provided for rescheduling an estimated $1.07 billion of GSM-102 debt, including a considerable amount of the arrears. In addition, Russia agreed to repay approximately $444 million in unrescheduled arrears in three installments by the end of 1993. Table 2.7 shows the schedule for Russia's repayment of FSU and Russian GSM-102 debt following the September 1993 debt rescheduling. As the table shows, the debt was to be fully repaid by the year 2000. In addition, Russia was required to continue to make payments, as they come due, for FSU and Russian GSM-102 export contracts made after 1991. According to USDA, a determination on resumption of the GSM-102 program for Russia could not be made until the debt issues were fully resolved and all arrears were eliminated.

Table 2.7: Total Principal and Interest Payments Due From Russia to U.S. Banks and the U.S. Government on the FSU and Russian GSM-102 Programs, as of October 1, 1993

Dollars in millions

Year payments due	Principal payments	Estimated interest payments[a]	Total principal & interest
1993	84	23	107
1994	$1,560	$124	$1,684
1995	$753	$76	$829
1996	289	53	342
1997	206	39	245
1998	206	28	234
1999	206	18	224
2000	179	7	186
Total	**$3,483**	**$368**	**$3,851**

Note 1: Payment includes rescheduled debt as agreed to in the September 30, 1993, debt-rescheduling agreement between the United States and Russia. It does not include unrescheduled arrears of $444 million that were repaid by December 31, 1993.

Note 2: Schedule does not reflect debt rescheduling agreement of June 1994.

[a]Interest amounts due were estimated. U.S. banks usually adjust the rate every 6 months based on rates in effect at the time of the adjustment.

Source: USDA's ASCS.

Russia did pay the arrears by the end of 1993. However, during early 1994, Russia again fell into default on GSM-102 debt. For example, during the first 70 days of 1994, Russia was in default about 51 days. In February, USDA agreed to reschedule $344 million in 1991 payments coming due during the January 1 through April 30, 1994, time period. On June 4, 1994, USDA agreed to reschedule another $517 million in payments due during the May 1 through December 31, 1994, period, as well as $22 million in deferred interest. Repayment terms for the principal included a 2.75-year grace period followed by an 8-year repayment period. The deferred interest on the rescheduling agreement is to be repaid over a 5-year period. Russia was still required to pay approximately $360 million owed to CCC and U.S. banks for the January through December 1994 period.

The amount of GSM-102 principal outstanding for Russia subsequent to the June 4 rescheduling agreement was $2.85 billion. This figure included principal amounts, interest, and capitalized interest due under the FSU program and the Russian program. At the time of the June rescheduling Russia was in arrears, and the rescheduling enabled Russia to become current on those arrears. The rescheduling occurred as part of a broader agreement concluded in Paris between Russia and its official creditors. The creditor countries also agreed to meet with Russia later in 1994 to discuss a longer term and more comprehensive rescheduling to address Russia's severe financial problems.

Meanwhile, on June 2, 1994, Ukraine began defaulting on its GSM loan payments. As of August 17, 1994, its defaults totaled about $31.1 million and CCC had paid $21.6 million for claims made by lenders.

Impact of U.S. GSM-102 Exports to the FSU on U.S. Commodity Support Programs and U.S. Farmers

According to USDA, providing export credit guarantees to banks willing to extend loans to foreign purchasers of U.S. agricultural commodities increases the demand for U.S. exports. This increase, in turn, results in higher commodity prices for U.S. farmers and lower costs for U.S. government commodity support programs.[26] Proponents of the GSM-102 credit guarantees point out that these reduced program costs offset the risk of default on the guaranteed debt.[27] We reviewed USDA estimates of the cost savings associated with the extension of export credit guarantees to the FSU and its successor states in fiscal years 1991 and 1992. The FSU and its successor states received GSM-102 export credit guarantees for the purchase of U.S commodities and freight, and they also secured lower prices for certain commodities as a result of USDA Export Enhancement Program (EEP) bonus payments to U.S. exporters.[28]

USDA initially provided us with two estimates of savings in commodity support programs associated with extending GSM-102 export credit guarantees to the FSU. The first estimate, which was made in conjunction with a proposed GSM-102 package in the spring of 1991, indicated that if CCC did not provide $1.5 billion in additional export credit guarantees to the FSU between January and July 1, 1991 ($1 billion in guarantees had already been extended between January and March 1991), CCC domestic support payments for wheat, corn, and soybeans could increase between $360 million and $755 million. The higher estimate was arrived at by assuming 100-percent program additionality—that is, that alternative export markets would not exist for GSM-102 guaranteed exports to the FSU.

[26]U.S. producers of certain commodities receive assistance through deficiency payments, nonrecourse loans, and marketing loans. Deficiency payments are direct payments to producers of certain commodities equal to the difference between the target price and the actual market price of each of those commodities. The target price is the minimum price determined by U.S. law to provide an economic safety net for farmers. The deficiency payments for corn and wheat for the 1990 crop year were estimated by USDA at approximately $3 billion and $2.4 billion, respectively. The deficiency payments for the 1991 crop year for corn and wheat were approximately $2 billion and $2.2 billion, respectively. A nonrecourse loan is a CCC loan made to a farmer using a quantity of the commodity produced as collateral at a set price referred to as the "loan rate." The farmer may elect to repay the loan plus accrued interest within a specified period of time, or default on the loan, in which case the ownership of the commodity passes to CCC, thereby fully satisfying the loan obligation. The latter action is taken if the market price is at or below the loan rate. For the market prices of wheat and feedgrains, nonrecourse loans provide a minimum price for the commodity. Marketing loans allow farmers who grow rice, cotton, and oilseeds to repay these nonrecourse loans at an adjusted market price rather than at the loan rate.

[27]For example, when the White House announced on November 20, 1991, that the United States would provide $1.25 billion in GSM-102 credit guarantees to the FSU, the announcement said that the sales would provide an important boost to the U.S. food and agricultural community. The announcement also stated that substantial budget savings would result from significantly lower deficiency payments.

[28]Under EEP, USDA provides cash payments as bonuses to U.S. exporters to help lower the export prices of certain U.S. agricultural commodities and make them competitive with subsidized foreign agricultural exports.

Thus, commodities not sold to the FSU would have to be sold in the U.S. market or added to unsold carryover stocks. For the lower estimate, USDA made two different key assumptions. The first assumption was that 25 percent of the commodities could be exported to other countries.[29] The second assumption was that $100 million of the guarantees for the FSU would be used for high-value products[30] for which USDA does not provide deficiency payments or nonrecourse loans. Therefore, this $100 million in GSM-102 guarantees would have no impact on the costs of USDA's domestic commodity support programs. Both of USDA's estimates deducted the expected cost of EEP bonus payments provided for wheat exports under the proposed GSM sales.

USDA's second estimate, made in February 1993, assessed changes in support costs for commodity programs if the United States did not export a projected 6 million tons of corn and 6 million tons of wheat to the FSU during 1993 and 1994. According to this estimate, support payments for corn would increase by $499 million and wheat payments by $685 million. Soybean costs were not included in the estimate. The estimate assumed that none of the corn and wheat would be sold into alternative export markets (i.e., 100-percent program additionality). Expected EEP bonus payments, however, were not netted out.

The USDA estimates of increased commodity support costs depend importantly on the assumption that alternative markets would not be generally available if the commodities were not exported to the FSU. USDA did not give us the basis for this assumption. If the commodities in question were exported to other nations, USDA's estimates of farm price changes and program savings would be less than it estimated.

Questions About an Assumption of 100-Percent Program Additionality

For a variety of reasons, USDA's assumption about 100-percent additionality is debatable: (1) special features of the GSM-102 program that were made available to the FSU and its successor states could have been attractive if offered to other importing nations; (2) competitor exporting nations may have displaced U.S. exports in other markets; and (3) CCC program costs depend on commodity farm prices that, in turn, are the result of many factors that influence global supply and demand conditions.

[29] In this case, program additionality is 75 percent.

[30] High-value products represent a diverse range of agricultural goods. They include unprocessed fruits and vegetables that employ low-skilled labor and are not technology-intensive but require specialized packing and transportation. They also include semiprocessed grains and oilseeds that rely on semiskilled labor and greater technology and capital inputs. In addition, they include highly processed products such as designer chocolates, prepared meats, and distilled beverages.

As previously noted, countries that participate in the GSM-102 program are able to obtain better interest rates on their credit than would be the case in commercial markets, as they are in effect using the repayment guarantee of the U.S. government to obtain the credit. In addition, most of the guarantees to the FSU and its successor states in fiscal year 1991 and fiscal year 1992 included coverage for 100 percent of the value of the commodities (rather than 98 percent, which is typical for the GSM-102 program). The 100-percent guarantee should also lower borrowing costs to prospective buyers. Also, the GSM-102 program for the FSU and its successor states included guarantees for freight costs. In fiscal years 1991 and 1992, freight coverage equaled nearly $443 million, or about 10 percent of the value of all GSM-102 credit guarantees offered the FSU and its successor states. The coverage of freight costs meant that each dollar of GSM-102 commitment to the FSU and its successor states supported only 90 cents' worth of commodity exports. Also, EEP bonus payments to the importing countries for selected commodities lowered the cost of importing these commodities, which in turn should have resulted in additional exports. Total EEP bonus payments for GSM-102 exports to the FSU and the successor states in 1991 and 1992 were about $579 million.

We estimated that the combination of freight cost financing and EEP bonus payments alone made the additionality attributable to the GSM program for the FSU and its successor states in fiscal years 1991 and 1992 equal at most to about 77 percent.[31] We believe that if USDA had offered GSM-102 credit guarantees to other potential buyers with similar generous terms, it is possible that the United States could have found alternative export markets for at least some of the GSM sales that were made to the FSU and its successor states.

The behavior of competitor exporters is also relevant to the question of program additionality. For example, if exporters from other nations responded to the GSM-102 guarantees that were made available to the FSU and its successor states by offering similar incentives to non-FSU importers, the exporters may have displaced potential U.S. exports to these other markets. Displaced U.S. exports would have reduced additionality resulting from increased exports to the FSU and its successor states. Alternatively, if the United States did not provide the guarantees to the FSU and its successor states but other exporter nations did, global commodity prices would presumably be about the same. As a result, there

[31]In our estimate, we used EEP bonus data for calendar years 1991 and 1992, since fiscal year data were not available.

would be little or no reduction in USDA commodity support payments to farmers.

Actual support cost is also affected by commodity prices. Commodity prices are the result of many factors that influence global supply of and demand for commodities. These include, among others, the overall economic performance of the United States, as well as the global economy; the weather and growing conditions for crops in the United States and competitor nations; purchasing decisions in importing countries; the prices of competing commodities; and the production and consumption subsidies of the United States and its competitors. These factors could cause commodity prices to reach levels that would reduce or eliminate the need for additional commodity support payments to U.S. farmers—even if the United States did not export to the FSU and its successor states. However, the complexity and variety of factors that could influence commodity prices make the isolation of the effect of a single factor difficult.

Without explicit and detailed investigation of the behavior of exporters and importers and specification of other macroeconomic and microeconomic variables, discerning the additionality of the GSM-102 program is difficult. In the absence of reliable data on the additionality of GSM-102 exports, we believe that estimated savings in commodity support programs associated with extending GSM-102 export credit guarantees to the FSU and its successor states should consider a range of additionality levels.

Conclusions

USDA provided more than $5 billion in export credit guarantees to the FSU and its successor states in 1991-92. It did so when its own assessments indicated that these were high-risk countries from a creditworthiness perspective. According to documents of USDA's Reconciliation Committee, which makes recommendations concerning whether to provide credit guarantees to specific countries and, if so, in what amounts, the committee saw a need to balance debt-servicing considerations against the need to maintain and expand overseas markets. On two occasions when the committee was unable to reach a consensus, the Chairman made recommendations that he believed balanced financial risk and market development considerations. Since the 1990 Farm Bill does not specify criteria to be used in assessing debt-servicing ability, USDA has considerable discretion and, thus, can provide large amounts of credit guarantees to high-risk countries, increasing the risk of defaults on GSM-102 loans.

Between November 1992 and the end of September 1993, Russia defaulted on more than $1.1 billion in GSM-102 loans made to the FSU and Russia. Under a September 30, 1993, agreement, the United States agreed to reschedule about $1.1 billion in GSM-102 debt, provided that Russia repaid $444 million of arrears (as of the end of 1993). Russia did repay the arrears on schedule. However, in January 1994, Russia again fell into default on GSM-102 loans. Between February and early June 1994, the United States agreed to reschedule approximately $882 million in additional payments due to CCC and U.S. banks under the GSM-102 program. Following the June 1994 rescheduling, there was approximately $2.9 billion in outstanding GSM-102 principal still owed by Russia on GSM-102 credit-guaranteed loans.

According to USDA estimates, export credit guarantees provided to the FSU and its successor states resulted in higher commodity prices and, in turn, lower costs for U.S. commodity support programs. Proponents of the credit guarantees assert that the reduced program costs help offset the risk of default on guaranteed debt. However, the estimated savings in commodity support costs depended importantly on an assumption that alternative markets would not be generally available if the commodities were not exported to the FSU. We disagree with analyses that assume only 100-percent additionality, and we believe that any estimated savings in commodity support programs should consider a range of additionality levels.

Debt Situation of the FSU and Its Successor States

During the latter part of the 1980s, a serious debt situation arose in the Soviet Union. As the situation evolved, western commercial lenders scaled back and then virtually halted lending to the Soviet Union. Western governments provided loans and credit guarantees to help fill the gap. By late 1991, the Soviet Union's debt problem had reached crisis proportions. At the same time, the country was in the final stages of political disintegration. The debt crisis was temporarily eased in November 1991, when official western creditors agreed to a 1-year deferral of principal payments on pre-1991 debt. Eight of the Soviet republics agreed to joint and several liability for the outstanding debt of the Soviet Union and to carry out economic reforms recommended by the IMF.

Following the dissolution of the Soviet Union in December 1991, the former republics sought membership in the IMF and the World Bank. The Group of Seven (G-7) nations[1] concluded that the international financial institutions could be used to promote economic reform in the FSU and to coordinate western financial assistance. They encouraged the new states to undertake substantial economic reforms designed to stabilize their economies. Doing so could lead to substantial new financial assistance from abroad and help the new states to improve their creditworthiness. Specifically, the G-7 nations said they would support a $24-billion financial assistance package for Russia, contingent on Russian progress in stabilizing and reforming its economy. However, Russia did not stabilize its economy, and the FSU debt arrears situation worsened. In April 1993, Russia's official creditors (i.e., creditor country governments) found it necessary to reschedule a significant amount of Russian and FSU debts due in 1993. At the same time, the G-7 promised a new package of economic support for Russia. However, debt relief and other financial assistance have remained largely contingent on economic stabilization and reform. During the first half of 1994, Russia's official creditors rescheduled additional FSU debt and agreed to meet later in the year to consider longer and more comprehensive rescheduling.

How Debt Became a Problem

For decades the Soviet Union was a conservative user of western credits and was regarded by western government and commercial lenders as an excellent credit risk, given its huge gold reserves and other exportable raw

[1]Includes Canada, France, Germany, Italy, Japan, the United Kingdom, and the United States.

materials.[2] During the first 9 years of the 1980s, the Soviets usually ran hard currency current account surpluses.[3]

In the mid- and late 1980s, political detente and increasingly lax fiscal policies of the Soviet government led to a rapid increase in commercial lending to the Soviet Union, according to the World Bank. It estimates that the Soviet Union's gross hard currency debt more than doubled, from $38.3 billion at the end of 1987 to $81.5 billion at mid-1993 (see table 3.1).[4]

Table 3.1: Total External Debt and Debt Service of the FSU/Russia, 1986-Mid-1993

Dollars in billions

Debt components	1986	1987	1988	1989	1990	1991	1992	Mid-1993
Total debt	$30.7	$38.3	$42.2	$53.8	$59.3	$67.1	$78.7	$81.5
Medium- & long-term	23.3	29.7	31.0	35.6	47.5	54.3	65.7	69.8
Short-term	7.4	8.6	11.2	18.2	11.8	12.8	13.0	11.7
Total debt accounted for by export credits[a]	15.9	13.7	10.2	11.1	15.1	25.3	22.4	[b]
Total debt service	7.8	8.8	8.4	9.4	22.9	17.0	12.8	[b]
Principal due	5.4	6.2	5.4	5.7	18.2	12.8	8.9	[b]
Interest due	2.4	2.6	3.0	3.7	4.7	4.2	3.9	[b]
Arrears[c]	0	0	0	0.5	4.5	4.8	11.8	8.0

Note: The table assumes 100 percent reallocation of FSU debt to Russia. Mid-1993 data are for June 30 and may be subject to revision.

[a]Of total short-term, medium-term, and long-term debt, export credits accounted for amounts shown.

[b]Not available.

[c]Arrears occurred when principal or interest payments were not fully met.

Sources: World Debt Tables 1992-93 and 1993-94, World Bank (Washington, D.C.: Dec. 1992 and Dec. 1993).

[2]William H. Cooper, Russia and the Commonwealth of Independent States: Economic Conditions and Reforms, Library of Congress, Congressional Research Service Issue Brief IB92003 (Washington, D.C.: Jan. 29, 1992).

[3]In 1991, the Soviet Union had nominal claims on developing countries estimated at about $143 billion. According to the World Bank, well over a quarter of these claims may have been in arrears. The bank estimated that only 25 percent of the debt service that fell due in 1991 was paid. The record for the first half of 1992 was worse. See World Debt Tables 1992-93, Vol. I, World Bank (Washington, D.C.: Dec. 1992).

[4]Estimates of the former Soviet Union's hard currency debt vary considerably. For example, on September 7, 1992, LDC Debt Report cited estimates ranging between $54.7 billion (the Bank for International Settlements) to $80 billion (Russian officials).

In 1989, the Soviet Union experienced a negative hard currency trade balance of $2.4 billion due to surging imports.[5] The imbalance was financed by hard currency borrowing. During 1989 and 1990, a growing debt burden, debt-servicing problems, and increasing world concern about a collapsing Soviet economy and political disintegration began to affect the country's access to the commercial financial market.[6] According to the World Bank, the surge of imports caused a severe liquidity crisis, leading to a buildup of arrears to western banks and suppliers. The liquidity crunch was exacerbated, in part, because the government had extended authority to Soviet enterprises to negotiate overseas business.[7]

According to a World Bank analysis, the Soviet Union was $4.5 billion in arrears at the end of 1990 (see table 3.1). In an earlier analysis, the bank estimated that about 10 percent of year-end 1990 arrears was guaranteed debt to official creditors, 30 percent unguaranteed debt to commercial banks, and 60 percent debt to others (mainly suppliers).[8] As arrears accumulated, commercial banks reduced and then stopped new lending. The Soviet Union was faced with large net repayment obligations, which it financed to a great extent out of its deposits in western banks. As a result, these liquid reserves fell sharply, from $14.6 billion in December 1989, to $8.6 billion in December 1990, and to $6.4 billion by March 1991. At the end of 1991, estimated reserves were only about $5.1 billion, which represented less than 2.5 months' coverage of import costs. According to one source, a 3- to 6-month coverage is generally considered adequate.[9]

[5]The Soviet Union had a negative hard currency trade balance of $2.7 billion with the developed West in 1988, but this amount was more than offset by positive balances with developing countries and centrally planned economies. In 1989, the negative balance with the developed West grew to $5.2 billion.

[6]By the second quarter of 1990, short-term credit lines had been exhausted, and the Soviet Union was unable to pay $2 billion for imports of foodstuffs and other consumer goods.

[7]The decentralization of foreign trade made it possible for many Soviet enterprises to make purchases they could not pay for in foreign exchange. When VEB refused to bail them out, a rapid buildup of arrears began, in late 1989. Subsequently, the Soviet government recentralized foreign exchange transactions.

[8]World Debt Tables 1991-92, the World Bank (Washington, D.C.: Dec. 1991). In this study, the bank estimated year-end 1990 arrears at $4 billion.

[9]See Patricia A. Wertman, The International Reserve Position of the Former Soviet Union: Is the "Cupboard" Bare? Library of Congress, Congressional Research Service (Washington, D.C.: Apr. 10, 1992). According to the author, between the end of 1985 and the end of 1989, Soviet end-of-year bank claims were consistently in excess of $13 billion. The peak occurred at the end of 1988, when Soviet claims on western banks amounted to $15.3 billion. During 1990, Soviet short-term bank liabilities, i.e., bank debt with maturities of less than a year, declined by $9.7 billion. This latter was considerably more than the Soviet reserve losses for 1990.

Gold reserves, the other major component of the FSU's international reserves, were apparently either drawn down to very low levels or already at low levels. Thus, they were not available for financing the liquidity problem. According to 1991 Central Intelligence Agency (CIA) estimates, Soviet gold reserves had ranged between 1,679 metric tons in 1980 to 2,105 metric tons in 1990, with a peak level of 2,366 metric tons in 1985.[10] However, during the latter part of 1991 an economic adviser to the Soviet President asserted that the Soviet government had been selling off large amounts of gold reserves for several years. He added that only 240 tons of reserves were left (valued at less than $3 billion). In May 1992, the U.S. Minister Counsellor for Economic Affairs at the U.S. embassy in Moscow told us that Russia had only 220 metric tons of gold. He said these amounts were minimal reserves. In early February 1993, a former Soviet prime minister said that the Soviet Union had squandered its gold reserves before President Gorbachev took over in 1985 but had managed to keep the matter secret until 1991.[11]

Structure, Composition, and Maturity of the Debt

Due to its problems with debt servicing, by 1990 the Soviet Union had become a high-risk country for lenders. The worsening political, economic, and liquidity conditions virtually halted the flow of commercial financing. This halt in commercial financing became an impetus for western governments to undertake considerable official financing. Consequently, the structure of Soviet debt was substantially altered, as evidenced by changes in the source and maturity of the Soviet debt.

Whereas commercial banks and other private creditors had accounted for 78 percent ($44.1 billion) of the Soviet Union's convertible currency debt at the end of 1989, they held only 41 percent ($25 billion) at the end of 1991. Conversely, Soviet official bilateral debt increased from $12.4 billion, or 22 percent of convertible currency debt, to $36.5 billion, or 59 percent, during the same period.[12]

A substantial change in the maturity of FSU debt accompanied the change in the sources of FSU debt. As commercial lenders increased their efforts to collect on their short-term loans, western governments extended medium- and long-term credit or credit guarantees. Whereas in 1988 about

[10]Other western analysts estimated Soviet gold reserves as ranging between 1,500 and 3,000 metric tons. See The International Reserve Position of the Former Soviet Union.

[11]Fred Hiatt, "Soviets Hid Gold Loss for Years," Washington Post (Feb. 3, 1993).

[12]Of this amount, $15.6 billion was owed to commercial banks and $9.4 billion to other private lenders. See Paul Gardiner, "A Riddle in a Mystery in an Enigma," Euromoney (supplement Apr. 1992).

27 percent of the debt was short term, at mid-1992 short-term debt was estimated at only 17 percent.

As table 3.2 shows, in mid-1991 Germany was by far the largest creditor of the FSU, accounting for more than two-fifths of FSU external debt. However, much of the debt to Germany (about 40 to 43 percent at the end of March 1991) was owed to the former German Democratic Republic (East Germany). The United States was not among the six biggest creditors.

Table 3.2: Principal Creditors of the FSU, June 1991

Dollars in billions

Country	Guaranteed debt	Nonguaranteed debt	Total
Germany	$14.4-$17.9	$4.0-$7.5	$21.9[a]
France	0.8	4.8	5.6
Japan	[b]	[b]	4.5
Italy	4.0	0.4	4.4
Austria	1.8	1.7	3.5
United Kingdom	2.8	0.6	3.4
Others	[b]	[b]	7.9
Total	**[b]**	**[b]**	**$51.2[c]**

Note: Countries are listed in descending order based on the total value of their loans to the FSU.

[a]Equals the sum of $14.4 and $7.5 or $17.9 and $4.0.

[b]Not provided.

[c]Includes official or guaranteed debt and nonguaranteed debt to commercial banks. Excludes nonguaranteed debt to other lenders, such as suppliers.

Source: World Bank.

Table 3.3 provides information on both loans and grant assistance pledged to the FSU by the G-7 nations and the European Community during 1990 through 1992. It shows that Germany pledged the largest amounts of both loans and grants during this period—$54 billion out of $81 billion. The United States was second, with combined pledges totaling about $9.2 billion.

Table 3.3: Pledged Assistance From the G-7 Nations and the European Community to the FSU, 1990-92

Dollars in millions

Donor	Loans[a]	Grants	Total	Percent[b]
Germany[c]	$42,000	$12,000	$54,000	66.7
United States	6,685[d]	2,552	9,237	11.4
Italy	5,600	18	5,618	6.9
EC Commission	2,363	1,702	4,065	5.0
France	2,580	103	2,683	3.3
Japan	2,600	106	2,706	3.3
Canada	1,940	91	2,031	2.5
United Kingdom	476	197	673	0.8
Total	**$64,244**	**$16,769**	**$81,013**	**100**

Note: Countries are listed in descending order on the basis of their total pledged assistance.

[a]Includes credits and guarantees.

[b]Country total as a percent of donor total.

[c]Much of the German assistance was tied to the withdrawal of former Soviet troops from the former East Germany.

[d]Of this amount, $5.75 billion represents CCC GSM-102 commitments to guarantee loans.

Source: U.S. Department of State.

Soviet Debt Situation Reaches a Crisis Point in Late 1991

The year 1991 marked a turning point for Soviet debt as well as for Soviet territorial, economic, and political integrity. The hard currency situation worsened significantly as a result of capital flight[13] and declining exports, particularly oil. According to a World Bank report, capital flight for 1991 was estimated at about $15 billion. That figure represents a staggering 88 percent of Soviet contractual debt service for the year and 61 percent of estimated merchandise exports.

According to the Wharton Econometrics Forecasting Associates (WEFA) Group, in 1991 Soviet oil exports fell by about 50 percent from the previous year's level; iron ore, by 64 percent; steel mill products, 70 percent; timber, 50 percent; and diesel fuel, about 25 percent.[14] Declining

[13]According to the World Bank, the main forms of capital flight from Russia include (1) a portion of export revenues deposited in overseas accounts under the pretense that the importer refused to pay; (2) over-invoicing of imports and under-invoicing of exports; (3) advance payments for import contracts without subsequent deliveries; (4) capital outflow through offshore companies, many of which were recently set up by Russian residents (legislation for offshore business is nonexistent); and (5) growing "spontaneous exports," mainly of consumer goods.

[14]Planned Economies in Transition July 1992 (Bala Cynwyd, Pa.: The WEFA Group, 1992).

exports adversely affected hard currency earnings. Whereas 1990 hard currency earnings from merchandise exports were $36 billion, according to WEFA, in 1991 the earnings equaled only about $24.8 billion. According to WEFA's figures, most of the decrease can be accounted for by reduced fuel exports. In terms of dollar earnings, the value of Soviet fuel exports to nonsocialist countries fell from an estimated $21.8 billion in 1990 to $9.2 billion in 1991.[15] Soviet merchandise imports also declined markedly—from $39.5 billion in 1990 to $25.4 billion in 1991—due to the lack of hard currency and the unwillingness of foreign commercial banks to grant short-term credits.

Following the failed coup in August 1991, Soviet economic deterioration and political disintegration accelerated. A crisis point was reached in autumn, when the Soviet Union found itself unable to repay all of its debts and to secure new credits badly needed to purchase food imports. Owing to concern about whether the Soviet Union would continue to exist, officials of the G-7 nations indicated that additional western loans would not be forthcoming unless the various Soviet republics pledged to honor the Soviet Union's debt, according to various Soviet media reports.[16] On November 21, 1991, six Soviet republics signed an agreement with the G-7 nations affirming joint and several liability for the outstanding debt of the Soviet Union, based on an October 28, 1991, memorandum of understanding. Subsequently, two other republics also signed the document. (See table 3.4.) The eight also agreed to carry out economic reforms recommended by the IMF, including reducing fiscal deficits, public expenditures, and monetary growth and liberalizing prices and the foreign exchange rate.

[15]Soviet oil production and exports have been declining for several years. Crude oil production peaked in 1988 at 11.8 million barrels per day (mbd). In 1989, production was 11.4 mbd and 10.7 mbd in 1990. In March 1993, an Energy Information Administration analyst told us that his agency estimated 1991 production at 10.4 mbd, 1992 production at 9 mbd, and that in 1993 production would decline another 1 mbd-1.5 mbd. The Soviet Union exported 4.1 mbd of crude oil and petroleum products in 1988, 3.7 mbd in 1989, and 3.2 mbd in 1990. The analyst said his agency's preliminary forecast for the former Soviet Union for 1993 was 2.2 mbd and that several other forecasters were estimating that oil exports would be 2 mbd-2.1 mbd in 1993.

[16]See for example, Audrey Pershin, "Gorbachev Meets Representatives," Moscow Tass International Service (Nov. 20, 1991), as reported by the Foreign Broadcast Information Service.

Table 3.4: Debt Responsibility Agreed to by the FSU/Successor States, 1991-1993

Republic/ independent state	Signed 10/28/91 memorandum of understanding to honor debt to foreign creditors[a]	Signed 12/4/91 treaty on allocating foreign debt and assets[b]	Preliminary debt shares[c] (percent)	Signed agreement with Russia to exchange FSU assets for debt, as of December 1993
Armenia	Yes	Yes	0.9%	Yes
Azerbaijan	No	No	1.6	Yes
Belarus	Yes	Yes	4.1	Yes
Estonia	No	No	0.6	No
Georgia	Yes	Yes	1.6	Negotiating
Kazakhstan	Yes	Yes	3.9	Yes
Kyrgyzstan	Yes	Yes	1.0	Yes
Latvia	No	No	1.1	No
Lithuania	No	No	1.4	No
Moldova	No	No	1.3	Yes
Russia	Yes	Yes	61.3	[d]
Tajikistan	Yes	Yes	0.8	Yes
Turkmenistan	No	No	0.7	Yes
Ukraine	Yes	Yes	16.4	Negotiating
Uzbekistan	No	No	3.3	Yes

[a]Signatory states agreed to accept joint and several liability for FSU debts and to use VEB as debt manager.

[b]Agreed to accept responsibility for a portion of the FSU's foreign debt and to set up the interrepublic debt management committee to oversee VEB's handling of the FSU's debts and assets.

[c]As set by signatories of the December 4, 1991, treaty.

[d]Not applicable.

Sources: World Debt Tables 1992-93 and 1993-94, and information provided to GAO by the Treasury Department.

Debt Deferral Agreement of November 1991

The hard currency crisis was temporarily alleviated on November 21, 1991. On that day representatives of the G-7 nations reached agreement with the Soviet government and governments of 8 of the 12 republics on a financial package designed to ease Soviet liquidity problems. According to the U.S. Department of the Treasury, the package included

- the deferral of about $3.6 billion in principal payments on medium- and long-term debt contracted before January 1, 1991, and falling due to official creditors in G-7 nations before the end of 1992;
- the maintenance of short-term credit lines by G-7 nations' export credit agencies; and
- the possible emergency financing of up to $1 billion in the form of a loan secured by gold.

In December 1991, the Soviet Union was formally dissolved. During that month, eight republics of the Soviet Union reached preliminary agreement among themselves on how to share the external debt and assets of the FSU. (See table 3.4.) The signatory republics agreed to accept responsibility for a portion of the Soviet Union's overall foreign debt and to set up an interrepublic debt management committee to oversee handling the Soviet Union's debts and assets. The committee calculated preliminary debt shares for the 15 republics on the basis of each republic's economic stature within the union. Table 3.4 shows which republics signed the agreement and the debt shares of the republics.

Also during December 1991, the Soviet Union suspended all principal payments to commercial creditor banks for loans made before January 1, 1991. An agreement between the commercial bankers and officials of a majority of the successor states stipulated that talks on the issue resume in March 1992.

On January 4, 1992, 17 principal creditor nations, including the G-7 countries, met in Paris with VEB, the designated debt manager for the 8 former republics that signed the October 28, 1991, memorandum of understanding previously discussed. The creditors agreed to defer principal payments on medium- and long-term official debts contracted before January 1, 1991, and falling due from December 5, 1991, to the end of 1992. They said the deferral would continue beyond March 31, 1992, provided satisfactory progress were made by the debtor countries in mobilizing foreign exchange and adopting comprehensive macroeconomic and structural adjustment programs, in full consultation with the IMF.

Role of International Institutions and Linkage to Economic Reform

Shortly before and following the dissolution of the Soviet Union, Ukraine, Russia, and other republics requested membership in the IMF and the World Bank. Membership in the international financial institutions could lead to substantial new financial assistance from abroad and help the new states to improve their creditworthiness. The United States and other members of the G-7 nations concluded that the international financial institutions could be used to promote economic reform in the FSU and to coordinate western financial assistance. They encouraged the new states to develop economic adjustment programs that could be supported by the institutions.

On March 31, 1992, the IMF endorsed a draft economic reform program that had been prepared by the Russian government. A suitable reform program was a condition for extension of the moratorium on debt service payments for the FSU. Among the program's main points were that the Russian government would (1) reduce its budget deficit to 1 percent of gross national product (GNP) by the end of 1992 through cuts in military spending and subsidies to enterprises; (2) tighten central bank monetary and credit policies; (3) adopt new taxes, including restoring a 28-percent value-added tax; and (4) target social subsidies more precisely, so aid could be provided to the most needy and the unemployed. Russian officials claimed the program would slow the rate of inflation to 1 to 3 percent by the end of 1992. They also said the reform program would have to be cut back if Russia did not receive substantial foreign financial aid, including debt relief, a stabilization fund for the ruble, and balance-of-payments support.[17]

On April 1, 1992, the United States and other G-7 nations announced support for a $24 billion international aid program for Russia. The package was to include rescheduling of $2.5 billion of official debts of the Russian government. It also was to include about $11 billion in bilateral aid (export credits and humanitarian and other foreign aid) from the G-7 nations; $4.5 billion in loans from the IMF,[18] World Bank, and the European Bank for Reconstruction and Development; and a $6-billion fund to stabilize the ruble for Russia and other former Soviet republics that continued to use the ruble. The stabilization fund was to be funded by IMF member loans to the IMF.[19] However, implementation of much of the aid package was seen

[17]See Jonathan E. Sanford and Shirley A. Kan, International Financial Institutions: Assistance to Soviet Successor States, Library of Congress, Congressional Research Service Issue Brief IB92093 (Washington, D.C.: July 21, 1992).

[18]The IMF is a revolving loan fund used to help member countries that are experiencing balance of payments difficulties. The IMF is considered the lender of last resort. Countries that fail to repay the IMF are likely to be cut off from all other sources of international finance and forced to operate on a cash-and-carry basis. Conversely, a country that qualifies for an IMF loan is likely to find additional financing from other sources as well. See Patricia A. Wertman, Russia and the IMF: Coming to Terms, Library of Congress, Congressional Research Service (Washington, D.C.: Mar. 25, 1994).

[19]See Jonathan E. Sanford and Shirley A. Kan, Russian and Other Ex-Soviet Participation in International Financial Institutions, Library of Congress, Congressional Research Service Issue Brief IB91133 (Washington, D.C.: July 6, 1992).

as contingent on Russian progress in stabilizing and reforming its economy, and including IMF approval of an IMF standby program.[20]

In mid-April 1992, the IMF Managing Director reported that the challenge involved in trying to engineer a transformation from command to market economies in the former Soviet republics would cost billions of dollars in outside aid from the IMF, the World Bank, the governments of industrial nations, and private investors over the next 4 years. After taking into account the expected level of exports, the obligation to service the debt, the need to replenish international reserves, and the allowance for a stabilization fund for the ruble (about $6 billion), the financing requirement for 1992 in Russia alone, the Director said, could be $20 billion to $25 billion. IMF projections for the other republics, he said, indicated an external financing requirement of about $20 billion in 1992. He estimated that the IMF could provide $25 billion to $30 billion over the next 4 to 5 years. Other sources indicated the World Bank might provide as much as $12 billion to $15 billion for development projects over the same period. The IMF Director noted that if the transformation is to succeed, private capital will eventually have to play the leading role.[21]

On April 27, 1992, the IMF and the World Bank approved membership for Russia and most other republics. Russia became a member on June 1, 1992. However, most aid was held up pending further agreement between Russia and the IMF concerning the nature of the Russian reform program and the terms for an IMF standby loan to Russia. Concerns were raised about whether Russia remained committed to and would implement an adequate reform program. In fact, in the spring of 1992, the Russian reform program was relaxed in response to attacks by domestic critics, particularly in the Russian parliament. For example, the government gave miners large pay increases; promised new bank loans to help state

[20]IMF financial support varies, depending on the nature of the borrower's macroeconomic and structural problems and the degree of conditionality attached to IMF loans. Under the IMF's regular facilities, credit is made available to members in up to four tranches or segments. For first tranche loans, members are required to demonstrate reasonable efforts to overcome their balance of payments difficulties. Performance criteria are not attached and repayments are made in 3-1/2 to 5 years. Additional or upper credit tranche loans are normally associated with "standby arrangements." In the latter case, loans are conditioned on macroeconomic policy changes and economic performance targets that borrowing countries agree to undertake in exchange for a loan. The arrangements typically cover a period of 1 to 2 years. See Patricia A. Wertman, Quota Increase and Former Soviet Republics: New Directions for the IMF? Library of Congress, Congressional Research Service Issue Brief IB91059 (Washington, D.C.: July 16, 1992); and 1992 International Monetary Fund Annual Report, IMF (Washington, D.C.: Apr. 30, 1992).

[21]In July 1992, WEFA forecast gross financial requirements for the FSU at approximately $120 billion over the 1993 through 1997 period. It estimated net direct investment and net portfolio investment at $2.4 billion. If the net investments reached $2.4 billion and the IMF and the World Bank provided $45 billion, other sources would have to supply another $72.6 billion to reach the $120-billion level.

enterprises teetering on the edge of bankruptcy; and agreed to delay until June 1992 an 80-percent increase in oil, gas, and electrical prices scheduled for April.[22]

With final agreement on a reform package still not achieved between Russia and the IMF by June 1992, the IMF proposed a compromise approach: it would advance Russia $1 billion of a planned $4-billion standby loan before agreement was reached on the reform program. In July, the G-7 nations expressed support for the proposal. On July 5, the IMF agreed to release $1 billion to Russia; however, the $1 billion was to be retained in Russia's international reserves.

Debt Servicing Problems Worsen

In spite of the 1991 deferrals, the successor states have not kept current on servicing the FSU debt. As table 3.1 shows, during 1992 arrears on the Soviet debt more than doubled (from $4.8 billion at the end of 1991 to $11.8 billion at the end of 1992). Capital flight continued to contribute significantly to the FSU's liquidity problems. The World Bank estimated capital flight during the first 8 months of 1992 at $5 billion to $8 billion ($7.5 billion to $12 billion on an annualized basis).

In June 1992, Russian officials requested that the G-7 agree to a 5-year moratorium on repayments of principal and interest on all FSU debt. In July, G-7 leaders discussed a 10-year restructuring of both principal and interest payments, with a 3- to 5-year grace period. At the July 1992 G-7 meetings, they expressed support for the Russian President's proposal to defer Russia's share of the FSU debt. However, they also made it known that the deferral issue had to be addressed by the Paris Club.[23] Following the G-7 meeting, the Russian President indicated that his country would also consider proposals for swapping debt relief for Russian land, buildings, raw materials, and oil and gas exploration rights.

Meanwhile, the December 1992 agreement that had deferred principal payments on commercial FSU debt through March 1992 was reextended in June and again in September 1992.

Negotiations with Russia on debt restructuring got underway with the Paris Club in late 1992. According to the World Bank, as a result of capital

[22]International Financial Institutions.

[23]The Paris Club deals with restructuring of debt service payments on loans extended by, or guaranteed by, the governments or the official agencies of participating creditor countries. The club, which is open to all official creditors that accept its practices and procedures, normally handles official multilateral debt renegotiations.

flight, lower gold sales, and already depleted reserves, FSU external debt servicing reached only $1.3 billion during the first 3 quarters of 1992—far short of scheduled obligations.

Differences Between Russia and Other Republics Complicate Situation and Affect Credit Standing of All

Under the G-7 Debt Allocation Treaty of December 4, 1991, Soviet successor states were to transfer foreign exchange to VEB for FSU debt payments. However, in December 1992, the World Bank reported that Russia had been the only contributor since late 1991. One reason why other republics had not contributed was a lack of agreement on the disposition of the FSU assets.

An official of the Kazakhstan bank responsible for guaranteeing foreign loans told us that none of the former republics, except Russia, were making payments on the FSU debt. He said payments were not being made because (1) Russia had not divided up the FSU assets and (2) VEB had frozen the hard currency accounts of enterprises located in the other states. Ukrainian officials also told us that the assets had not been divided and hard currency accounts had been frozen. Ukrainian officials also said it was not true to claim that the other states were not paying their debt shares because Russia might be using or might already have used hard currency from the other states' frozen enterprise accounts to make payments on the debt.

Ukrainian officials said that Ukraine (1) had accepted responsibility for 16.4 percent of the FSU's debt, (2) was ready and wanted to begin paying off its debt, and (3) was willing to pay 20 percent of the total debt if states other than Russia could not pay their share. However, the officials indicated Ukraine was not willing to make payments on Ukraine's share through VEB, because there was no assurance that the latter would use the monies to pay off Ukraine's debt: VEB might instead use the funds to pay off Russia's debt or the debt of some other republic. Consequently, the officials said, Ukraine wanted to deal directly with its creditors.

Kazakh officials said Kazakhstan had tried to arrange to pay debt owed to Germany's Deutsche Bank directly to the bank rather than through VEB Moscow, but Deutsche Bank had not agreed to such an arrangement.

Uzbek officials said the debt share apportioned to their country was not fair. They said Uzbekistan did not even know how much of the FSU's debt had been expended on Uzbekistan and that Uzbekistan's appropriate share of the old debt was still under discussion. They also said the Uzbekistan government was prepared to pay its share of debt once it was provided accurate data on how Uzbekistan's share was calculated.

Russian officials denied that the enterprise accounts of other former republics were frozen. Rather, they said, all of the funds in the enterprise accounts (estimated at $10 billion for all republics, including Russia) had been spent by the Soviet government before the dissolution of the Soviet Union. The money was used to pay foreign debts and to purchase grain and food imports. A VEB official said that although all of the states considered themselves responsible for the FSU's hard currency external debt, only Russia had accepted responsibility for the FSU's hard currency internal debt. He estimated the latter at approximately $11 billion to $12 billion and said that Russia's debt claims on the various other states would be far greater than the other states' asset claims on VEB.

In June 1992, the Russian government launched negotiations with most of the other states aimed at assuming responsibility for their external debts if, in turn, the states agreed to forgo claims on the external assets of the FSU. As long as the issue is not fully resolved, the credit standing of all the republics could be adversely affected, we believe, owing to the previous agreement on joint and several responsibility. For example, according to the news organization Itar-Tass, on November 2, 1992, the Russian Deputy Prime Minister said that the Paris Club had indicated that the former Soviet republics would need to settle their debts fully with each other before the debt of the FSU could be rescheduled.

Toward the end of November 1992, a tentative agreement was reached between Ukraine and Russia, giving Russia the sole right to negotiate with Ukraine's western creditors. In return, Moscow promised to negotiate a pact with Ukraine sharing remaining assets and liabilities. Each country reserved the right to renounce the agreement if either failed to agree to a bilateral pact by the end of 1992.[24] However, an agreement was not reached by the end of 1992.

According to a State Department official, the Paris Club creditors were not willing to reschedule FSU debt unless satisfactory arrangements were reached between Russia and Ukraine concerning responsibility for the debt. During the early part of 1993, Russia and Ukraine made some progress toward reaching an agreement. On the basis of this progress, the Paris Club creditors felt sufficiently comfortable to consider Russia as

[24]See "Russia and Ukraine Agree on Managing Soviet Debt," New York Times (Nov. 24, 1992); and Leyla Boulton, "Russia Offers Deal to Volsky," Financial Times (Nov. 14-15, 1992).

primarily responsible for FSU debt, subject to conclusion of an agreement between Russia and Ukraine. The Paris Club decision means that the creditors will pursue Russia first in their efforts to secure payment of FSU debt. As of December 1993, Russia and Ukraine had still not finalized an agreement on the handling of FSU assets and debts.

According to the World Bank, by the end of 1993, nine republics had signed agreements with Russia to exchange FSU assets for debt, and Ukraine and Georgia were negotiating with Russia. Russia had also offered to sign agreements with the Baltic countries. However, according to the bank, the Baltic countries had taken the position that they were not the legal successors of the FSU and therefore could not take responsibility for servicing and paying off its debt.

Western Nations Reschedule Debt and Offer New Financial Assistance in 1993

In early 1993, western governments became increasingly concerned about a deteriorating political situation in Russia and the possibility that Russia's commitment to democracy and economic reform might be reversed (see ch. 4). As a result, in April the G-7 nations agreed on a $28.4-billion package for providing economic support to Russia. In addition, as part of the effort to assist Russia, the United States and other western creditor governments agreed to reschedule some $15 billion in Russian and FSU debt.

Financial Assistance Package

On April 15, 1993, representatives of the G-7 nations and the European Community announced agreement on a new package for providing financial assistance to Russia. A considerable portion of the G-7's April 1992 aid package had never been forthcoming, in part because Russia had failed to stabilize its economy and reach agreement with the IMF on a standby agreement. As table 3.5 shows, the 1993 package included renewed commitments of support from 1992, totaling $7 billion, and it included $21.4 billion in new commitments for 1993.

Table 3.5: Elements of the Proposed G-7 Multilateral Support Package for Russia Announced on April 15, 1993

Dollars in billions

G-7 support package	Amounts
New commitments, 1993	$21.4
Proposed IMF Systemic Transformation Facility[a,b]	3.0
New World Bank commitments[c]	3.5
Cofinancing of World Bank oil sector loan	0.5
Proposed European Bank for Reconstruction and Development small/medium enterprise fund	0.3
Export credits and guarantees	10.0
IMF standby loan[d]	4.1
Renewed commitments from 1992	$7.0
World Bank loan pipeline[e]	1.0
IMF currency stabilization fund[f]	6.0

[a]Defined in following pages.

[b]The G-7 urged the facility to disburse aid in two segments—the first segment when Russia made a political commitment to adopt an appropriate adjustment policy, as indicated by a policy statement; the second tranche when there was satisfactory policy implementation with focus on monetary policy measures to contain inflation, paving the way for an IMF standby arrangement.

[c]The bank expected to provide $3 billion in new loan commitments, above what was expected in 1992.

[d]The 1993 standby loan was expected to differ from 1992 in two respects. First, the loan would be larger. (The 1992 loan was expected to total $3 billion, but only $1 billion was disbursed due to the lack of progress in Russian stabilization efforts.) Second, the IMF would negotiate a fast-track standby agreement, streamlined to focus only on the issue of stabilization.

[e]The bank would move quickly to approve and disburse unused funds from 1992, including $500 million for import rehabilitation and $500 million for an energy sector loan.

[f]Fund was not activated in 1992 due to the lack of progress in Russian stabilization efforts. Fund would be activated when Russia had an IMF standby loan and was prepared to stablize the ruble exchange rate.

Source: Department of the Treasury.

As was the case with the financial assistance offered by the G-7 nations in 1992, there was no assurance that Russia would receive all of the aid. While some of the assistance was expected to start flowing quickly, fulfillment of the package remained contingent on Russian progress in stabilizing its monetary situation and continuing the process of structural economic reform. In addition, much of the assistance depended on the cooperation of multilateral institutions, including the IMF, the World Bank, and the European Bank for Reconstruction and Development. Russian cooperation was also needed.

During early 1993, the G-7 encouraged the multilateral institutions to ease up on their normal standards for conditionality and to provide financial assistance earlier as a way of encouraging later reform. On April 23, 1993, the IMF approved creation of a new loan facility for this purpose—the Systemic Transformation Facility (STF) that was included in the April 15 proposal of the G-7 and the European Community. The program is designed to provide several billion dollars in low-interest loans to Russia, and possibly other former socialist countries as well, under less stringent financial conditions than is typical for IMF loans. For example, countries are not required to have a standby loan in place to receive STF loans. The loans would be approved in two segments, with the first half disbursed immediately. Although a standby loan program is not required, a commitment to achieving macroeconomic stabilization is still important for receiving STF loans. STF is a temporary facility that expires at the end of 1994; however, withdrawals can be completed as late as the end of 1995.[25]

In early June 1993, the IMF held up approval of an STF loan that it was considering for Russia, in spite of pressure from the United States and others. However, on June 30, 1993, it approved a first drawdown of $1.5 billion on a $3-billion loan. In return, Russia committed itself to reducing its budget deficit to 5 percent of gross domestic product (GDP) and its monthly inflation level to a low, single-digit level.

In July 1993, the G-7 established a $3-billion privatization and restructuring program for Russia that was expected to distribute funds over an 18-month period. It was to be made up of $500 million in bilateral grants to be used largely for technical assistance to newly privatized companies; $1 billion in bilateral export credits and $1 billion in World Bank and European Bank for Reconstruction and Development loans to be used by Russian companies to import western goods; and $500 million in World Bank loans to be used by local Russian governments to help them make up for health, education, and other services previously supplied to employees by state-owned companies.[26]

In late September 1993, President Clinton signed a foreign aid bill that authorized $2.5 billion of assistance for Russia.

[25] Russia and the IMF: Coming to Terms.

[26] Curt Tarnoff, U.S. and International Assistance to the Former Soviet Union, Library of Congress, Congressional Reseach Service (Washington, D.C.: Mar. 24, 1994).

Debt Rescheduling Agreements

On April 2, 1993, representatives of the United States and 18 other western creditor governments reached a political agreement with Russia to recommend rescheduling $15 billion in Russian and FSU debt. The agreement concerned all arrears (at the end of 1992) on medium- and long-term official and officially guaranteed debt incurred before January 1, 1991, and maturities relevant to that debt falling due in 1993. This rescheduling referred to a 10-year span, with a 5-year grace period. Other obligations were also rescheduled, including those related to medium- and long-term obligations incurred during 1991, some short-term debt obligations, and some moratorium interest falling due during 1993. These latter obligations were rescheduled over 7 years, with a 2-year grace period.[27]

Arrears not covered by the rescheduling were to be fully paid by June 30, 1993, and Russia was required to stay current on all other scheduled payments. Under the agreement, interest would continue to accrue on deferred or rescheduled debt and would have to be repaid as it came due. However, 60 percent of the interest due in 1993 was rescheduled. Governments of the creditor countries were to work out the details in bilateral agreements with Russia. Russia committed itself to seek comparable terms from other external official creditors, banks, and suppliers.

In effect, the April agreement was a practical recognition by official western creditors that Russia could not service most of its debt in 1993. By rescheduling overdue debt and debt likely to fall into arrears in 1993, the April agreement would enable Russia to apply for new loans from western governments and other creditors.

According to a Treasury Department official, under the April agreement Russia also agreed to accept responsibility for repaying all of the official FSU debt.

According to CCC, the April agreement was concluded outside of the Paris Club. Ordinarily the Paris Club does not reschedule government-to-government debt unless an IMF economic reform program is in place. Nonetheless, the agreement required that the Russian government adopt and implement an ambitious and comprehensive macroeconomic and structural adjustment program. The Russian delegation stressed the strong determination of its government to reduce Russia's economic monetary and financial imbalances and to conclude an

[27] World Debt Tables 1993-94.

IMF upper credit tranche arrangement approved by the IMF Executive Board.[28] Signatory creditor governments could declare the agreement null and void if Russia had not concluded an upper tranche arrangement by October 1, 1993. Russia did not conclude such an agreement by that time. However, the creditor nations waived their right to terminate the agreement. According to a State Department official, the creditors considered the IMF arrangement a significant issue, but they felt it was more important to normalize relations on the debt issue.

Commercial Debt Rescheduling

As discussed earlier, in December 1991 the former Soviet Union suspended all principal payments to commercial creditor banks made before January 1, 1991. In January 1992, commercial creditors, negotiating through a bank advisory committee chaired by Deutsche Bank, granted a 3-month rollover of debt payments. It was extended for each consecutive quarter through the end of 1993. All agreements deferred payment on current principal due during the individual deferment periods. Interest was mostly unpaid, however, and as of June 30, 1993, cumulative interest arrears on commercial bank debt were $2.4 billion, excluding late interest charges.

On July 30, 1993, Russia signed an agreement in principle with the commercial banks. According to Chemical Bank, the debt at that time included $24 billion in principal and $4.5 billion in interest arrears. Russia announced that it would make a $500 million partial payment on its interest arrears by the end of 1993, and the parties agreed to seek to restructure the overall debt in early 1994.

Developments in 1994

According to PlanEcon, at the end of 1993, Russia's total debt was about $87 billion,[29] and it estimated that Russia's debt had increased nearly $9 billion during 1993.[30]

At the time of the April 2, 1993, debt rescheduling agreement between Russia and its official creditors, the latter agreed to meet again with Russia in 1994 to discuss further debt relief. According to the World Bank, the creditors' willingness to do so depended on Russia's having an IMF upper

[28]See section in chapter 5 on arrears, debt relief, and IMF arrangements for a discussion of the types of IMF credit arrangements.

[29]As previously shown in table 3.1, the World Bank estimated the FSU's debt at about $81.5 billion in mid-1993.

[30]Review and Outlook for the Former Soviet Republics August 1994.

credit tranche arrangement in place and arranging debt relief on other obligations due in 1993 (mainly commercial bank credit). However, according to USDA, on January 20, 1994, Russia's major official creditors agreed, in response to a Russian request, to extend the terms of the April 2, 1993, agreement through April 30, 1994. They did so even though neither of the two above conditions was in place.

In March 1994, a State Department official told us that Russia and the IMF had begun serious talks on additional debt relief arrangements. The official indicated that debt relief was no longer being made contingent on Russia's having an upper credit tranche arrangement or concluding a debt rescheduling agreement with commercial creditors. In March 1994, the IMF Director indicated a standby agreement would not be possible until the second half of 1994, and he said that such an agreement would depend on Russia's planned budget for 1995 and implementation of its STF program as intended. In addition, he said that the IMF must have a clear idea of how the process of disinflation was developing in 1994.

As of March 1994, the IMF still had not approved the second half of the $3 billion STF loan to Russia. According to the WEFA Group, the IMF was unhappy with Russia's lack of progress in stabilizing its economy.[31] Subsequently, on April 20, 1994, the IMF announced approval of the second drawdown, equivalent to about $1.5 billion. The IMF said it was approving the loan to support Russia's 1994 economic reform and stabilization program.

The agreement was reached only after direct negotiations between the IMF Managing Director and Russia's Prime Minister. According to the IMF Managing Director, the loan will provide foreign exchange and be part of the general financing. He noted that Russia has a lot of debt payments to make to the international community.

According to the IMF, the Russian program's main objectives are to further reduce the rate of inflation through tighter fiscal and monetary policies and to consolidate and strengthen structural reforms and the transition to a market economy. The IMF said the monthly rate of inflation is projected to decline to 7 percent by the end of 1994, and the federal budget deficit is expected to represent about 7 percent of GDP during the year.

[31]See, for example, Eurasia Outlook, The Countries of the Former Soviet Union (Bala Cynwyd, PA: The WEFA Group, Apr. 1994).

The IMF warned that success of the Russian program hinges critically on the strict implementation of the government's fiscal plan. The IMF noted that various sectors would probably be reluctant to accept a reduced level of budgetary support. In addition, the IMF reported that Russia would clearly need a further comprehensive debt relief package to normalize relations with external creditors. The IMF said that external financing would also be needed by Russia and other FSU countries to help them consolidate large budget deficits in a noninflationary manner and to finance social safety nets. According to the IMF, official and private external financing would be available only in the context of strong and sustained stabilization and a reform program. Regarding the latter, as of November 1994, Russia had not concluded a standby loan agreement with the IMF.

As table 3.6 shows, the IMF, the World Bank, and the European Bank for Reconstruction and Development delivered only $3 billion of $19 billion in aid that was announced for Russia during 1992 and 1993. Total official aid delivered from all sources was only $23 billion or about 58 percent of the $40 billion announced. According to the IMF, much of the $17 billion that was promised but not received was due to Russia's failure to implement appropriate macroeconomic stabilization policies.

Table 3.6: Official Financial Assistance to Russia, 1992-93

Dollars in billions

	1992		1993		Total[b]	
Type of assistance[a]	**A**	**D**	**A**	**D**	**A**	**D**
Conditional IMF financing	$9.0	$1.0	$13.0	$1.5	$14.0	$2.5
Facilities	3.0	1.0	7.0	1.5	8.0	2.5
Stablization fund[c]	6.0	0	6.0	0	6.0	0
World Bank and European Bank for Reconstruction and Development	1.5	0	5.0	0.5	5.0	0.5
Bilateral creditors and European Union[d]	11.0	14.0	10.0	6.0	21.0	20.0[f]
Export credits	[e]	12.5	[e]	5.5	[e]	18.0
Grants	[e]	1.5	[e]	0.5	[e]	2.0
Total	**$21.5[g]**	**$15.0**	**$28.0**	**$8.0**	**$40.0**	**$23.0**

Legend
A=announced
D= delivered

[a]Excludes debt relief assistance.

[b]Excludes most double counting, that is, amounts announced but not disbursed in 1992 and announced again in 1993.

[c]The $6 billion stablization fund was potentially available in both 1992 and 1993 to help stablize the ruble in the context of a comprehensive reform strategy. It was not activated because the appropriate conditions were not in place.

[d]Does not include German grants of more than $3 billion to rehouse Russian troops.

[e]Not reported.

[f]Excludes some items for which reliable data were not available.

[g]Excludes $2.5 billion of promised debt relief on interest payments that was not formally granted in 1992.

Sources: World Economic Outlook, Part I (Washington, D.C.: IMF, Apr. 20, 1994). Jeffrey D. Sachs, Russia's Struggles with Stabilization: Conceptual Issues and Evidence, World Bank's Annual Conference on Development Economics (Washington, D.C.: Apr. 28-29, 1994).

Table 3.6 also shows that export credits accounted for most of the official assistance that was delivered in 1992-93. Some observers have been highly critical of the counting of export credits as financial assistance. For example, according to Jeffrey Sachs, a former financial adviser to the Russian government, most of the credits were short-term trade credits that had to be repaid in 1 to 3 years. Thus, the credits became government debt that rather quickly added to the government's debt-financing problems.

On June 4, 1994, Russia's official creditors agreed to reschedule about $7 billion in FSU debt payments due in 1994, including debt contracted before 1991 and during 1991. According to a Treasury Department official, the $7-billion figure includes payments that had been deferred under the January through April extension previously discussed. The rescheduling included some short-term debt and previously rescheduled interest. The agreement provided for a grace period of 2 to 3 years, with payback periods ranging between 5 and 13 years. Russia and its official creditors also agreed to meet later in 1994 to discuss longer term and more comprehensive rescheduling.

Regarding commercial debt rescheduling, on April 1, 1994, an official of Chemical Bank advised us that talks were being held between the Russian government and the bank advisory committee. According to the official, Russia had not paid any of the promised $500 million in interest during the last quarter of 1993 and had paid no interest during 1994.

In October 1994, the Russian government issued a statement saying it was prepared to assume legal responsibility for the former Soviet Union's commercial debts. Also, in early October 1994 there were press reports that Russia had reached agreement with its foreign bank creditors on a framework for a long-term rescheduling of the commercial debt. However, a representative of Chemical Bank advised us that the terms of an agreement had still not been defined (e.g., grace period, number of years over which principal would be repaid, contractual interest rate). He said it was possible that an agreement could provide for a grace period of up to 5 years and for repayment of rescheduled debt over 10 to 15 years. He said commercial creditors hoped that the Russian government would make some kind of cash payment on the debt. There were, he said, hopes that an agreement would be reached in the near term, but an agreement was far from being wrapped up.

Conclusions

Between 1989 and 1991, the FSU experienced increasing debt problems. The situation reached crisis proportions in late 1991. Russia and many successor states eventually reached agreements whereby Russia would accept responsibility for external FSU debt in return for the other states not making claims on the FSU's external assets. Russia has agreed with its official creditors to accept responsibility for the FSU debts. However, as of early October 1994, Russia had still not reached agreement with its foreign bank creditors on a framework for rescheduling and resuming payments on the FSU commercial debts.

Since late 1991, the United States and other official creditor nations have provided considerable debt relief to the FSU and its successor states. The United States, other official creditor nations, and the IMF have also provided important financial assistance to Russia. However, much of the promised financial assistance has not been forthcoming because of insufficient progress by Russia in stablizing and restructuring its economy. Although official creditor nations have provided considerable debt relief, additional debt relief is needed.

General Economic and Political Situation in the FSU/Successor States

During the past few years, the FSU and its successor states have experienced historic economic and political change. The process is not yet complete. The Soviet empire is gone, replaced by 15 successor states, and the central role of the Communist Party has been abolished. The region has begun to move away from the old command economy of the FSU toward market-like economies, and some progress has been made in establishing democratic institutions. However, progress varies widely across the successor states.

The successor states' economies are in serious decline, and further deterioration is projected for most of them. Political legitimacy is an issue in a number of the new states. During 1993, Russia itself experienced a constitutional crisis concerning the respective roles of the parliament and the presidency in directing the affairs of the country, the direction and pace of economic reform, and the question of whether its leaders represented the views of the electorate. Five of the former Soviet republics have experienced significant armed conflict within their borders.

Whether efforts to create effective market-based economies and democratic polities will succeed is not clear. Also uncertain is whether the political boundaries that resulted from the breakup of the Soviet empire will survive. Such uncertainties can affect the willingness of westerners to invest in the new states. Without substantial foreign investment, the new states' creditworthiness can be adversely affected.

Background

It is 3 years since the Soviet Union disintegrated. Shortly before the breakup, the central administrative organs of the Communist Party were dissolved, its assets confiscated, and its archives seized. The party that dominated life in the Soviet Union for decades was banned or suspended in Russia and many other successor states. Also gone are the central governmental ministries and planning system in Moscow that played major roles in directing affairs across the various republics.

Having discarded the Marxist-Leninist ideology, the successor states are trying to make a transition from command economies to free and open markets. In addition, many have made progress toward establishing democratic institutions. Nonetheless, former Communist elites continue to govern under the names of newly created parties in many of the new states, and Communist elites cling to power at regional and local levels as well. Although the old Communist Party was banned as a national organization after the 1991 coup attempt, several neocommunist parties have been formed in Russia since then. They have a strong national organization and, as discussed in the following section, experienced some success in December 1993 elections for a new parliament.[1] Former Communists were recently returned to power in Lithuania.

All of the states are experiencing acute economic crises that stem from the general economic collapse that preceded the dissolution of the Soviet Union and that has been further exacerbated by the breakup of the empire. Common elements of the crisis have included very high levels of inflation, hard currency shortages, and failing public health systems. Many of the new states are politically unstable, not only as a result of the economic crisis but also, in many cases, because of a lack of political legitimacy. Several states have been adversely affected by intraregional and internal ethnic and civil conflicts that have turned violent, particularly in the Caucasus[2] region (see app. I).

The Economic Situation

The economies of the former Soviet republics are in disarray. Economic deterioration was a major factor associated with the development of the debt crisis and the disintegration of the Soviet Union itself. According to WEFA estimates, Soviet GDP fell by 2 percent in 1990 and 16.9 percent in 1991. WEFA estimated that aggregate GDP for the former Soviet republics declined another 20 percent during 1992. It estimated the cumulative drop for 1990-92 at 34.9 percent.[3]

PlanEcon, a Washington, D.C., economic forecasting group specializing in East European countries, has estimated GNP losses for each of the former Soviet republics. According to its calculations, during 1989 through 1993, three of the republics/successor states sustained GNP declines ranging from about 12 to 26 percent (Belarus, Turkmenistan, and Uzbekistan); six states experienced declines of about 31 to 37 percent (Estonia, Kazakhstan, Kyrgyzstan, Moldova, Russia, and Ukraine); five states declines of 44 to 57 percent (Armenia, Azerbaijan, Latvia, Lithuania, and Tajikistan); and one state a decline of about 66 percent (Georgia).[4] (See table 4.1.) The GNP estimates indicate that economic decline in most

[1]Stuart D. Goldman, Russia, Library of Congress, Congressional Research Service Issue Brief IB92089 (Washington, D.C.: Mar. 25, 1994).

[2]The Caucasus is a mountain system located between the Black Sea and the Caspian Sea. Armenia, Azerbaijan, and Georgia fall within the Caucasus, as well as part of Russia.

[3]World Economic Outlook, Vol. 3 (Bala Cynwyd, PA: The WEFA Group, Jan. 1993).

[4]Review and Outlook for the Former Soviet Republics February 1994, (Washington, D.C.: PlanEcon, Feb. 1994).

republics is already comparable to or greater than that experienced by the United States during the Great Depression.[5]

Table 4.1: Annual Percent Change in GNP for FSU/Successor States, 1990-1993

Country[a]	1990	1991	1992	1993	1989-1993
Georgia	–12.4	–17.9	–43.8	–16.2	–66.2
Armenia	–5.9	–13.1	–39.1	–13.1	–56.7
Lithuania	–3.1	–13.0	–35.0	–17.0	–54.5
Tajikistan	–1.3	–3.8	–30.4	–24.7	–50.2
Latvia	–8.9	–8.3	–32.9	–10.0	–49.6
Azerbaijan	–12.6	–0.7	–26.7	–12.4	–44.3
Moldova	4.7	–8.1	–26.0	–7.0	–36.7[b]
Estonia	12.6	–11.0	–25.0	–5.1	–36.7[b]
Russia	0.6	–8.9	–19.0	–12.0	–35.0
Ukraine	–1.5	–10.0	–13.7	–14.5	–34.6
Kyrgyzstan	0.6	–5.0	–19.0	–14.8	–34.4
Kazakhstan	4.7	–6.8	–13.4	–14.9	–31.3[b]
Belarus	–6.7	–2.0	–10.0	–9.7	–25.7
Turkmenistan	0.5	–7.1	–11.9	2.4	–16.2
Uzbekistan	–2.7	–0.5	–9.6	0.8	–11.8

Note: GNP data at purchasing power parity rates, 1990 dollars. Percent change figures calculated by GAO.

[a]Countries are listed in ascending order for percent change during the 1989-93 or 1990-93 period.

[b]Percent change 1990-1993.

Source: PlanEcon.

According to a Congressional Research Service analysis,[6] the breakdown of the economies of the former Soviet republics can be attributed to the legacy of the Stalinist economic planning system combined with incomplete economic reforms that were introduced during the Gorbachev era. Under the command economy, the state owned all the means of production and controlled production and investment decisions. The result was an inefficient system that produced, with only a few exceptions, poor quality goods and services. Gorbachev's reforms included laws to decentralize economic decisionmaking but did not go far enough. The reforms reduced the discipline of the state-run economy but left intact

[5]U.S. GNP declined 30 percent between 1929 and 1933 (in terms of 1958 prices).

[6]Russia and the Commonwealth of Independent States.

most of its fundamental elements—price controls, nonconvertibility of the ruble, public ownership, and the government monopoly over most of the means of production.

The economic breakdown was manifested in monetary imbalances that led to high inflation and a shortage of goods as the former Soviet government ran up large budget deficits. The central government financed these deficits primarily by printing money, thereby generating inflation as increasing amounts of rubles chased decreasing amounts of goods. In addition, the distribution system collapsed. Direct relationships between suppliers and manufacturers and between manufacturers and distributors that were to substitute for the centrally controlled system did not fully develop.[7]

Further Economic Decline Is Projected for Most FSU States

In February 1994, PlanEcon forecast[8] another 2 years of economic decline in Russia and 3 years of additional decline in Belarus and Ukraine. It concluded that prospects for economic recovery in Armenia, Azerbaijan, Georgia, Moldova, and Tajikistan would remain bleak until their various political, interethnic, and territorial conflicts are resolved (see app. I). It forecast another 2 years of economic decline or stagnation in Kyrgyzstan, Turkmenistan, and Uzbekistan. And it forecast another year of economic decline in Kazakhstan.[9]

There were four bright spots in PlanEcon's forecast. Although forecasting another year of decline in Kazakhstan, PlanEcon said it anticipated a strong recovery in 1995 and 1996. The recovery would be led, directly and indirectly, by several large projects to develop Kazakhstan's natural resource wealth that involve a commitment of substantial resources by a significant number of major multinational corporations. However, PlanEcon said its forecast would be endangered if developments materialize that discourage the continued participation of western firms in the joint ventures. Without the imminent takeoff of these joint venture

[7]Russia and the Commonwealth of Independent States. According to the CIA, in 1991, the Soviet Union's total fiscal deficit was about 20 percent of GDP. Retail prices rose as high as 140 percent. Inventories of food in the traditional system were drawn down to rock-bottom levels. Imports from outside the FSU fell by about 40 percent and exports by about 30 percent. See Statement for the Record, by John McLaughlin, Director of Slavic and Eurasian Analysis, Before the Technology and National Security Subcommittee of the Joint Economic Committee of the Congress (Washington, D.C.: Central Intelligence Agency, June 8, 1992).

[8]See, for example, Review and Outlook for the Former Soviet Republics February 1994.

[9]As discussed in ch. 5, economic forecasts of the FSU and its successor states are difficult to make and should be used with caution.

products, Kazakhstan's recovery would be more closely tied to and possibly even lag behind Russia's recovery.[10]

The other bright spots were the Baltic states. PlanEcon forecast recovery would get underway in these states in 1994 and 1995—provided that macroeconomic stabilization policies were continually pursued and that industrial restructuring got fully underway. According to PlanEcon, the Baltic states have made the most progress in transition toward market economies of all the former republics. PlanEcon said that tough monetary and fiscal measures had paid off—inflation had been sharply reduced, and all three states boasted strong new currencies. According to PlanEcon, (1) all three states closed 1993 with current account surpluses; (2) their trade balances were positive (except for Estonia); and (3) sizable aid and loan transfers, combined with surpluses in services, have made the near-term external payments picture quite solid. With generally stable monetary policies in place, PlanEcon said, they have been able to increase the level of confidence in their currencies, raise their foreign exchange reserves, and maintain the convertibility of their currencies for current account transactions. However, PlanEcon said, the Baltic states are highly dependent on foreign trade, including trade with the CIS. Consequently, prospects for recovery in foreign trade over the medium term, and thus their external payments environment, will depend on developments in the CIS and particularly Russia.[11]

Economic Reform Has a Long Way to Go

As discussed in chapter 3, during 1991 the IMF and the G-7 encouraged Russia to set certain economic goals. Of all the CIS republics, Russia had the most reform-minded leadership, and its reform program set the pace for the others, according to the CIA. It has passed many of the laws and regulations required to establish market institutions and provide the necessary guidelines for private business activity. It took the lead on price deregulation. In terms of foreign exchange, it set exchange rates at more realistic levels, reduced the number of goods requiring export quotas and licenses, and abolished import quotas. It also made some serious efforts to stabilize its economy by reducing its budget deficit, and it made substantial cuts in defense expenditures.

However, Russia still has far to go to create a market economy. Russian fiscal and monetary restraint has weakened considerably in the face of pressures from the old establishment for increased spending and easier

[10]Review and Outlook for the Former Soviet Republics February 1994.

[11]Review and Outlook for the Former Soviet Republics February 1994.

credit. Elements of that establishment—industrial managers, farm bureaucrats, and local government officials—are resisting reforms that reduce their influence and diminish their financial support.

In addition, Russia has also fallen far short of the goals that it outlined to the IMF in March and July 1992. As discussed in chapter 3, the March 1992 program called for Russia to reduce its budget deficit to 1 percent of GNP by the end of 1992 and indicated the rate of inflation would be slowed to 1 to 3 percent by the end of the year. In July 1992, Russian officials indicated to the IMF that these goals were not obtainable. At that time, they committed to reduce Russia's budget deficit to below 10 percent in the second half of 1992 and to lower the monthly rate of inflation to 9 percent by December 1992. According to the IMF, Russia's budget deficit in 1992 was nearly 19 percent of its GDP (see table 4.2). Regarding inflation, PlanEcon estimated that Russia's average annual inflation in 1992 was 1,414 percent (see table 4.3) and that it averaged about 25 percent per month during the last quarter of 1992.

Table 4.2: FSU/Successor States' General Government Budget Balances, 1991-93

	Percent of GDP			
Country[a]	1991	1992	1993	Average[b]
Tajikistan	[c]	–37.0	–37.0	–37.0
Armenia	–1.9	–34.8	–52.0	–29.6
Georgia	–3.5	–35.1	–40.0	–26.2
Ukraine[d]	–15.0	–28.7	–15.0	–19.6
Moldova[d]	[c]	–26.0	–6.1	–16.1
Russia[e]	–16.0	–18.8	–9.3	–14.7
Azerbaijan	2.6	–26.8	–14.4	–12.9
Uzbekistan[d]	–4.8	–13.0	–15.7	–11.2
Kyrgyzstan[d]	4.5	–14.8	–8.2	–6.2
Kazakhstan[d]	–7.9	–7.3	–2.9	–6.0
Belarus	3.6	–5.7	–11.8	–4.6
Lithuania	2.8	0.6	–0.2	1.1
Estonia	4.6	0.6	0.2	1.8
Turkmenistan[d]	3.5	14.1	–7.0	3.5
Latvia	6.3	[c]	0.9	3.6

[a]Countries listed in ascending order for the average.

[b]Averages based on the number of years for which estimates are shown and calculated by GAO.

[c]Not available.

[d]Excludes extrabudgetary funds.

[e]Includes unbudgeted import subsidies.

Source: IMF.

Table 4.3: FSU/Successor States' Percent Change in Consumer Prices, 1990-96

Average annual

						Forecast		
Country[a]	1990	1991	1992	1993	Average 1991-93	1994	1995	1996
Georgia	5	79	913	10,000	3,664	1,500	400	175
Ukraine	5	87	1,019	3,500	1,535	1,750	600	300
Kazakhstan	4	91	1,381	1,250	907	700	250	100
Tajikistan	5	95	1,040	1,450	862	900	205	100
Belarus	5	97	1,042	1,400	846	700	300	200
Russia	5	94	1,414	905	804	525	175	75
Moldova	5	110	926	1,300	779	650	175	80
Kyrgyzstan	2	180	1,033	1,040	751	600	125	65
Armenia	10	100	800	990	630	600	250	100
Lithuania	8	225	1,021	410	552	70	40	30
Uzbekistan	4	83	800	700	528	175	60	50
Turkmenistan	5	101	737	700	513	250	100	75
Azerbaijan	5	106	533	820	486	500	300	200
Estonia	17	211	1,069	55	445	20	10	10
Latvia	5	124	951	108	394	25	20	17

[a]Countries are listed in descending order for the average percent change during 1991-93. Averages calculated by GAO.

Source: PlanEcon.

According to the IMF, Russia reduced its budget deficit considerably in 1993; however, the deficit was still more than 9 percent of GDP for the year. Russia also reduced inflation significantly during 1993. Nonetheless, its average annual inflation for the year was 905 percent, and PlanEcon estimated that monthly inflation during the last quarter of 1993 averaged 16 percent.

During the first half of 1994, Russia made unexpected progress in reducing inflation as the government maintained tighter fiscal and monetary discipline than had been expected.[12] The average monthly inflation rate fell below 10 percent. PlanEcon estimated that the federal budget deficit during the first half of the year amounted to about 10.4 percent of GDP. However, during the summer, monetary policy was relaxed, raising concerns that inflation would significantly increase before the end of the year. In early October, the ruble began to depreciate significantly. A crisis

[12]See, for example, Review and Outlook for the Former Soviet Republics August 1994.

erupted when the Russian ruble lost more than 25 percent against the dollar in 1 day, October 11—raising new concerns about the effectiveness of the government's efforts to stabilize the economy. President Yeltsin fired the Finance Minister, sought the resignation of the head of the Russian Central Bank, and appointed a state commission to investigate the situation. The day following the collapse of the ruble, Russia's Economic Minister was reported to have attributed the ruble collapse, in part, to the government's easing of monetary and credit policy.[13]

Progress in stabilizing economies and implementing economic reform varies widely across the other successor states. As table 4.2 shows, 12 other states had budget deficits in 1993. For 10 of the 12 states, the deficits ranged between 6.1 percent to 52 percent of GDP. Regarding inflation, PlanEcon estimated that 12 other states had average annual inflation rates in 1993 ranging between 410 percent and 10,000 percent. Estonia and Latvia, the countries with the lowest inflation, had annual rates of 55 and 108 percent, respectively. (See table 4.3.)

According to PlanEcon, little progress on economic reform has been made in many of the successor states. For example, Armenia, Azerbaijan, Georgia, Moldova, and Tajikistan have been sidetracked by war, civil conflicts, and/or trade embargoes. Kyrgyzstan, Tajikistan, Turkmenistan, and Uzbekistan continue to adhere to many features of the old centrally planned systems, including state orders, price controls, and trade regulation through permits and quotas. Belarus has failed to undertake any significant economic reform, partly because of a parliament dominated by old-style Communists. Kazakhstan hesitated in introducing market reforms during 1992 and 1993. Since then, it has begun to accelerate the transition, yet is still struggling to set up the institutions needed to manage the economy of an independent state. Ukraine made some progress on economic stabilization and reform during later 1992 and early 1993, but meaningful reform was then largely abandoned in favor of a return to greater central control. According to PlanEcon, the members of the old Communist Party continue to dominate that country.[14]

Recent IMF Assessment

According to an IMF May 1994 assessment,[15] most FSU successor states had not yet achieved a reasonable measure of macroeconomic stability.

[13]"Shokin Against Easing Anti-Inflation Policy," Moscow Interfax (Oct. 12, 1994), as reported by the Foreign Broadcast Information Service.

[14]Review and Outlook for the Former Soviet Republics August 1994.

[15]World Economic Outlook (Washington, D.C.: IMF, May 1994).

Exceptions cited were the Baltic states.[16] High inflation and budget deficits, the IMF said, are contributing to economic uncertainty and inefficiency, the impoverishment of vulnerable groups of people, capital flight, and a protracted adjustment period. The high inflation and budget deficits are also discouraging needed foreign investment. According to the assessment, states that have pursued very expansionary monetary and fiscal policies (Belarus, Russia, and Ukraine are cited as examples) have not significantly mitigated the large declines in output associated with the transition to market economies.

In those countries where macroeconomic stability has not been achieved, the IMF said, the first priority should be to eliminate the underlying sources of inflation—by sharply reducing budget deficits and reining in credit growth. Tax reform is required to enhance revenues and reduce distortions. Expenditure reform is required to reduce subsidies and to target social assistance more effectively. Eliminating excessive credit growth requires allowing financial markets rather than central banks to allocate credit at market-determined rates.

The IMF found that most countries in transition have made substantial progress in structural reform. In particular, it said, prices are now largely market determined, and international trade has been liberalized in many countries. Privatization has also proceeded rapidly in some—but not all—countries. However, the IMF also found that the reform process has been significantly delayed in most FSU countries because the large declines in economic output, high inflation, and erosion of the financial position of vulnerable groups have resulted in severe economic and social strains. In some cases, the IMF said, the strains threaten to derail the reform process. As a result, it said, all countries in transition still face a daunting agenda of structural reform, which is crucial to the medium-term prospects for economic growth. A priority for the FSU countries (except the Baltics) is the elimination of the system of state orders, bilateral trading arrangements, barter agreements, and export controls and tariffs. These distortionary measures should be replaced, the IMF said, with more uniform tariff structures at low rates, a workable interstate payments system, and a trading system based on the most-favored nation principle.[17]

[16]Like PlanEcon, the IMF projected that FSU successor states other than the Baltic states would experience further economic decline in 1994. According to the IMF, Armenia, Azerbaijan, Georgia, and Tajikistan are all suffering from virtual economic collapse because of wars.

[17]Each nation would agree to extend to other nations the best trade privileges it grants to any other nation.

According to the IMF, privatization and enterprise reform are central to the establishment of market economies but are proceeding more slowly in most FSU countries than had been anticipated. As a result, it said, the pace and scope of privatization need to be strengthened, particularly to include the large enterprises. Land reform, including liberalized real estate markets and the privatization of agricultural land, should be speeded up in most countries. In addition, there is an urgent need in most of the countries to strengthen the financial sector and put in place a legal framework of property rights and effective bankruptcy procedures.

According to the IMF, the decline in FSU and its successor states' output has put great strain on social, economic, and public institutions. It said the old, the unemployed, and the unskilled have been exposed to severe hardship as inflation has eroded the real value of pensions, unemployment benefits, and minimum wages. In general, the patchwork of enterprise-provided social services that prevailed under central planning has not been replaced by adequate alternatives, and the absence of a social safety net has deterred firms from shedding labor. IMF said that there is an urgent need to maintain the purchasing power of many benefits in the face of inflation and to better target benefits by overhauling eligibility criteria and benefit structures, while keeping expenditures at levels consistent with sustainable budgetary positions.

The Political Situation

The FSU's political situation is characterized by great uncertainty, with the economic depression that has swept across each state a major destabilizing force. Between the latter part of 1992 and the end of 1993, Russia experienced a political and constitutional crisis that pitted the powers of the Russian presidency against the parliament. The conflict also included a struggle between those who supported the government's western-oriented market reforms, democratization, and foreign policies against those who wanted to moderate or reverse one or more of these policies.[18]

Conflicts have arisen among the republics over the disposition of the FSU's armed forces, nuclear weapons and other assets, and foreign debts. Finally, historic ethnic rivalries that were largely suppressed during decades of Soviet rule have broken out into the open. They have already led to serious armed conflicts in five of the former republics—Armenia, Azerbaijan, Georgia, Moldova, and Tajikistan. Each conflict has affected

[18]See, for example, Stuart D. Goldman, Russia, Library of Congress, Congressional Research Service Issue Brief IB92089 (Washington, July 2, 1993).

Russian minorities living there, and Russia has employed military forces in some of the conflicts to protect its minorities and other interests. Russia has also deployed troops within its own borders in an effort to separate ethnic combatants and prevent a further spread of violence. (See app. I.)

Developments in Russia[19]

Russia is the most important of the republics, because it accounts for the large majority of the area, population, and resources of the FSU, and because it has been in the forefront of CIS republics attempting to institute economic and political reforms. Russia includes several highly disparate regions, each of which has an economy larger than nearly all of the other former Soviet republics.

Russia's population of more than 148 million includes over 150 ethnic groups. Several ethnically based groups have declared themselves sovereign entities and are practically self-governing. These include the Chechen and Tuva Republics and Tatarstan.[20] One concern is whether some of the larger ethnically based groups will be content to remain a part of the Russian Federation or will prefer to seek full independence. Russia's integrity and viability could be threatened if certain groups seek to leave the country. A related concern is that conflict between minorities could become violent and challenge the Russian government's ability to maintain order. As discussed in appendix I, Chechens declared independence in 1991, but Russia did not recognize Chechnya's claim to independence. In late 1994, the Russian government sent large military and police forces into Chechnya to disarm the Chechens and restore Russia's authority. Chechens fought back fiercely. The conflict could seriously affect Russia's transition to democracy and a market economy.

The number of Russian minorities in other republics is also a source of concern.[21] Many nationalists within Russia have attacked President Yeltsin for being too conciliatory in relations with neighboring states where the rights of resident Russians are seen to be at risk. Others have worried that Russia might use actual or alleged abuse of Russian minorities in the other

[19]For additional information about several of the other republics, see appendix I.

[20]Jim Nichol, Russian Federation: Basic Facts, Library of Congress, Congressional Research Service (Washington, D.C.: Feb. 6, 1992).

[21]The percent of the population in other republics that is Russian is: Kazakhstan (41 percent); Latvia (33 percent); Estonia (28 percent); Kyrgyzstan (26 percent); and Ukraine (21 percent). In addition, Russians account for 9 to 13 percent of the population in Belarus, Lithuania, Moldova, Tajikistan, Turkmenistan, and Uzbekistan and 7 to 8 percent of the population of Georgia and Azerbaijan. In Armenia, Russians account for only 2 percent of the population.

successor states as a pretext for intervention and possible territorial aggrandizement.

As discussed previously, in early 1992 Russia embarked upon a serious economic reform program. During that year, the Russian President governed largely by use of special emergency powers that allowed him to enact changes by executive decree. However, his government found it increasingly difficult to implement its program because of the rise of a powerful industrial lobby that established considerable influence with the Russian parliament. The lobby included large enterprise managers, trade union leaders, and other conservatives who wanted to roll back the government's economic reform program. The program threatened to restrict the lobby's powerful role in the Russian economy by decentralizing economic decision-making and holding firms accountable for their actions.[22] During 1992 the lobby demanded and received hundreds of billions of rubles worth of easy credits. It was aided by the Russian central bank, which controlled the printing of money and was responsible to the parliament rather than to the President. The bank's policy of printing rubles and making large credits available to state-owned industry and farms undermined the government's monetary and credit policy, threatening hyperinflation. As a result, the budget deficit became much larger than planned, and high inflation rates continued unabated.

Toward the end of 1992, a full-blown constitutional crisis developed. In November 1992, the President told the British Parliament that a cabal of militant nationalists and former Communist officials were plotting to overthrow him and sweep aside the economic and political reforms that his government had pursued. The President vowed to do whatever was necessary to prevent their success. In December, Russia's supreme legislative body, the Congress of People's Deputies, convened.[23] As the Congress got underway, estimates indicated that only a minority of its members was committed to the government's reform program; a larger minority was opposed. A crisis occurred when the Congress voted to not approve making the Acting Prime Minister, Yegor Gaidar, Prime Minister. He had spearheaded the government's radical economic reform program. Following his rejection, the President declared that it had become impossible to work with the Congress. He called for a national referendum, to be held in January 1993, in which the public would be

[22]Review and Outlook for the Former Soviet Republics, November 1992 (Washington, D.C.: PlanEcon, Nov. 1992).

[23]Russia had a two-tier legislature. The Congress of People's Deputies met twice a year in 2-week sessions. It elected from its ranks a Supreme Soviet, which was the day-to-day functioning legislature.

asked to choose between the Congress' or the President's ideas for leading Russia out of its economic and political crisis. The President said he would resign if he did not win the vote. The proposal was threatening to members of the Congress, since their terms were not due to expire until 1995 and a vote against the Congress could lead to early elections.

The crisis was temporarily defused in mid-December 1992 when the President and the parliament agreed instead to hold a referendum in April 1993 to approve the basic principles for a new constitution, such as whether Russia should have a presidential or parliamentary system of government. However, in January the parliament began to try to back away from holding a referendum. In February the President and the parliament explored possible compromise power-sharing formulas that would allow them to postpone or call off the planned April referendum. At issue, in part, were concerns that a referendum would contribute to separatist tendencies in Russia's regions and to political and economic instability more generally. In March the Congress met in emergency session to decide whether to pursue a referendum or approve a power-sharing arrangement between the parliament and the presidency. Instead, the Congress chose to cancel the referendum and reduce the President's powers. It gave itself authority to suspend the President's decrees, made it easier to remove him from office for unconstitutional conduct, and indicated it would act to further reduce the President's powers and dismantle many of his reforms.

In a televised address to the nation on March 20, 1993, President Yeltsin announced he was assuming temporary special powers to rule by decree and indicated he intended to hold a referendum on a new constitution and to secure a vote of public confidence in his leadership. Such measures were necessary, he said, to prevent restoration of Communist power. President Yeltsin also said that he had ordered the Prime Minister to speed up the economic reform process, including introduction of private land ownership, and to assume control over Russia's central bank. A few days later, Russia's constitutional court ruled that the President had violated the constitution by assuming special powers (even though the court had not yet received a copy of a presidential decree ordering an assumption of special powers). On March 23, the speaker of the parliament called for President Yeltsin's impeachment.

This crisis eased somewhat when the President's decrees were published, since they backed away from the assumption of special powers. Even so, on March 28, 1993, nearly 60 percent of the members of the Russian

Congress voted to impeach the President. However, the vote fell short of a required two-thirds majority. (Only a quarter of the legislators opposed the proposal to oust the President.) The Congress also rejected a proposal that called for elections for both the President and the parliament in November 1993. The Congress then passed a resolution calling for a referendum on April 25, with four questions to be put to the voters. They were whether the voters (1) had confidence in the President, (2) approved of the social and economic policies conducted by the President and the government since 1992, (3) considered it necessary to hold early elections for the presidency, and (4) considered it necessary to hold early elections for the Congress. The Congress did not approve questioning, as had been agreed upon in December 1992, the electorate on the basic principles for a new constitution.

The Congress stipulated that a majority of the electorate would have to approve any question put to the voters before a decision would be accepted. The standard exceeded the normal condition for referendums that 50 percent of the electorate simply vote. The higher standard was considered difficult to achieve, given an apathetic electorate. However, on April 21, 1993, Russia's Constitutional Court ruled that the President need secure only a majority of votes by those actually voting on the issues of (1) confidence in the President and (2) approval of the President's socio-economic policy.

In the April 25 referendum, a majority of those voting expressed confidence in the President, his handling of the economy, and early elections for the legislature. Nearly a majority (49.5 percent) voted for early presidential elections. However, the referendum did not bring an end to political gridlock or the constitutional crisis that had gripped Russia for many months. Less than a majority of the total electorate voted for early elections to the legislature and the presidency; consequently, early elections were not mandatory. Although there was a large voter turnout, key opponents of the President sought to discredit the election results before the vote counting had been completed and warned that the President might resort to unconstitutional measures to further his objectives.

Between then and September 1993, relations between President Yeltsin and the parliament deteriorated further. As a result, on September 21 the President announced that he was disbanding the parliament and decreed that elections for a new legislature would be held in December. The lower tier of the parliament responded by voting in favor of impeaching the

President and declaring Vice President Alexander Rutskoi as Acting President. The latter said he was nullifying Yeltsin's decree and named new ministers of defense, interior, and security. However, Yeltsin won support from the existing defense, interior, and security ministries.

On September 28 and 29, the Interior Ministry sealed off the White House (the building that housed the Russian parliament) with armored personnel carriers and barbed wire and ordered remaining armed parliamentary deputies to surrender their arms and leave the building. On October 3, thousands of anti-Yeltsin demonstrators overran police forces surrounding the parliament and seized control of several key facilities. There were many casualties, and the government launched a counteroffensive. The rebellion collapsed on October 4 when army troops subdued the opposition, including using armed force to retake the White House. Rutskoi and other hardliners were arrested.[24]

Following the collapse, President Yeltsin, in a televised address to the nation, warned that conditions in the nation remained dangerously unstable and said that quick action was needed to eliminate the remnants of the old system and put a new democratic structure in place. To this end, he called for (1) a new constitution, (2) elections for a new parliament in December and possibly for new local legislatures as well, and (3) unswerving commitment to continuing economic reform.

Elections were held in mid-December 1993 but yielded mixed results. Voters did approve a new constitution for Russia, but progovernment parties fared poorly in the parliamentary elections. Hardline opposition parties won more than 40 percent of the popular vote and elected more deputies than those elected by the reformist parties.[25] Ultranationalists, Communists, and their allies won the upper hand in the Duma, the more powerful legislative chamber. The significant representation that they achieved reflected widespread economic distress and increased opposition to President Yeltsin's policies.[26] Nonetheless, during the first half of 1994, Russian political developments were surprisingly favorable, according to PlanEcon, as the new parliament demonstrated greater professionalism and the President, Prime Minister, and parliament

[24]Jim Nichol, Russia's Violent Showdown: Chronology of Events, September 21-October 4, 1993, Library of Congress, Congressional Research Service (Washington, D.C.: Oct. 5, 1993).

[25]ERS analysts told us that they believe the share of parliamentary seats held by nonreformers (including those who believe that reforms should move more slowly) is at least 50 percent if not more.

[26]Jim Nichol, Russian Legislative Elections and Constitutional Referendum, Library of Congress, Congressional Research Service, (Washington, D.C.: Jan. 7, 1994). Russia (Mar. 25, 1994).

achieved more stability in their interactions with one another.[27] However, as previously discussed, in late 1994 Russian military and police forces became involved in a major conflict in Chechnya, and the conflict could adversely affect Russia's transition to democracy.

Political Reform in the Other States

As with economic reform, progress on political reform varies widely across the other successor states. According to PlanEcon, the Baltic states have established viable democratic institutions capable of managing the economic transition and relations with their neighbors, especially Russia. However, all of the other states remain considerably or even far behind. For example, owing to armed conflict and civil strife, Armenia, Azerbaijan, Georgia, Moldova, and Tajikistan have not even been able to achieve political stability. As a result, according to PlanEcon, none of the countries seems close to establishing the political stability necessary to promote economic recovery and attract foreign investment.[28]

In Belarus, there was little political change until recently. According to PlanEcon, since January 1994, the chief of state resigned under allegations of corruption, the parliament adopted a new constitution, and the country elected a new president. However, the new president's positions on major issues remained unclear. In addition, parliamentary elections have not been held since 1990, and the legislature is dominated by a faction that consists largely of holdovers from the old Communist regime.[29]

In Central Asia, the political leaders of Tajikistan, Turkmenistan, and Uzbekistan have not strayed far from their Communist roots, according to PlanEcon. The President of Kyrgyzstan is characterized as somewhat of an exception. According to PlanEcon, he seems genuinely committed to change. However, he has been discouraged by corruption and resistance to reform and recently indicated that the people are not yet prepared for democracy. In Kazakhstan, the other successor state in Central Asia, policies have largely been decreed by its executive branch, headed by President Nursultan Nazarbayev. A new constitution was adopted in January 1993 that provided for a strong president (elected for 5 years), a legislature, and a quasi-independent judiciary. The country held its first parliamentary elections in March 1994, with the President's political

[27] Review and Outlook for the Former Soviet Republics August 1994.

[28] Review and Outlook for the Former Soviet Republics August 1994. Moldova did manage, in February and March 1994, to hold its first multiparty elections since the end of communist rule.

[29] Review and Outlook for the Former Soviet Republics August 1994.

supporters securing a large majority. However, according to PlanEcon, both the candidate selection process and voting were not fair.[30]

In Ukraine, the first post-independence parliamentary elections were held in March and April 1994. Ukraine also elected its second post-independence president in July. However, according to PlanEcon, the country is still governed by a Soviet-era constitution and a small cadre of bureaucrats, driven by greed and heavily influenced by industrial bosses, controls the levers of both legislative and executive authority.[31]

Uncertain Future

As the prior discussion indicates, the economic and political situation in the FSU has changed dramatically, and there is much uncertainty about its future. As the CIA has noted, "an empire has collapsed, the dust has barely begun to settle, and the forces that will both buffet and propel reform are epic in proportion. The elements of uncertainty and unpredictability in this part of the world are greater than at any time since the Bolshevik Revolution of 1917."[32]

At issue is whether attempts to establish democratic and market-based systems will succeed. Also at issue is whether the political boundaries that resulted from the breakup of the Soviet empire will survive. According to one observer, possible outcomes for the area during the next decade include (1) splintering the empire into different groupings, with widely divergent foreign policies and cultures; (2) instability and possibly even civil war; (3) restoration of the Russian empire under an authoritarian, xenophobic, anti-Western regime; or (4) the emergence of truly independent democratic nations united by some form of a common market and collective security framework.[33]

Regarding the latter two possibilities, PlanEcon recently concluded that a few of the new states have already begun to trade some of the normal attributes of sovereignty for closer ties with Russia. In support of this conclusion, it noted the following developments. During 1993, Russia muscled three recalcitrant countries into joining or promising to become full members of the CIS. Georgia had resisted membership since the collapse of the Soviet Union, but in 1993 the Georgian President asked for

[30]Review and Outlook for the Former Soviet Republics August 1994.

[31]Review and Outlook for the Former Soviet Republics August 1994.

[32]Statement for the Record.

[33]Dimitri Simes, "America and the Post-Soviet Republics," Foreign Affairs, Vol. 71 (summer 1992), p. 1.

military assistance to prevent the overthrow of his government; simultaneously, he brought Georgia into the CIS. Azerbaijan, faced with a series of military defeats by the Armenians, turned to Russia for military support and, in exchange, began to participate more actively in the CIS. Moldova's parliament had not ratified an agreement to participate in the CIS until Russia pressured it to do so in the fall of 1993. In addition, PlanEcon said, Tajikistan and Belarus have abandoned some of the normal attributes of sovereignty for closer integration with Russia. Tajikistan's ruling group lost the initial rounds of a civil war and needed Russian assistance to reestablish control. The current government relies on Russian economic and security assistance to stay in power and has agreed to follow Russian security and economic policies. Belarus has said it will subordinate its economic, foreign, and security policies to Russia. According to PlanEcon, Kazakhstan and Ukraine are major question marks; if they relinquish the same powers as Belarus, Russia will have reestablished the heart of the former Soviet Union.[34]

Some observers believe the successor states lack the necessary political and economic preconditions for undertaking large and instant reforms. For example, Peter Reddaway, a professor of political science and international affairs at George Washington University in Washington, D.C., has concluded that Russia's deeply Sovietized political culture is highly unsuited to free markets, entrepreneurism, privatization, and the rule of law and will remain so for a decade or two, even with sustained western assistance. According to Reddaway, Russians have reached the limits of their stoicism after the demoralizing traumas of loss of empire, ideology, and familiar institutions, and with severely diminished real incomes.[35]

Zbigniew Brzezinski, a former national security adviser to President Carter, has also indicated that the former Soviet republics enjoy little prospect of a successful transition to market-based democracies in the foreseeable future. According to him, the more realistic scenarios for the future of the FSU include (1) continued fragmentation of Russia itself—splitting perhaps into two or three states, with Moslem Central Asia going its own way; (2) emergence of an inward-oriented and rather authoritarian but modernizing Russian national state; or (3) establishment of an authoritarian and nationalist Russian state that seeks to recreate its imperial status. Brzezinski also said that the reforms demanded by the IMF and the West as part of the privatization process would force the post-Communist countries to accept prolonged, massive, and painful

[34]Review and Outlook for the Former Soviet Republics February 1994.

[35]"Next from Russia: 'Shock Therapy' Collapse," The Washington Post, Outlook Section (July 12, 1992).

unemployment. This situation, he said, is politically and morally unacceptable; rather, the West should, at a minimum, help create some temporary safety nets for the victims of the transition process.[36]

In June 1992, the CIA said that it expected the reform process to continue in Russia and elsewhere but believed the process would be contentious and marked by recurring crisis. The CIA said the process would probably last a decade—during which the downside risks would be enormous and the range of possible outcomes wide, including extended political deadlock and instability so serious that it could derail reform in both the economic and political spheres.[37] In early 1993, the CIA reported that there were reasonable prospects that Russia would continue its positive internal transformation and integration into the western system of values, but inevitably with continued great travail. Moreover, it said, there remains the possibility that Russia could revert to dictatorship or disintegrate into chaos, with immediate disastrous consequences for the world.[38]

In January 1994, the U.S. Ambassador responsible for coordinating U.S. assistance to the NIS advised Congress that a titanic struggle was underway in Russia over the future of the country. He said the struggle involved a long-term process that could take a generation or more to resolve. In March 1994, the Secretary of Defense said the struggle could lead to a fully democratic and market-oriented Russia, which he characterized as the best possible outcome imaginable or, in the worst case, an authoritarian, militaristic, imperialistic nation hostile to the West. The latter case, he said, could see a renewal of some new version of the old Cold War.

Economic and Political Situation Can Adversely Affect Foreign Investment

As discussed in chapter 1, one of the factors that affects the creditworthiness of countries is their ability to attract foreign exchange to finance new investment within their borders as well as their external debt. As discussed in chapters 3 and 5, estimates are that Russia and the other new states will require billions of dollars in outside financing over the next several years to engineer a transformation from command to market economies. However, as WEFA recently noted, the amount of direct foreign investment already in Russia is meager. It noted that estimates by Russian officials vary widely, citing figures ranging between $2 billion and

[36]"The West Adrift: Vision in Search of a Strategy," The Washington Post, Outlook Section (Mar. 1, 1992).

[37]Statement for the Record.

[38]Statement of George Kolt, National Intelligence Officer for Russia and Eurasia, before the Senate Armed Services Committee, (Washington, D.C.: Central Intelligence Agency, Feb. 3, 1993).

$7 billion. Even the latter figure, WEFA said, is small relative to the size of the Russian economy and Russia's professed desire for foreign investment.[39] In April 1994, a Commerce Department official told us that most observers agree that total foreign investment in Russia is not more than $4 billion. According to a recent report to Congress, total U.S. companies' investment in Russia is estimated at about $1 billion.[40]

The willingness of foreigners to invest in the various new states depends importantly on their assessments of each state's (1) political stability; and (2) willingness to pursue the economic reforms needed to establish viable market economies, according to PlanEcon and WEFA. Consequently, to the extent that there is considerable uncertainty about the future of economic reform and political stability in the new states, foreign direct investment is likely to be adversely affected.

Conclusion

Severe economic problems and political and ethnic tensions make the future political and economic situation of the FSU highly uncertain. As long as such uncertainty persists, the FSU successor states will be less likely to attract needed foreign investment, thus adversely affecting their creditworthiness.

[39] Eurasia Outlook for Foreign Trade and Finance (Bala Cynwyd, PA: The WEFA Group, Jan. 1994).

[40] National Export Strategy (Washington, D.C.: Trade Promotion Coordinating Committee, Oct. 1994).

Financial, Country Risk, and Other Assessments of the FSU/Successor States' Creditworthiness

Before 1992, all of the successor states had a relatively small debt compared to their economic output. Since then, all would be classified as severely indebted if held responsible for their respective shares of the FSU debt. Many of the FSU states have agreed to give up their claim on FSU assets in return for Russia's accepting their share of the FSU debt. This situation would reduce their debt burden but increase Russia's. Most of the new states have experienced severe liquidity problems. Russia's serious and growing arrears in debt payments, its inability to meet current and future debt payments, and its need to reschedule its debts demonstrate weighty creditworthiness problems. The secondary market for trading country debt has deeply discounted FSU securities.[1] Since Russia has been commonly perceived as having major responsibility for the FSU's debt, the discounting shows that commercial investors do not perceive Russia as creditworthy. In addition, several major, private-sector assessments of country risk have rated Russia and all other successor states as high-risk or low on creditworthiness. The lack of creditworthiness of the successor states exposes the GSM-102 program to a high level of risk. For example, GSM-102 credit guarantees on the outstanding principal for the FSU and to Russia and Ukraine equaled about 44 percent of the GSM-102 portfolio. Moreover, these guarantees represented nearly 60 percent of the program's portfolio risk exposure, according to our calculations.

Debt Burden and Creditworthiness

The amount of a country's debt burden can be an important indicator of its solvency—the ability to fulfill its obligations in the long run. All other things being equal, a country with a high debt level poses a greater risk of default than one with a low debt level.[2] The burden that debt poses depends, in part, on its relationship to a country's economic output and its capacity to earn foreign exchange. One method used for analyzing country debt burden was developed by the World Bank. The bank used four indicator ratios to assess whether developing countries are less,

[1]The market expresses the value of a given country's loan or bond as a percentage of its face value. The extent to which a bond's or loan's value is discounted in the secondary market indicates how the financial market assesses the risk of default.

[2]Appendix II provides data comparing countries' debt burden levels to their arrears, IMF arrangements, and debt relief agreements.

moderately, or severely indebted.[3] The ratios are (1) debt to GNP, (2) debt to exports of goods and services, (3) debt service to exports of goods and services, and (4) interest payments to exports of goods and services. The World Bank established thresholds for each of the ratios to use in classifying whether a country has a low level of indebtedness or, alternatively, is moderately or severely indebted. For each indicator, the bank's moderate threshold represents 60 percent of the value of the severe threshold. A country is classified as "moderately" or "severely" indebted if three of its four ratios exceed the corresponding thresholds shown in table 5.1.

Table 5.1: World Bank Debt Burden Indicators and Classification Thresholds for a Country's Degree of Indebtedness

Debt burden indicator ratios	Moderately indebted thresholds	Severely indebted thresholds
Debt-to-GNP	30 percent	50 percent
Debt-to-exports	165 percent	275 percent
Debt service-to-exports	18 percent	30 percent
Interest-to-exports	12 percent	20 percent

Note: A country is classified as moderately or severely indebted if three of the four indicators are above the thresholds.

Source: World Debt Tables 1989-90.

The Debt Ratios

Debt-to-GNP Ratio. This is the broadest measure of the solvency of a country and its ability to fulfill its debt obligations. A low debt-to-GNP ratio suggests good creditworthiness, since it shows that a nation's output is large relative to its debt obligations.

Debt-to-Exports Ratio. For countries that lack or are limited in their ability to draw upon foreign exchange reserves, exports are the principal means for obtaining foreign exchange needed to pay off loans. Countries with large export revenues relative to their debt are likely to be less vulnerable to foreign exchange crises and thus are less likely to default on their foreign loans.

[3]The World Bank revised its methodology during the final processing of this report. The revision bases debt indicators on the present value of debt service rather than on the nominal value of debt to capture the effect of borrowing terms (such as the maturity and concessionality of loans). The old method incorporated borrowing terms through ratios related to debt service payments. The present value calculation in the new method directly incorporates borrowing terms. The new method, therefore, reduces the debt burden measures from four to two. The new method corrects for the static nature of the old method. The classification of most countries (i.e., about 86 percent) did not change under the new method. We applied the old method because data required for the new method were not available.

Debt Service-to-Exports Ratio. Debt service ratios relate principal and interest payments to revenues received from the exports of goods and services. They indicate a country's ability to service its debt from hard currency export earnings.

Interest-to-Exports Ratio. The interest-to-exports ratio indicates a country's debt burden from the perspective of interest payments alone. Creditors generally do not reschedule interest payments on outstanding loans. If a country needs to reschedule its debt, creditors will want the country to at least stay current on its interest payments. The increasing frequency with which countries with debt service problems are rescheduling their principal payments has increased the relative importance of this indicator.

Debt Burden of the Successor States

Prior to 1992, the FSU and its successor states were not included in the World Bank's debtor reporting system. Therefore, we used historical and forecast data for the FSU and the successor states to calculate their debt burden ratios and thus classify their overall debt burden.

For a variety of reasons, economic forecasts for the former Soviet Union and its successor states are difficult to make because of major uncertainties associated with their transition from command to market economies. These uncertainties include the form and pace of economic restructuring that will be attempted, the amount of external assistance they might receive, and the extent to which they will cooperate with each other. In addition, official statistics of the FSU and the new states are difficult to obtain and do not adequately capture the growing nonstate sector.[4] Consequently, although we have attempted to minimize these data problems by using relative indicators such as ratios instead of absolute values, the forecast, as well as our analysis, should be used with caution.

Data were obtained from the WEFA Group.[5] WEFA did not provide disaggregated data for the external debt of the successor states. We estimated the states' individual debts by allocating total FSU debt according to a fall 1991 agreement among the successor states that assigned preliminary debt shares for each of the states. Other economic variables necessary for calculating the ratios were obtained from state level data as reported by WEFA. Although WEFA stopped making detailed forecasts for the

[4]See Planned Economies in Transition Outlook, (Bala Cynwyd, PA: The WEFA Group, Oct. 1992). See also, Review and Outlook for the Former Soviet Republics November 1992.

[5]Planned Economies in Transition, (Bala Cynwyd, PA: The WEFA Group, Jan. 1993).

FSU as an entity in October 1992, it continued publishing forecasts for each former republic. Its forecasts for the former republics were denominated in rubles. When there was a need to convert them to dollar values, we used PlanEcon data on historical or forecast market exchange rates to convert the republic data to their dollar equivalents (see below). The extraordinarily severe depreciation of the ruble relative to the dollar, however, may cause an undervaluation of the data for the former republics.

We made our analysis using historical and forecast data made by WEFA in January 1993. We were not able to obtain compatible, more recent data to update the forecast data. Nonetheless, we believe the underlying economic conditions for the forecasts have not been significantly altered for most of the successor states. Important problems being faced then are still being confronted by the states. Examples include large government budget deficits, decreasing economic output, and high levels of inflation.

Table 5.2 summarizes the results of our analysis, using the World Bank's old methodology, in terms of whether and when each country is considered to have low, moderate, or severe indebtedness during 1988 through 1997.

Table 5.2: Estimated Debt Burden Problems of the FSU/Successor States, 1988-97

Country	1988-91[a]	1992	1993-97[a]
Armenia	Severe	Severe	Severe
Azerbaijan	Severe	Severe	Severe
Belarus	Low	Severe	Severe
Estonia	Severe	Severe	Severe
Georgia	Severe	Severe	Severe
Kazakhstan	Moderate	Severe	Severe
Kyrgyzstan	Severe	Severe	Severe
Latvia	Severe	Severe	Severe
Lithuania	Moderate	Severe	Severe
Moldova	Severe	Severe	Severe
Russia	Low	Severe	Severe
Tajikistan	Moderate	Severe	Severe
Turkmenistan	Moderate	Severe	Severe
Ukraine	Moderate	Severe	Severe
Uzbekistan	Moderate	Severe	Severe
Russia:[b] 100%	Moderate	Severe	Severe
FSU[c]	Low	Severe	Severe

[a]Based on an average of annual values for the time period. Data for 1993-97 are forecasts.

[b]Estimate when Russia is made responsible for the outstanding foreign debt of the former Soviet Union.

[c]Estimate when the successor states are grouped together.

Source: GAO analysis of WEFA historical and January 1993 forecast data, using the World Bank's debt burden classification method. Debt shares for the former republics were calculated according to a November 1991 debt distribution formula that was agreed to by most republics.

As table 5.2 shows, before its dissolution in late 1991, the Soviet Union was a less-indebted country. If the outstanding 1988 through 1991 FSU debt were to be distributed among the republics according to the formula agreed upon in 1991, Belarus and Russia would be classified as less-indebted republics. In contrast, Armenia, Azerbaijan, Estonia, Georgia, Kyrgyzstan, Latvia, and Moldova would fall into the severely indebted category. For 1992, and for the 1993 through 1997 period, all of the states are classified as severely indebted.

As earlier indicated, we arrived at the debt classifications in table 5.2 by allocating the total FSU debt among the various republics. As discussed in chapter 3, many of the former republics have now reached agreement with Russia to give up their claims on FSU assets in exchange for Russia's assuming their shares of FSU debt. Successor states that do this will have reduced their debt burden and thus may no longer be classified in the same category for the forecast years. At the same time, Russia will have increased its debt burden.

While a number of successor states have benefited from Russia's assuming responsibility for all of the FSU's debt, they have been hurt by a reduction in transfers received from Russia. According to the IMF, most FSU countries have experienced a steep decline in large explicit and implicit transfers, including fiscal transfers from the former Soviet Union budget, which disappeared in 1992, and the subsidy implicit in the underpricing of energy and raw material exports (relative to world prices). This subsidy was reduced significantly as interstate prices for these goods were raised. The IMF estimated that between 1992 and 1994, the loss of official transfers from Russia and the rise in the import bill—on the assumption that energy and materials prices rise to world levels—may cost the other FSU countries $15 billion, or about 15 percent of their estimated 1994 GDP (at market exchange rates).[6]

In addition, a number of successor states have fallen into serious arrears as a result of trade deficits with other FSU countries. For example, PlanEcon estimated that Ukraine had a 1993 trade deficit with CIS countries of about $2.5 billion and that it owed Russia more than $1 billion for energy resources while having substantial arrears with Turkmenistan for gas deliveries. As a result, creditor states were refusing to deliver new supplies until old arrears were paid for. Turkmenistan has cut back on gas deliveries to Georgia because of the latter's inability to pay for supplies. Armenia and Moldova have had large trade deficits with other CIS countries, especially Russia and Turkmenistan. Uzbekistan reduced gas deliveries to Kyrgyzstan and threatened to cut off all supplies if the latter did not pay its debts. Tajikistan has accumulated large deficits with Russia.

Liquidity and Creditworthiness

"Liquidity," as used in this report, refers to a country's ability to secure foreign exchange over the short- and medium-term future sufficient to meet its debt service payments. We used two different methods to measure the liquidity of the successor states:

[6]Even so, the IMF calculated that during 1992 and 1993 new financial transfers extended by Russia and a buildup of unpaid claims by Russian enterprises on companies in the other countries (except the Baltic states, which received virtually no new transfers) equaled about 20 percent of the combined GDP of the countries.

(1) We examined the gross financial requirements of a country, defined as the amount of financial resources needed to meet its debt service obligations and international payments, including imports of goods and services.

(2) We constructed liquidity ratios that parallel the World Bank's old method for measuring debt burden to assess the liquidity of the successor states.

Gross Financial Requirements of the Successor States

Table 5.3 provides recent historical and forecast data for the hard currency financial requirements for the former Soviet Union. Figures for 1992 and the forecast years of 1993 through 1997 treat the 15 independent states as a single aggregate. The data are from the WEFA Group.

Table 5.3: Gross Financial Requirements for the FSU, 1992-97

U.S. dollars in billions

Components	1992	1993	1994	1995	1996	1997
Merchandise exports	$21.0	$22.4	$24.3	$26.7	$30.5	$32.8
Merchandise imports	21.7	22.6	23.8	25.3	26.4	28.1
Trade account balance	(0.7)	(0.2)	0.5	1.4	4.1	4.7
Current account balance	(3.9)	(5.3)	(4.6)	(3.8)	(0.8)	(0.2)
Net new debt[a]	11.3	8.5	6.2	3.4	1.5	4.1
Scheduled long-term principal repayments	2.4	4.4	5.6	9.2	11.6	13.5
Payments due on short- term debt	16.2	11.3	10.2	9.5	10.1	10.6
Gross financial requirements[b]	30.0	24.3	21.9	22.2	23.2	28.2

Note 1: The forecast does not take account of the April 1993 and June 1994 debt rescheduling agreements (see ch. 3).

Note 2: Figures in parentheses are negative numbers.

[a]Net new debt composes the current account deficit less net direct and portfolio capital flows, changes in reserves, and other debt valuation items.

[b]The sum of net new debt, scheduled long-term principal repayments, and payments due on short-term debt. The sum may not equal the total shown due to rounding error.

Source: WEFA, January 1993.

WEFA's forecast indicates that as an aggregate, the FSU will require major assistance to meet its gross financial needs during the next several years. As the table shows, WEFA forecast a negative current account balance—a nation's trade in goods and services and net transfers—for each year during the 1993 through 1997 period. Net capital flows—direct and portfolio investments and changes in gold and foreign exchange reserves (not shown in table 5.3)—were estimated to be positive in each of the years but were not large enough to offset the current account deficit. Consequently, net debt, i.e., debt in excess of reserves (also not shown in table 5.3) is expected to grow throughout the forecast period. The net new credit (debt) required to finance the current account deficit and net capital flows is expected to decrease from a high of $11.3 billion in 1992 to $1.5 billion in 1996. However, when combined with the financing required to meet scheduled repayments on short-term and long-term debt, the financial requirements of the FSU and its successor states are considerable—ranging between $22 billion and $30 billion per year. Unless the successor states of the FSU receive substantial debt relief, they would require, on average, an estimated $24 billion annually of external financing between 1993 and 1997.

In contrast, according to the IMF, the annual average gross external financing for developing countries as a whole and for the former centrally planned economies as a separate grouping for 1990 to 1993 was estimated at $213 billion and $45.6 billion, respectively. Thus, the FSU annual gross financial requirement represents approximately 11 percent of the requirement for all developing countries and 53 percent of the gross financial requirement for all of the formerly centrally planned economies. It is doubtful that such a large financial inflow can be attained from financial markets if they are not confident that the successor states represent a growing economy and a stable investment climate.

We also provide in table 5.4 the distribution of the gross financial requirements among the successor states as well as the average ratio of the gross financial requirements to the gross domestic product for each republic from 1993 to 1997. The financial requirement of Russia and Ukraine combined accounts for about 85 percent of the total requirements for all successor states. However, when the gross financial requirements are viewed relative to the economic resources of the FSU and its successor states as measured by their GDP, the requirements of Russia and Ukraine represent only 27 percent of their respective gross domestic products. In contrast, the gross financial requirement for Estonia, Kyrgyzstan, Tajikistan, and Turkmenistan is less than $200 million each but represents several hundred percent of their respective gross domestic products.

Table 5.4: The Distribution of Estimated Annual Average Gross Financial Requirements Among the Successor States, 1993-97

Country	Annual average 1993-97 ($ in millions)	As percent of gross domestic product[a]
Armenia	216	58%
Azerbaijan	345	113
Belarus	1,042	64
Estonia	124	434
Georgia	333	86
Kazakhstan	807	67
Kyrgyzstan	191	442
Latvia	233	302
Lithuania	286	159
Moldova	259	274
Russia	24,134	27
Tajikstan	165	298
Turkmenistan	139	301
Ukraine	4,375	27
Uzbekistan	735	103
Total	**$33,384**	**30%**
Russia[b]	$31,807	36%

[a]The gross domestic product of each of the former republics was converted into U.S. dollars using market exchange rate forecasts for the ruble. Consequently, the percentages are sensitive to the devaluation of the ruble relative to the dollar. It is advisable that the percentages be interpreted as indicators of the relative severity of the gross financial requirements.

[b]Estimate when Russia alone is assumed to be responsible for all outstanding debts of the FSU.

Source: GAO analysis of WEFA January 1993 forecast and related data.

Liquidity Ratios of the Successor States

We used four indicator ratios to measure liquidity: (1) foreign exchange reserves to imports, (2) current account balance to GNP, (3) government budget balance to GNP, and (4) short-term debt (credit) to imports.[7] These variables were selected because they are used by the banking industry to determine a country's general ability to service its debt in the shortterm.

Reserves-to-Imports Ratio. This ratio describes a country's stock of foreign exchange relative to its annual import levels. As such, it measures the extent to which a country could pay for its imports out of reserves alone if that were necessary. Moreover, a country with large reserves relative to

[7]As discussed in the following paragraphs, we used GDP in lieu of GNP for the successor states.

imports is likely to have increased flexibility for using reserves to help service its debt, at least over the short run.

Current Account Balance-to-GNP Ratio. The current account balance measures a country's trade in goods and services and financial flows related to interest and dividends and transfer payments. If a country has a current account deficit, it is not taking in sufficient foreign exchange from its exports of goods and services and financial earnings inflows to offset the costs of its imports and financial payments outflows. A current account deficit is roughly equal to the amount of new financing required to meet international purchases and transfers. The lower a country's current account deficit relative to its GNP, the greater its potential for servicing its debt and the lower the probability of default.

Government Budget Balance-to-GNP Ratio. Countries with a surplus of central government revenues relative to expenditures are less likely to face short-term liquidity problems. Countries in surplus may be able to dedicate some of the surplus to paying off foreign debt if it is in the form of hard currency. However, countries that have a budget deficit will need additional domestic or foreign financing if they want to use government monies to help pay off debt.

Short-Term Debt (Credit)-to-Imports Ratio. As short-term debt[8] increases relative to medium- and long-term debt, a country will require more foreign exchange over the short term to meet its near-term payments. When not paid for in cash, imports represent the amount of revolving trade credits that have to be maintained in good order. The ratio of short-term debt to imports is a measure of the short-term cash flow or immediate demands on a country's foreign exchange. We hypothesize that as short-term debt to imports increases, a country's creditworthiness is more likely to decrease.

We constructed our own thresholds for these indicators by using IMF and World Bank data on net debtor developing countries for 1986-90.[9] In October 1992, the IMF reported that 72 out of 122 net debtor countries had experienced recent debt service difficulties because they had incurred external payments arrears or entered into official or commercial bank debt-rescheduling agreements during 1986 through 1990. For each of our liquidity measures, we calculated the liquidity ratio for each of 114

[8]Short-term debt is debt with a maturity of less than a year.

[9]Unlike debt burden, the World Bank does not report thresholds for liquidity.

countries for each year between 1986-90.[10] We then calculated the average ratio for each country over the 5-year period. Since roughly 60 percent of the IMF's list of net debtor countries (72 of 122) were designated as having a debt service problem, we used the observation that marks the 60th percentile on each liquidity measure as a threshold for characterizing a severe liquidity problem.[11] We believe this is a reasonable characterization, since arrears and rescheduling are indicative of serious liquidity problems.

We followed the World Bank's old method of designating "moderate" thresholds equal to 60 percent of the value of "severe" thresholds. Also similar to the bank's approach, we designated a country as having an overall moderate or severe liquidity problem only if three or more of its liquidity ratios equaled or exceeded the moderate or severe threshold values, respectively. (See prior discussion on debt burden.) Table 5.5 presents our country liquidity thresholds for the ratios of reserves to imports, current account deficit to GNP, government deficit to GNP, and short-term debt to imports.

Table 5.5: GAO Liquidity Indicators and Classification Thresholds for Liquidity Problems

Percent

	Classification thresholds	
Liquidity indicator ratios	**Severe[a] problems**	**Moderate[b] problems**
Reserves-to-imports	25.1	40.2
Current account balance-to-GNP	–3.2	–1.9
Government budget balance-to-GNP	–5.3	–3.2
Short-term debt-to-imports	16.8	10.1

[a]The observation that marks the 60th percentile of net debtor countries, 1986-90.

[b]Sixty percent of the "severe" indicator levels with the exception of the reserves-to-imports ratio. For the latter indicator, a higher score represents better liquidity than a lower score. Therefore, the moderate threshold for this indicator represents 160 percent of the severe threshold.

Source: GAO analysis of data from International Financial Statistics (Washington, D.C.: IMF) and World Debt Statistics (Washington, D.C.: World Bank). We accessed the data from an IMF computerized data retrieval system.

[10]We analyzed data on 114 countries that participate in the World Bank's debtor reporting system. We excluded countries where missing data were a problem or where data were not reported in U.S. currency values. Data for a few of the variables were obtained from IMF data series. The countries that we analyzed included 104 of the 122 countries that the IMF designated as net debtors during 1986-90.

[11]With the exception of the short-term debt (credit)-to-imports ratio, a higher and/or positive score represents better liquidity than a lower or negative score.

We used data from the WEFA Group to calculate the liquidity ratios for the successor states. However, data were not available for republic-level foreign currency reserves. To estimate the foreign currency reserves for each republic, we defined a relationship between the FSU's foreign currency reserves and its imports and exports. We then estimated each republic's reserve using its export and import data so that the level of reserves is proportional to its external trade balance. In addition, we used data on GDP in place of GNP for the two ratios previously discussed that include the GNP variable.[12] As with the debt burden analysis, we used historical and forecast data provided by WEFA in January 1993. Table 5.6 summarizes the results of our analysis in terms of whether and when each country is considered to have low, moderate, or severe liquidity problems.

[12]GNP is the sum of the total domestic and foreign output of all residents of a country, whereas gross domestic product is the value of goods produced and services provided in a country by its residents and nonresidents without regard to its allocation among domestic and foreign claims. For many developing countries, there is little difference between GNP and GDP. We used GDP in our ratios for the successor states, since GNP data were not reported for the countries in our data source.

Table 5.6: Estimated Liquidity Problems of the FSU/Successor States, 1988-97

Country	1988-91[a]	1992	1993-97[a]
Armenia	Severe	Severe	Severe
Azerbaijan	Severe	Severe	Severe
Belarus	Severe	Severe	Severe
Estonia	Severe	Moderate	Moderate
Georgia	Severe	Severe	Moderate
Kazakhstan	Moderate	Severe	Moderate
Kyrgyzstan	Severe	Severe	Severe
Latvia	Severe	Severe	Severe
Lithuania	Severe	Severe	Moderate
Moldova	Severe	Moderate	Moderate
Russia	Severe	Severe	Severe
Tajikstan	Moderate	Moderate	Moderate
Turkmenistan	Severe	Moderate	Moderate
Ukraine	Severe	Severe	Severe
Uzbekistan	Moderate	Severe	Severe
Russia[b]	Severe	Severe	Severe
FSU[c]	Severe	Severe	Severe

[a]Based on an average of annual values for the time period. Data for 1993-97 are forecasts.

[b]Estimate when Russia is made responsible for the outstanding foreign debt of the former Soviet Union.

[c]Estimate when the NIS are grouped together.

Source: GAO analysis of WEFA historical and forecast data.

As table 5.6 shows, for 1988 through 1991, the liquidity problem of the FSU would have been classified in the severe category. However, if the outstanding debt at that time were distributed among the various republics, three—Kazakhstan, Tajikistan, and Uzbekistan—would have been classified as having moderate liquidity problems. The rest would have remained in the severe category.

For 1992, 11 of the 15 successor states were estimated to have severe liquidity problems. The other four states were estimated to have moderate problems. For the forecast period, 1993 through 1997, 8 of the 15 states are expected to experience severe liquidity problems. The other seven are estimated to have moderate problems. During both periods, Russia and the 15 successor states treated as a single entity are estimated to have severe liquidity problems.

Liquidity is a more appropriate measure of creditworthiness than debt burden, since liquidity more directly measures the ability to generate foreign currency for servicing short- and medium-term debt. The liquidity results indicate that most of the successor states, including Russia, are high-risk countries because of their severe liquidity problems.

Arrears, Debt Relief, and IMF Arrangements

The amount of arrears, the need for debt relief, and the specific types of IMF loan arrangements a country has accepted are major indicators of a lack of creditworthiness.

When countries with liquidity problems cannot meet all of their immediate debt obligations, they fall into arrears. In some cases, arrears reflect an unwillingness to service debt. In either case, if arrears continue and the situation is not remedied, the country is likely to be considered a poor credit risk. If arrears persist and/or become prolonged, a country may reach a point where it concludes it cannot meet its current and future debt payments unless it obtains debt relief.

Debt relief is obtained by rescheduling outstanding debt or by debt forgiveness. Debt rescheduling alters the terms and maturity of outstanding debt. Debt relief is typically undertaken only after payments have been missed or when default is imminent or has already occurred.

To initiate a debt renegotiation, official creditors must be convinced that (1) the debtor country will be unable to meet its external payments obligations unless it receives the relief and (2) the debtor will take necessary steps to eliminate the causes of its payment difficulties and to achieve a lasting improvement in its external payments position. For countries that are members of the IMF, creditors rely on the IMF to help the debtor country design appropriate adjustment measures. Creditors have also required that an "upper credit tranche" arrangement with the IMF be in place before the start of debt renegotiations.[13] Many countries that have accepted IMF arrangements are also countries that have rescheduled their debts.

As previously discussed, the Soviet Union was in substantial arrears by the end of 1990 (see ch. 3). In the fall of 1991, international creditors agreed to defer a substantial amount of the country's principal payments that were due in 1992. Since the dissolution of the Soviet Union in December 1991, only Russia has been making payments on Soviet debt. During 1992, Russia's arrears worsened, and Russian officials requested debt relief. In April 1993, official creditors agreed to reschedule $15 billion in debt that was already in arrears or scheduled for payment in 1993. By the end of 1993 a number of the successor states had reached agreement with Russia to exchange their responsibility for repaying a portion of the FSU debt in return for dropping their claims on a share of the FSU's assets held by Russia. In June 1994, Russia's official creditors agreed to reschedule another $7 billion (approximately) of FSU debt already due and/or yet to come due during 1994—indicating that Russia was unable to fully service the debt in spite of the 1993 rescheduling.

Meanwhile, Russia had still not reached agreement with bank creditors on rescheduling remaining FSU commercial debt. This issue had been outstanding since the dissolution of the Soviet Union in December 1991. As discussed in chapter 3, the commercial debt at the end of July 1993 was estimated by one source at $28.5 billion.

According to an April 1994 IMF assessment, it is clear that Russia will require a further comprehensive debt-relief package to normalize relations with external creditors. And, the IMF said, Russia and the other FSU

[13]When the IMF provides financial support to its members, its support varies depending on the nature of the macroeconomic and structural problems its members seek to address and the degree of conditionality it attaches to its support. The IMF provides short-term and medium-term financing for the purpose of correcting problems in a country's balance of payments. It extends credit to its members in conformity with their quotas and in four segments. Members are required to demonstrate only reasonable efforts to overcome their balance-of-payments difficulties to receive the first tranche. The IMF does not require performance criteria for the first segment, which is to be repaid in 3 to 5 years. Members who want to obtain credit beyond the first segment are required to enter into standby arrangements. Standby arrangements typically cover periods of 1 to 2 years and focus on macroeconomic policies such as fiscal, monetary, and exchange rate policies aimed at overcoming balance-of-payments difficulties. The IMF applies performance criteria, such as budgetary and credit ceilings, reserve targets, and external debt targets during the period. Extended standby arrangements support medium-term programs lasting 3 to 4 years and are aimed at overcoming balance-of-payment difficulties stemming from macroeconomic structural problems. The IMF also provides concessional terms to support medium-term macroeconomic adjustment and reform to countries facing protracted balance-of-payments problems, known as the Structural Adjustment Facility. Countries are required to develop 3-year policy frameworks with detailed programs for each year, including quarterly benchmarks. A similar program, known as the Enhanced Structural Adjustment Facility, is also administered by the IMF with more stringent IMF monitoring.

countries will require external financing to help them consolidate large budget deficits in a noninflationary manner and to finance social safety nets. But, the IMF warned, official and private external financing will be forthcoming and helpful to Russia and the other states only in the context of strong and sustained stabilization and reform programs. (See also ch. 4.) Otherwise, foreign lending will tend to increase capital flight and external debt and further delay the development of an environment in which a strong private sector can emerge.[14]

As discussed in chapter 2, Ukraine began defaulting on its GSM-102 loan repayments to the United States in the spring of 1994. As of August 17, 1994, defaults totaled about $31.1 million, and CCC had paid $21.6 million on claims made by lenders.

The successor states' prolonged arrears, the repeated need to reschedule debt, and the failure to reach agreement on re-scheduling FSU commercial debt all indicate a lack of creditworthiness. Successor states that have agreed with Russia to exchange their responsibility for the FSU debt for forgoing claims on FSU assets cannot be faulted for subsequent arrears that arise on FSU debt or a need to further reschedule FSU debt. However, as the recent IMF assessment indicates, other successor countries will still require external financing to help them consolidate large budget deficits in a noninflationary manner and to finance social safety nets.

USDA Criteria Focus on Debt Relief in Assessing Creditworthiness

As discussed in chapter 1, USDA's Trade and Economic Information Division is responsible for analyzing the ability and willingness of countries that have requested GSM-102 export credit guarantees to meet their current and future external debts, including potential GSM debt. As reported in chapter 2, TEID judged FSU and Russian debt as high risk between December 1990 and September 1992 when USDA committed to making available more than $5 billion in export credit guarantees to these states.

Table 5.7 shows that TEID grades countries on a scale that ranges between A and F, and risk is evaluated primarily in terms of whether a country is currently involved in and likely to be involved in future debt rescheduling. For example, a country is classified as "high risk" or a "D" if there is a greater than 50-percent chance that it will reschedule its old debt during the next 3 years. (See table 5.7.)

[14]According to the IMF, much of $17 billion in official financing that Russia had been promised but did not receive during 1992 and 1993 was not given because Russia had failed to implement appropriate macroeconomic stabilization policies.

Table 5.7: USDA Risk Grading Criteria for GSM-102 Credit Guarantees

	Country risk grade[a]				
Conditions	A (below average risk)	B (average risk)	C (above average risk)	D (high risk)	F (unacceptable risk)
CCC claims paid last 3 years	No[b]	No[b]	No	May have	May have[b]
Currently involved in rescheduling old debt	No[b]	No[b]	No	May be	Yes
Risk of rescheduling old debt in next 3 years	None	Small	< 50%	> 50%	Likely[c]
Risk of rescheduling new debt in next 3 years	None	Small	< 50%	Unlikely[c]	Likely[c]

[a]Relative to developing countries in general.

[b]Deduced by GAO from USDA information.

[c]Not further defined in terms of a probability.

Source: GAO, based on information provided by USDA/TEID.

TEID considers a country's risk to be "unacceptable" or an "F" if the state is both currently involved in rescheduling old debt and likely to reschedule new debt within the next 3 years.

On the basis of the analyses presented in this report and the terms of the April 1993 and June 1994 debt-rescheduling agreements and related developments, we believe that additional debt rescheduling for Russia during the next 3 years is a real possibility. As discussed in chapter 4, Russia experienced a constitutional crisis during 1993 that was based importantly on disagreement between the parliament and the President over the pace and extent of economic reform. Although voters approved a new constitution and elected a new parliament in December 1993, it remains to be seen whether the executive and legislative branches will work well together. As presented in this chapter, Russia is shown to have both a severe debt burden and severe liquidity problems. Although the April 1993 debt rescheduling alleviated Russia's liquidity problems in 1993, it has continued to have serious problems in 1994. In June, it entered into another substantial rescheduling agreement with its official creditors. As table 5.3 showed, the FSU gross financial requirements could exceed $20 billion per year between 1994 and 1997.

Given these considerations, we believe that Russia would continue to be classified as at least high risk under the TEID criteria displayed in table 5.7.

In fact, in May 1994, USDA officials advised us that TEID has assessed Russia as not creditworthy for more than a year. Other countries rated as not creditworthy by TEID included Armenia, Azerbaijan, Belarus, Georgia, Kyrgyzstan, Moldova, Tajikistan, and Ukraine.[15] According to the officials, TEID has rated the Baltic states, Kazakhstan, Turkmenistan, and Uzbekistan as creditworthy.

The Secondary Market

The secondary market for trading developing countries' loans and bonds is another measure that can be used to assess creditworthiness. Countries whose debt trades close to the face value of the loan or bond are considered quite creditworthy, whereas those whose debt is traded at a deep discount are not.

Some observers have criticized the use of secondary market prices as a measure of creditworthiness. They assert that the market exhibits abrupt price movements regardless of changes in the underlying economic conditions of the debtor countries. There have also been allegations that publicly reported secondary prices and actual transaction prices are different. Additionally, not all secondary market price movements can be linked to economic performance, as some price movements reflect only a country's willingness to pay back its debt. Moreover, the ability to service debt is dependent, in part, on the economic conditions of developed countries. Therefore, one might expect that the secondary market would be correlated with global economic conditions. However, there is little correlation between secondary price movements and variations in measures of global economic aggregates, such as industrial countries' growth.[16]

On the other hand, we believe the secondary market is the most reliable source of risk-adjusted valuation of debt that can be used to convert judgmental perceptions of risk into a measurable amount in dollars and cents.[17] Prices in the secondary market for countries with strong growth and lower levels of external debt have been found to be generally higher than prices in the secondary market for countries with severe economic and debt problems in part because investors associate strong growth and

[15]The officials noted that while TEID might rate a country as not creditworthy, USDA might find, after taking account of U.S. agricultural market development objectives, a country sufficiently creditworthy for receiving some GSM-102 credit guarantees.

[16]Przemyslaw Gajdeczka and Mark Stone, "The Secondary Market for Developing Country Loans," Finance and Development (Dec. 1990).

[17]GAO/GGD-93-45.

low debt with improved creditworthiness.[18] (See ch. 6 for further discussion of why we believe the secondary market is a useful measure.)

Secondary Market's Assessment of the FSU and Russia

A secondary market has developed for FSU loans and bonds. According to a March 1993 trade publication, the FSU/Russian debt market had been very illiquid. The study reported that transactions on FSU/Russian debt in the secondary market were very structured and often took a few months. Very often transactions were in the form of debt-for-debt swaps, and each transaction was dependent on its own specifications. As a result, the study said, FSU/Russian debt has been one of the most illiquid papers on the secondary market, and total market turnover for the sovereign debt amounted to at most $200 million in 1992.[19] However, according to more recent information, trading of FSU/Russian debt was considerably higher in 1992 (i.e., $678 million) and increased dramatically in 1993, to $24.7 billion.[20]

According to another trade publication, Soviet debt started trading in the secondary market in about 1990 and during 1991 traded at 55 to 60 cents on the dollar. By spring 1992, it said, prices had fallen to 30 to 35 cents on the dollar.[21] According to Chemical Bank data, secondary market prices for FSU loans traded for about 17 to 21 cents on the dollar between July 1992 and February 1993 and then fell to a low of 10 to 11 cents on the dollar in March 1993. Loan prices gradually increased to reach a high of 55 cents on the dollar during part of December 1993. Between then and March 1994, prices again declined, reaching a low of 28 cents on the dollar on March 21, 1994.

Vnesheconombank began issuing Eurobonds in the late 1980s. By March 1993, there were seven issues, amounting to a total value of $1.7 billion. VEB made servicing of these bonds a priority, continuing to make payments despite defaults on its debt service payments for loans. Consequently, the bonds have carried a higher price than the loans since they started being quoted at a discount at the beginning of 1991. In mid-1991 the bonds approached 55 to 60 cents on the dollar. By spring

[18]"The Secondary Market for Developing Country Loans."

[19]See Letitia Rydjeski, "Russia: The Struggle to Reform," Chemical (New York, NY: Chemical Bank, Mar. 20, 1993).

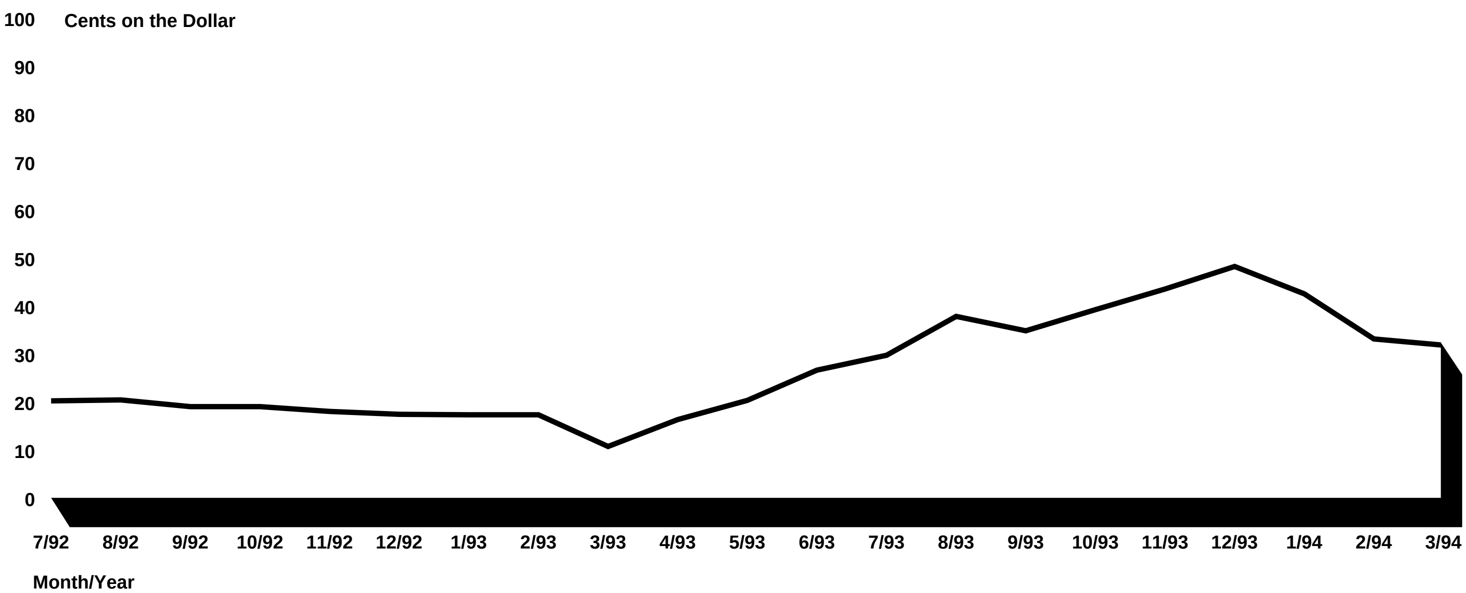
[20]Emerging Markets Traders Association, 1992 Trading Volume Survey (New York, N.Y.: Sept. 15, 1993) and 1993 Trading Volume Survey (New York, N.Y.: Aug. 8, 1994).

[21]"Russian Debt Payments Lag; Pressure to Reschedule Builds," LDC Debt Report (Sept. 7, 1992).

1992, they had fallen as low as 44 cents. In June 1993, they were trading at 60 to 65 cents on the dollar.

We believe the secondary market's valuation of FSU debt can be considered to represent market participants' judgment about Russian creditworthiness. (As previously discussed, Russia has assumed responsibility for making payments on FSU loans and bonds.) Figure 5.1 provides secondary market prices of FSU loans for July 1992 to March 1994.[22] The low prices indicate that the market finds Russia quite uncreditworthy.

Figure 5.1: Secondary Market Average Monthly Prices of FSU Loans, July 1992-March 1994



Source: Chemical Bank. Monthly averages calculated by GAO.

Country Risk Assessments

Following the rapid growth of developing countries' debt in the early 1970s and an increasing number of debt reschedulings in the 1980s, an assessment of the risk posed by cross-border lending and investments grew in importance. Therefore, the international financial community

[22]According to a Chemical Bank representative, the prices were for dollar-denominated variable-rate loans. He said he was not aware of any forces affecting the prices other than the evaluation of risk by investors.

developed country risk assessments to evaluate the risk of loss from the future actions of debtors.

Country risk analysis is based on a holistic approach. It encompasses social and economic risk, as well as "sovereign" (i.e., political) risk. The latter refers to exposure arising from events that are substantially under the control of a foreign government rather than a country's private sector.

A number of private organizations rate countries on the degree of risk associated with cross-border financial transactions. Lenders and investors can use the ratings in deciding whether to lend to or invest in particular countries. We analyzed the ratings of three publication services: Euromoney, Institutional Investor, and International Country Risk Guide (ICRG). Each assigns a country risk rating ranging between 0 for least creditworthy to 100 for most creditworthy. Each rating service uses a unique methodology for assessing country risk. Not surprisingly, there is considerable overlap in terms of the factors each considers.

Euromoney

Euromoney, a leading international publication, assigns credit ratings as a weighted average of market indicators covering access to bond markets and trade finance, credit indicators covering payment records and rescheduling difficulties, and analytical indicators incorporating economic performance forecasts and political environments.

In April 1992, a Euromoney analysis concluded that the republics of the FSU were not in a position to repay the full amount of their debts at that time and that a debt restructuring package seemed inevitable. At the same time, the analysis said it was generally accepted that the former Soviet republics as a whole were potentially wealthy enough to meet their obligations over time and that debts should be fully serviced and paid.[23]

As shown in table 5.8, in September 1992, Euromoney rated Russia and several other successor states in the range of 14.6 (Moldova) to 24.2 (Estonia) out of a possible 100. Relative to 169 countries rated, they fell into the bottom quartile. Euromoney concluded that access to bank lending by any of the successor states is "impossible" and that their access to international bond and syndicated loan markets is "nearly impossible."

[23]Paul Gardiner, "A Riddle in a Mystery in an Enigma."

Table 5.8: Country Risk Ratings for the Successor States and Selected Other Countries, 1992

Country	Euromoney[a]	Institutional Investor[b]	International Country Risk Guide[c]	Composite[d]	
				Rating	Rank
Switzerland	98.5	91.8	89.5	98.8	1
Japan	99.6	90.8	86.0	98.5	2
Netherlands	99.1	88.1	86.0	98.3	3
Germany, FR	98.2	89.8	84.0	98.2	5
United States	98.1	87.1	83.0	97.9	7
Canada	97.1	81.6	83.0	97.4	10
Italy	88.7	76.1	75.0	94.5	20
Korea, Rep.	75.5	67.6	80.0	92.1	24
UAE	76.5	57.3	73.0	87.1	30
China, PR	60.7	54.9	74.0	82.0	35
Oman	60.9	49.4	73.5	79.6	40
Turkey	66.2	43.9	68.0	75.9	45
Mexico	59.4	42.6	71.5	74.9	47
Venezuela	51.1	39.0	69.5	68.2	50
Tunisia	52.5	36.8	66.5	65.4	54
Trindad & Tobago	41.3	27.8	65.0	53.7	60
Gambia, The	30.5	[e]	65.5	45.7	70
Egypt	31.1	26.8	62.0	45.5	71
Zimbabwe	42.7	26.1	55.0	45.3	72
Romania	35.8	24.8	56.5	42.3	78
Algeria	37.8	28.9	51.5	41.6	80
Ecuador	28.8	20.4	61.0	40.0	83
Sri Lanka	33.9	24.1	51.5	37.0	90
Russia	**21.8**	**23.6**	**52.5**	**31.8**	**100**
Yemen, Rep.	24.5	[e]	54.5	30.6	102
Estonia	**24.2**	**22.1**	**[e]**	**29.7**	**104**
Lithuania	**24.1**	**20.7**	**[e]**	**28.5**	**109**
Latvia	**23.0**	**21.4**	**[e]**	**28.4**	**110**
Ukraine	**23.0**	**21.1**	**[e]**	**28.1**	**112**
Belarus	**21.2**	**21.1**	**[e]**	**27.0**	**117**
Togo	24.7	[e]	48.5	26.1	120
Kazakhstan	**20.8**	**18.7**	**[e]**	**25.0**	**126**
Mali	24.7	[e]	45.5	23.9	130
Uzbekistan	**18.4**	**16.6**	**[e]**	**22.1**	**134**
Bhutan	20.2	[e]	[e]	19.2	140

(continued)

Country	Euromoney[a]	Institutional Investor[b]	International Country Risk Guide[c]	Composite[d]	
				Rating	Rank
Turkmenistan	**18.4**	[e]	[e]	**17.3**	**145**
Kyrgyzstan	**17.7**	[e]	[e]	**16.5**	**149**
Georgia	**17.6**	[e]	[e]	**16.4**	**150**
Tajikistan	**16.7**	[e]	[e]	**15.5**	**152**
Azerbaijan	**15.2**	[e]	[e]	**14.1**	**154**
Armenia	**15.1**	[e]	[e]	**14.0**	**155**
Moldova	**14.6**	[e]	[e]	**13.6**	**158**
Mozambique	10.5	7.5	39.5	13.2	160
Iraq	6.1	7.6	25.0	7.1	169
Cambodia	2.6	[e]	[e]	5.7	170
Liberia	12.2	6.1	13.0	4.8	171
Somalia	7.7	[e]	17.5	3.8	172

[a]September 1992.

[b]September 1992.

[c]August 1992.

[d]Derived by GAO from the relative country ratings of each publication.

[e]The country was not rated.

Institutional Investor

Institutional Investor surveys leading international banks to rate the creditworthiness of sovereign states. Each bank provides its own rating, and Institutional Investor weights the responses using a formula that gives more importance to responses from banks with greater worldwide exposure and more sophisticated country analysis systems.

In March 1992, following the demise of the Soviet Union, Institutional Investor made its last rating for that entity. The score, 29.7,[24] represented a staggering decline of 34.6 points over the previous 2-1/2 year period. The Soviet Union's score of 29.7 placed it 58 out of the 113 countries rated by Institutional Investor.

In September 1992, Institutional Investor rated Russia 23.6, Belarus 21.1, Ukraine 21.1, Kazakhstan 18.7, and Uzbekistan 16.6. These ratings placed them 73, 78, 79, 90, and 98, respectively, among 126 countries. With the exception of the Baltic states, individual scores for the other republics

[24]Harvey D. Shapiro, "A Turn for the Better," Institutional Investor (Mar. 1992).

were not reported. The ratings for the Baltics were lower than their March 1992 ratings. Estonia was rated 22.1, Latvia 21.4, and Lithuania 20.7.

International Country Risk Guide

International Country Risk Guide (ICRG) provides a detailed country-by-country assessment of the risk of operating, investing in, or lending to particular countries using a three-part system that evaluates political, financial, and economic risk. It assigns an overall score to each country by using a weighting system that allocates 50 percent of the score to political risk, 25 percent to financial risk, and 25 percent to economic risk. According to ICRG, its country scores can be interpreted as in table 5.9.

In August 1992, ICRG rated Russia 52.5, putting it slightly above countries it considers as very high risk. ICRG did not provide ratings for any other former republic. (See table 5.8.)

Table 5.9: ICRG Country Risk Evaluation Scoring

Score	Degree of risk
0 - 49.5	Very high
50 - 59.5	Moderately high
60 - 69.5	Moderate
70 - 84.5	Low
85 - 100	Very low

Source: International Country Risk Guide, August 1992.

Comparison of Country Risk Ratings and Our Composite Rating and Ranking

As table 5.8 shows, the scores of the three rating services appear to be generally consistent with one another in the way they rank the creditworthiness of countries. Not surprisingly, though, there are some differences. The scores of Euromoney and Institutional Investor most closely approximate one another. ICRG scores are generally considerably higher than those of the other two services except for countries that are rated as high in creditworthiness.

Using a statistical method for effectively summarizing data from several sources, known as "principal components analysis," we analyzed whether the three rating services are measuring the same phenomenon. The analysis indicated that overall the ratings do measure a common factor. The principal components method was then used to generate a combined, overall rating for each of the countries. To the extent that the rating services are measuring different yet important aspects of creditworthiness and to the extent that bias or poor information may affect their ratings of some countries, we believe our combined ratings provide a better measure of the relative creditworthiness of countries.

As table 5.8 shows, the combined creditworthiness ratings for the successor states range from a low of 13.6 points for Moldova to a high of 31.8 points for Russia. In terms of rankings, Moldova ranked 158 and Russia 100 out of the 172 countries rated.

More Recent Country Risk Ratings

The previous analysis was prepared using country risk ratings from the August and September 1992 period. Table 5.10 provides more recent information on the FSU successor states for two of the rating services, Euromoney and Institutional Investor. The table shows that both services ranked nearly all of the countries as worse on creditworthiness in September 1993 as compared to September 1992.

Table 5.10: Euromoney and Institutional Investor Rankings for FSU/Successor Countries, 1992-94

	Euromoney			Institutional Investor		
Countries	**Sept. 92**	**Sept. 93**	**Mar. 94**	**Sept. 92**	**Sept. 93**	**Mar. 94**
Armenia	154	159	162	[a]	[a]	[a]
Azerbaijan	153	165	154	[a]	[a]	[a]
Belarus	132	139	145	78	100	109
Estonia	117	122	105	74	84	88
Georgia	148	151	151	[a]	117	125
Kazakhstan	134	129	129	90	98	99
Kyrgyzstan	146	144	135	[a]	[a]	[a]
Latvia	123	132	104	77	87	94
Lithuanaia	118	130	110	80	93	97
Moldova	156	160	148	[a]	[a]	[a]
Russia	129	137	138	73	92	98
Tajikistan	152	163	144	[a]	[a]	[a]
Turkmenistan	143	148	117	[a]	[a]	[a]
Ukraine	122	146	149	79	96	111
Uzbekistan	144	153	126	98	110	112
Global indicators[b]						
Total number of countries ranked[c]	169	170	167	126	132	135
Median	85	85	84	63	66	68
75 percentile	127	128	126	95	99	102
66 percentile	113	114	112	84	88	90

[a]Not rated.

[b]Based on GAO analysis of the rankings for all countries rated.

[c]Includes countries not shown in the table.

Sources: Euromoney and Institutional Investor. Global ranks calculated by GAO.

In March 1994, all of the countries rated by Institutional Investor, including the Baltic states, were ranked lower than they had been in September 1993. In March 1994, 8 of the 15 countries rated by Euromoney, including the Baltic states, improved on their rankings relative to September 1992 and September 1993. Even so, four of those countries were still ranked among the bottom quartile of all countries rated (i.e., Kyrgyzstan, Moldova, Tajikistan, and Uzbekistan); the other four were ranked close to or among the bottom one-third of all countries rated (i.e., the Baltic states and

Turkmenistan, respectively). For both services, the 1994 rankings of Russia and Ukraine declined further compared to September 1993.

The Cost of GSM-102 Exports to the FSU/Russia When the Risk of Default Is Taken Into Account

As of August 17, 1994, the extension of GSM-102 credit guarantees for exports to the FSU and to Russia had created a contingent liability to the U.S. government of about $2.9 billion for outstanding principal payments. That amount includes the large reschedulings that occurred in September 1993 and early June 1994. We used country risk ratings and secondary market prices to estimate the risk of default and, in turn, the expected cost of the GSM-102 loans to the FSU and Russia as of June 1994.

Risk of Default Estimated From Country Risk Ratings

Table 5.11 provides Euromoney country risk ratings for the FSU successor states for three time periods between September 1992 and March 1994 and the average of the three ratings.[25] As previously discussed, countries were rated by Euromoney on a scale ranging between 0 and 100. The higher the score, the better the creditworthiness and the lower the score, the worse the creditworthiness.

[25]We used Euromoney ratings in this analysis because it had the most complete data for all FSU successor states.

Table 5.11: Country Risk Ratings of the FSU/Successor States and Implied Default Risk, 1992-94

	Euromoney risk ratings				Implied default risk			
Countries	**Sept. 1992**	**Sept. 1993**	**Mar. 1994**	**Avg.**	**Sept. 1992**	**Sept. 1993**	**Mar. 1994**	**Avg.**
Armenia	15.10	18.59	17.77	17.15	85%	81%	82%	83%
Azerbaijan	15.20	15.66	20.71	17.19	85	84	79	83
Belarus	21.20	24.63	23.75	23.19	79	75	76	77
Estonia	24.20	28.94	33.50	28.88	76	71	67	71
Georgia	17.60	21.15	22.07	20.27	82	79	78	80
Kazakhstan	20.80	26.59	28.11	25.17	79	73	72	75
Kyrgyzstan	17.70	23.53	26.58	22.60	82	76	73	77
Latvia	23.00	26.00	33.54	27.51	77	74	66	72
Lithuania	24.10	26.55	32.68	27.78	76	73	67	72
Moldova	14.60	17.70	22.89	18.40	85	82	77	82
Russia	21.80	24.69	25.96	24.15	78	75	74	76
Tajikistan	16.70	15.77	24.16	18.88	83	84	76	81
Turkmenistan	18.40	22.21	31.81	24.14	82	78	68	76
Ukraine	23.00	22.62	22.73	22.78	77	77	77	77
Uzbekistan	18.40	21.02	29.47	22.96	82	79	71	77
Average	**19.45**	**22.38**	**26.38**	**22.74**	**81%**	**78%**	**74%**	**77%**

Note: Implied default risk was calculated by subtracting each country's score from 100 and dividing the result by 100.

Source: Country risk ratings are from Euromoney; GAO calculated the average country risk ratings and the implied default risk.

We used the country risk ratings to estimate an implied risk of the country's defaulting on its external debt.[26] The results are presented in table 5.11. As with the country risk ratings, we also calculated the average risk of default for the three time periods. As table 5.11 shows, the average country risk ratings for the FSU successor states varied between a low of 17.2 for Armenia and Azerbaijan to a high of 28.9 for Estonia. The average implied risk of default for the countries ranged between a low of 71 percent for Estonia to a high of 83 percent for Armenia and Azerbaijan.

Russia's country risk ratings ranged from 21.8 in September 1992, to 24.7 in September 1993, to 26.0 in March 1994. Its average rating was 24.2. The March 1994 implied risk of Russia's defaulting was 74 percent, and its average risk of default for the September 1992 to March 1994 period was

[26]The Euromoney creditworthiness ratings have been characterized by other analysts as a reasonable measure of the market's perceived default probabilities.

76 percent. As previously stated, Russia's contingent liability for GSM-102 debt in August 1994 was about $2.9 billion. Using the March 1994 implied risk of default score for Russia, we calculated that $2.1 billion in outstanding GSM-102 guaranteed principal repayments was at risk of default. If one uses the average risk of default score, nearly $2.2 billion was at risk of default.

Risk of Default Estimated From Secondary Market Prices

The average price of FSU loans in the secondary market in March 1994 was 32 cents on the dollar. This price implies a 68-percent risk of default at that time.[27] According to data provided to us by Chemical Bank, between July 1992 and March 1994, the price of FSU loans in the secondary market averaged 26.8 cents on the dollar—implying that financial markets expected about a 73-percent discount on repayment of outstanding FSU loans over that time period.[28] These default risk rates are quite similar to those indicated by the Euromoney country risk ratings previously discussed.

The March 1994 implied risk of default through the secondary market price suggests that $2 billion of the $2.9 billion GSM-102 principal is at risk of default. The average risk of default score for the secondary market price suggests that about $2.1 billion is at risk of default.

These estimates do not take account of possible savings in the cost of commodity support programs that may result when the GSM-102 program is used to promote increased exports of U.S. commodities. However, as discussed in chapter 2, whether and to what extent lower costs will result from the GSM-102 program depends importantly on the availability of alternative markets for the exports in question and how world market prices are affected by actions taken by other exporter nations in the absence of U.S. GSM program benefits for the FSU and its successor states.

According to an ERS official, while the potential CCC liability on GSM loans is great, one should consider Russia's self-interest in meeting its GSM-102 repayments responsibilities. If Russia does not meet its obligations, the official said, its ability to obtain future credit from the United States and other potential creditors would be complicated. In addition, the official

[27]We subtracted $0.32 from $1, divided the result by $1, and multiplied the latter by 100.

[28]In a recent report, we estimated probabilities of default for 170 countries based on estimates from financial markets where privately owned sovereign debt is traded. The estimates were based on data for October 1992. For Russia, we estimated a default probability of 67.6 percent. See Credit Reform: U.S. Needs Better Method for Estimating Cost of Foreign Loans and Guarantees (GAO/NSAID/GGD-95-31, Dec. 19, 1994).

noted that if Russia repays the credit and at an appropriate higher interest rate for rescheduled debt, U.S. taxpayers would endure no long-term cost under the program. Hence, the official said, rather than suffering a loss, U.S. taxpayers may earn revenue from rescheduled loans. In commenting on a draft of this report, USDA said GAO should examine the terms of rescheduled debt with the FSU. USDA said that taxpayers do not lose money as long as the interest charge exceeds the opportunity cost of funds to U.S. taxpayers[29] and as long as principal is repaid.

We agree that Russia will have greater difficulty in obtaining future credit if it does not meet its GSM-102 repayment obligations. However, whether and to what extent it will do so is the question. We have provided estimates of the likelihood of its repaying based on country risk ratings and the secondary market's valuation of FSU loans. It is conceivable that at some point in the future Russia may seek and obtain forgiveness for a substantial part of its GSM loan obligations. In the meantime, as of mid-August 1994, the United States had already paid out $1.4 billion to cover claims on GSM-102 defaults for FSU loans and was expecting to pay out another $429 million in claims by the end of 1994 as part of the June 4, 1994, rescheduling agreement.[30]

In its comments on our draft report, USDA disagreed with our use of the secondary market to estimate the risk of default on GSM-102 loans.[31] (See ch. 6.) However, in its comments, USDA itself questioned whether Russia had sufficient self-interest to repay GSM-102 debt. USDA said that Russia's self-interest had been overtaken by recent events, including lower import demand, large infusions of food aid, and the fact that the Russians had not requested new credit and did not seem very interested in staying current on GSM-102 debt payments.

Impact of Default Risk on the GSM-102 Portfolio

As discussed in chapter 1, the GSM statute prohibits USDA from extending credit guarantees to any country the Secretary determines cannot service the debt. However, the statute does not require that a country be considered generally creditworthy to receive GSM credit guarantees. In addition, the law does not provide any guidance as to what is an

[29]Regarding this point, a USDA official advised us that the United States negotiated with Russia a 5.25 percent interest rate for the GSM-102 debt that was rescheduled in September 1993. According to the official, this could be compared to a borrowing cost to the U.S. government at the time of 4.75 percent (i.e., for a 5-year Treasury bill).

[30]The $1.4 billion had been rescheduled and the $429 million was to be rescheduled as well.

[31]Our use of country risk ratings as another method for estimating the risk of default was added to our report after USDA's comments. Therefore, USDA did not comment on this method.

acceptable level of risk in evaluating whether countries can adequately service proposed GSM debt. Consequently, countries that USDA program officials assess as high risk in terms of creditworthiness can still be approved to receive GSM credit guarantees. Also, the statute does not place a limit on the amount of GSM guarantees that can be provided each year to high-risk countries in aggregate or to individual high-risk countries. As a result, USDA can allocate large amounts of guarantees to high-risk countries, making the GSM-102 portfolio subject to a potentially high rate of default.

In chapter 1 we showed that the FSU and two of its successor states (Russia and Ukraine) received the largest portion of GSM-102 credit guarantees provided during the fiscal years 1990-92. As a result of the large guarantees provided to the FSU and its successor states, the GSM-102 program became considerably exposed to default by these states.[32] Table 5.12 shows that on January 29, 1993, the FSU and its successor states were responsible for $3.6 billion, or about 44 percent, of all outstanding principal on GSM-102 guaranteed loans. Except for Mexico and Algeria, which were responsible for 26 percent and 11.5 percent, respectively, of the outstanding principal, most of the other GSM-102 recipients each accounted for less than 1 percent of the outstanding principal.

[32]As discussed previously, Russia began defaulting on GSM-102 loans in the fourth quarter of 1992, and in April 1993 the United States agreed to reschedule $1.1 billion of the debt. In early 1994, Russia began defaulting again on GSM loans. In June, USDA rescheduled another $882 million of GSM-102 debt.

Table 5.12: GSM-102 Recipient Countries' Principal Outstanding 1/29/93, Percent Share of Principal Outstanding, and Estimated Percent Share of Principal at Risk

Country[a]	Percent share of 1990-92 GSM-102 credit guarantees	Principal outstanding 1/29/93 ($ in million)	Percent share of principal outstanding	Estimated percent share of principal at risk[b]
FSU	**23.9%**	**$2,686.5**	**33.1%**	**44.6%**
Mexico	26.2	2,124.2	26.1	12.5
Algeria	12.4	933.1	11.5	12.8
Russia	**4.1**	**742.0**	**9.1**	**11.8**
Pakistan	4.0	372.1	4.6	5.1
Korea	9.8	344.2	4.2	0.6
Ukraine	**0.7**	**172.0**	**2.1**	**2.9**
Venezuela	2.4	144.9	1.8	1.1
Iraq	3.2	120.0	1.5	2.6
Trinidad & Tobago	1.0	71.3	0.9	0.8
Ecuador	1.4	57.3	0.7	0.8
Yemen	0.5	49.7	0.6	0.8
Turkey	1.7	46.6	0.6	0.3
Romania	0.3	45.5	0.6	0.6
Sri Lanka	0.4	34.2	0.4	0.5
Tunisia	0.7	30.7	0.4	0.2
Egypt	1.5	24.2	0.3	0.3
Zimbabwe	0.1	19.6	0.2	0.3
Others	5.6	105.8	1.3	1.4
Total[c]	**100.0%**	**$8,123.8**	**100.0%**	**100.0%**

[a]Countries are listed by percent share of principal outstanding, in descending order.

[b]We used the composite country risk ratings in table 5.8 to estimate principal at risk. The latter was calculated as outstanding principal times (100 - country risk rating) divided by 100. The country risk rating for the FSU was calculated as the debt-weighted average of the former republic ratings.

[c]Percentages may not add to 100 due to rounding error.

Source: GAO analysis of USDA information.

We used the combined country risk ratings presented in table 5.8 to estimate the principal at risk for each country participant in the GSM-102 export credit guarantee program.[33] The results are presented in table 5.12. As the table shows, the exposure of the GSM-102 program to default by the

[33]As table 5.8 shows, there was considerable variability among the three rating services. Thus, if one prepared separate estimates of percent share of principal at risk, the results would also vary considerably.

FSU and its successor states is considerably larger when the potential for default is considered. Whereas the FSU and its successor states together accounted for about 44 percent of the outstanding principal at the end of January 1993, they represented approximately 59 percent of the portfolio's risk, because their country risk ratings were lower than most of the other GSM-102 credit guarantee recipients. In contrast, Mexico, which accounted for 26.1 percent of the principal exposure, represented only 12.5 percent of the risk because its country risk ratings were significantly higher than most of the GSM-102 recipients.

GSM-102 Program Does Not Use Risk-Based Fees

Although GSM-102 recipient countries vary significantly from one another in terms of their risk of defaulting on GSM-102 loans, CCC does not adjust the fee that it charges for credit guarantees to take account of country risk. CCC fees are based upon the length of the credit period and the number of principal payments to be made. For example, for a 3-year GSM-102 loan with semiannual principal payments, CCC charges a fee of 55.6 cents per $100, or 0.56 percent of the covered amount. For 3-year loans with annual principal payments, the fee is 66.3 cents per $100.[34] CCC fees that included a risk-based component might not cover all of the country risk, but they could help to offset the cost of loan defaults.

USDA officials told us that including a fee for country risk could reduce the competitiveness of GSM-102 exports. However, they said they did not have recent or current data to support their claim.

The U.S. Export-Import Bank, which provides credit guarantees to promote a variety of U.S. exports, uses risk-based fees to defray the cost of defaults on its portfolio. Under its system, each borrower/guarantor is rated in one of eight country risk categories. Exposure fees vary based on both the level of assessed risk and the length of time provided for repayment. For example, in the case of repayment over 3 years, a country rated in the lowest risk category is charged a fee of 75 cents per $100, whereas a country in the highest risk category is charged a fee of $5.70 per $100 of coverage. Thus, the bank's fee structure includes a substantial added charge for high country risk. According to the bank, its system is designed to remain as competitive as possible with fees charged by official export credit agencies of other countries.

Under section 211(b)(1)(b) of the 1990 Farm Bill, CCC is currently restricted from charging an origination fee for any GSM-102 credit

[34]The fee for a 1-year loan and repayment at the end of the term is only 31.5 cents per $100 of coverage.

guarantee in excess of an amount equal to 1 percent of the amount of credit extended under the transaction. This restriction was initially enacted in 1985 following proposed administration legislation to charge a 5-percent user fee for exports backed with credit guarantees. Some Members of Congress were concerned that such a fee would adversely affect the competitiveness of GSM-102 exports. Under the 1-percent restriction, CCC would be considerably limited in the size of the fee that it could charge to take account of country risk should it decide to do so. For example, as previously noted, CCC charges 0.56 percent for a loan payable in 3 years and with principal payments due annually. The most it could increase the fee would be 0.44 percent. In contrast, the Export-Import Bank currently charges fees as high as 5.7 percent for 3-year loans.

Implications of a Lack of Creditworthiness and the High Exposure to Default of the GSM Portfolio

The various analyses previously presented above indicate that Russia and the other successor states are high-risk countries in terms of creditworthiness. Russia is severely indebted, and its agreement to accept responsibility for the other states' shares of the FSU debt increases its burden. Most of the successor states, including Russia, have severe liquidity problems, and these problems are likely to persist for the next several years. Russia's arrearage problems and its need to reschedule its debts also demonstrate a lack of creditworthiness. In addition, secondary market valuations of FSU debt and country risk ratings point to poor creditworthiness.

The large amount of GSM-102 export credit guarantees already provided to the FSU and its successor states, along with their low creditworthiness, means that the GSM-102 portfolio is exposed to a high level of risk that could result in additional, substantial costs to U.S. taxpayers. As earlier discussed, in September 1993 and June 1994 the United States rescheduled large amounts of GSM-102 debt. Providing the successor states with more guarantees at this time would add to the already high exposure of the GSM-102 portfolio to further defaults. Since the GSM-102 program provides financing with terms up to only 3 years, additional guarantees for the successor states would add to the difficult liquidity problems that they are expected to experience over the next several years. Consequently, the GSM-102 program may not be an appropriate vehicle for continued financing of U.S. agricultural exports to the FSU successor states at this time.

Nonetheless, there may be important economic and national security reasons for the United States to further assist the financing of food exports to Russia and one or more successor states. For example, if circumstances arise where the Russian government cannot obtain the hard currency to pay for food imports needed to balance its food needs, political stability could be threatened. In a major policy statement on April 1, 1993, President Clinton said that nothing could contribute more to global freedom, security, and prosperity than the peaceful progression of Russia's transformation from a totalitarian state into a democracy, a command economy into a market, and an empire into an a modern nation-state.[35] However, he noted, the outcome is not assured. The President warned of the danger of Russia, with its vast arsenal of nuclear weapons, being torn apart by the ethnic strife that has engulfed former Yugoslavia. If Russia were to revert to imperialism or plunge into chaos, he said, the United States would need to reassess its plans for defense savings. This could mean billions of less dollars for other uses, including creating new businesses and new jobs in the United States. America's interests, he said, lie with Russian reform and Russian reformers, and America's position is to support democracy and free markets in Russia and the other new independent states.

In support of the policy statement, on April 4, 1993, President Clinton announced a $1.6 billion assistance package for Russia for 1993. As discussed in chapter 3, on April 15, the United States, in concert with the G-7 nations, announced a financial assistance program of $28.4 billion for Russia. Also on April 15, the Secretary of State announced that the administration would propose to Congress another U.S. aid package for Russia of $1.3 billion in direct aid and $500 million in assistance to be channeled through international assistance agencies. Subsequently on September 30, 1993, the President signed the fiscal year 1994 foreign aid bill that included $2.5 billion for the NIS.

Alternatives to GSM-102 Export Credit Guarantees

There are alternatives to the GSM-102 program for helping to finance continued U.S. agricultural exports to successor states to the FSU. Examples include the GSM-103 program and various food aid programs. Since the latter include substantial concessionality and at times total grant aid, they would entail higher budgetary outlays.

As discussed in chapter 1, the GSM-103 export credit guarantee program is similar to the GSM-102 program but provides terms of credit whereby the repayment period can range up to 10 years. An advantage of this program

[35] "A Strategic Alliance with Russian Reform," Prepared Remarks of President William J. Clinton to the American Society of Newspaper Editors (Annapolis, MD: Apr. 1, 1993).

is that it would help recipient successor states to finance food imports without adding to their difficult liquidity problems during the next few years, since repayments can be stretched out over a decade. However, GSM-103 is not an appropriate program to use if the successor states are uncreditworthy and is questionable if they are high risk, since longer repayment terms may also increase risk. A limitation of the program is that far fewer dollars have been authorized for GSM-103 guarantees than for GSM-102 guarantees (see table 1.1). Under the 1990 Farm Bill, CCC is required to make available at least $5 billion for each of fiscal years 1991 through 1995, whereas the minimum level stipulated for GSM-103 assistance is only $500 million.

USDA has used several food aid programs to provide food assistance to the successor states during the past few years. These include Public Law 480, title I, the section 416(b) program of the Agricultural Act of 1949 (P.L. 81-439), and the Food for Progress program of the Food Security Act of 1985 (P.L. 99-198).

Title I of the Food for Peace program (P.L. 480) is a concessional sales program to promote exports of agricultural commodities from the United States and to foster economic development in recipient countries. The program requires annual appropriations and thus has a direct impact on federal spending. Food for Peace provides export financing over payment periods of 10 to 30 years, grace periods on payments of principal of up to 7 years, and low interest rates. Eligible countries are developing countries experiencing a shortage of foreign exchange earnings and having difficulty meeting all of their food needs through commercial channels. According to USDA, program allocations take into account changing economic and foreign policy situations, market development opportunities, existence of adequate storage facilities, and possible disincentives to local production.

Section 416(b) of the Agricultural Act of 1949 authorizes donations of uncommitted CCC stocks to assist needy people overseas. Food for Progress is a food aid program that is carried out using funds or commodities made available through Public Law 480, title I, or the section 416(b) program. Food for Progress is generally administered on grant terms. It provides commodities to developing countries and emerging democracies to encourage democracy and private enterprise, including agricultural reform.

Table 5.13 provides figures on the value of GSM-102 credit guarantee and food aid assistance to the FSU/successor states during fiscal year 1991 through April of fiscal year 1994. As the table shows, GSM-102 credit guarantees accounted for all of the assistance provided during fiscal year 1991 and most of the assistance made available during fiscal year 1992. As a result of the suspension of the GSM-102 program in the fourth quarter of 1992, food aid became the dominant form of agricultural assistance in fiscal year 1993. The combined total of GSM-102 and food aid assistance in fiscal year 1993 was slightly more than all GSM-102 assistance provided during fiscal year 1991 but represented only about two-thirds of the combined value of the GSM-102 and food aid assistance made available during fiscal year 1992. As the table shows, from fiscal year 1991 through April of fiscal year 1994, GSM-102 credit-guaranteed assistance was about $5.1 billion, while food aid assistance equaled about $2 billion. Total agricultural assistance made available in fiscal year 1994 (through April) was a small fraction of that provided during each of the 3 previous fiscal years.

Table 5.13: U.S. Agricultural Assistance to the FSU/Successor States, Fiscal Years 1991-94

Dollars in millions

	Fiscal year				
Type of assistance	**1991**	**1992**	**1993**	**1994 (As of April)**	**Total[a]**
GSM-102 credit guarantees	$1,915	$2,590	$523	$40[b]	$5,068
Food aid, total[c]	0	354	1,425	244	2,023
P.L. 480, title I	0	60	66	49	175
Section 416(b)	0	125	301	73	499
Food for Progress	0	72	958	107	1,137
DOD excess stock donations	0	62	42	0	104
Private donations	0	35	58	15	108
Technical assistance[d]	0	49	49	44	142
Total agricultural assistance	**$1,915**	**$2,993**	**$1,997**	**$328**	**$7,233**
Agricultural assistance as percent of total U.S. assistance	98%	71%	36%	6%	NA

Legend
NA = Not available

[a]Totals in this column calculated by GAO.

[b]Does not include $20 million unoperational credit for Ukraine.

[c]Programmed assistance.

[d]Estimate based on data from USDA and the Agency for International Development.

Source: Former USSR: Situation and Outlook Series, USDA, ERS (Washington, D.C.: May 1994).

Questions About the Need for More Credit Guarantees And/or Food Aid

Questions exist about the need for and value of additional credit guarantees and food aid for the FSU successor states. For example, FSU agricultural imports were down considerably in 1993 and, according to USDA, there generally is not a food shortage problem in the area.[36] According to USDA, economic reforms have begun to have some positive effects, and as they take further hold, the successor states are not likely to continue importing at their former high levels. At the same time, credits and credit guarantees have unintentionally impeded the reform process by increasing the successor states' external debt burden and perpetuating state control of agricultural distribution.

According to USDA, the successor states' demand for agricultural imports diminished by 27 percent in 1993 compared to 1992 levels. In commenting on a draft of this report, USDA said that Russian agricultural imports are down sharply largely due to a reduction in demand, particularly of grain, which makes up the bulk of imports. The drop in FSU agricultural imports is expected to continue and, according to USDA, is a sign that economic reforms are working, at least to some degree. USDA noted that high levels of Soviet agricultural imports in the 1980s were used to prop up an overexpanded and inefficient livestock sector. Declines in that sector have freed up domestic grain supplies (production of which has remained steady with the exception of 1991's drought-affected crop) and lowered the FSU demand for imports. In addition, USDA said, price liberalization in several republics has led to lower waste, increased incentives, and more rational use of inputs.

In commenting on a draft of our report, USDA indicated that food assistance has adversely affected reform in the FSU. USDA said that although widespread dislocation in the FSU food supply never occurred, the West continued to provide assistance (credits and food aid) to the FSU, which accepted it to the likely detriment of economic reforms (increased debt and continued state control of agricultural marketing).

According to a USDA analysis,[37] the high level of FSU grain imports in recent years—sustained by credits, credit guarantees, and food donations—allowed FSU authorities to delay increases in farm prices and to maintain the centralized grain distribution and marketing system to a large degree. For example, the average price of wheat imported by the FSU

[36]Food supply crises that were predicted by the popular press in the first years of post-Soviet reform never occurred except in those areas affected by civil war (the Transcaucasus and Tajikistan).

[37]"New Direction for FSU Ag Assistance," Agricultural Outlook (Washington, D.C.: USDA/ERS, Mar. 1994).

in 1992-93 was $125 a ton (excluding freight), while Russian farmers received less than $40 a ton. The state provided massive subsidies that lowered the price of the imported grain relative to domestic farm prices. Thus, instead of paying Russian farmers higher prices, which would have improved farm incomes, increased farm sales, and reduced waste,[38] the state chose instead to purchase large amounts of foreign grain. When commercial financing was no longer available, the state requested concessional loans and donations to help maintain these imports. Obtaining imports on concessional terms, which meant deferring immediate repayment, was easier for state planners than allowing market forces to set domestic grain prices. The commercial credits and credit guarantees also adversely affected the reform process, because scarce hard currency needed to support domestic reform was instead required to service the increased external debt.[39]

According to the USDA analysis, fewer credits and credit guarantees are likely to be provided in the future because of increased western concerns about FSU creditworthiness, particularly Russia's, and expectations of decreased FSU demand for imports. USDA also believes that concessional financing and humanitarian assistance may still be necessary for some of the successor states in the short- to medium-term future.

Conclusions

The GSM statute prohibits USDA from extending credit guarantees to any country the Secretary determines cannot service the debt. However, the statute does not provide any guidance as to what is an acceptable level of risk in evaluating whether countries can adequately service proposed GSM debt. In addition, the statute does not limit the amount of GSM guarantees that can be provided each year to very risky countries—either individually or in aggregate. Consequently, USDA can allocate large amounts of guarantees to high-risk countries and even to countries that are judged not creditworthy, making the GSM-102 portfolio subject to a potentially high rate of default. CCC fees that included a risk-based component could help to offset the cost of loan defaults. However, under the 1990 Farm Bill, CCC is currently restricted from charging an origination fee for any GSM-102 credit guarantee in excess of an amount equal to 1 percent of the amount of credit extended under the transaction. Given this restriction, CCC would be considerably limited in the size of the fee that it could charge to take account of country risk should it decide to do so.

[38]For example, if farmers were offered higher prices, they would be willing to sell more, and fewer commodities would be left to rot in the fields.

[39]See also GAO/GGD-94-17.

Most, if not all, of the FSU successor states are not creditworthy and all should be considered at least high risk from a creditworthiness perspective. The GSM-102 portfolio is exposed to a high level of risk of default because a large portion of the portfolio includes FSU debt and because of Russia's lack of creditworthiness. Since the GSM-102 program provides financing with terms to only 3 years, providing additional GSM-102 guarantees to the successor states could further add to their liquidity problems during the financing period. The GSM-103 program could help successor states to finance food imports without adding to their difficult liquidity problems during the next few years, since repayments can be stretched out over 10 years. However, GSM-103 is not a good program to use if the successor states are uncreditworthy and is questionable if they are high risk, since longer repayment terms may also increase risk. Consequently, both GSM programs may not be an appropriate vehicle at this time for financing additional U.S. agricultural exports to Russia or other successor states. Alternatives to the GSM programs include various food aid programs. Of course, the latter include substantial concessionality and at times total grant aid, and thus would result in higher budgetary outlays.

There may be important economic and national security reasons for the United States to further assist the financing of food exports to Russia and one or more successor states. For example, if circumstances develop where the Russian government cannot obtain the hard currency to pay for food imports needed to balance Russia's food needs, the country's political stability could be threatened. The latter could disrupt Russia's progress toward establishing democratic institutions and a free market economy and, in turn, significantly affect U.S. defense expenditures.

Matters for Congressional Consideration

If Congress concludes that Russia or other successor states are too risky to receive additional GSM-102 credit guarantees, and if Congress concludes that continued agricultural exports to the states serve important U.S. economic and national security interests, Congress may wish to consider authorizing additional foreign aid to finance the sale of the food. Such additional authorization of foreign aid to finance food exports to the states could then be weighed against other priorities for U.S. foreign economic assistance.

To reduce future exposure of the GSM-102 portfolio to default, Congress may wish to consider limiting the total amount of credit guarantees that can be issued each year to high-risk countries and the amount that can be provided to any single high-risk country. In addition, Congress may wish to consider (1) amending the statutory provision that precludes the Commodity Credit Corporation from charging a fee in excess of 1 percent of the amount of the credit guarantee and (2) requiring CCC to include a risk-based charge as part of its overall fee for GSM credit guarantees.

Agency Comments and Our Evaluation

We requested comments on a draft of this report from USDA. It provided general comments that are reproduced in appendix III. Most of these comments are discussed in this chapter; some are addressed directly in other chapters of this report, as indicated in marginal references. USDA also provided a separate set of technical and editorial comments that were incorporated into the previous chapters where appropriate.

Overall Comments

Our draft report was reviewed by a number of offices in USDA that concluded the draft was well researched and presented. According to USDA, the report accurately presented USDA source materials, the GSM-102/103 decisionmaking process, and the interviews we conducted pursuant to the investigation.

USDA expressed principal disagreements with our methodology for assessing the costs and benefits of the GSM-102 credit guarantees provided to the FSU and its successor states, particularly our use of the secondary market as a means of estimating losses. USDA also disagreed with our draft conclusion that all of the 15 successor states were not creditworthy.

Use of the Secondary Market to Estimate Default Costs

As discussed in chapter 5, we considered secondary market valuations of FSU loans in evaluating the creditworthiness of the FSU and its successor states, and we used the secondary market's valuation of FSU loans to estimate expected losses on the value of outstanding GSM-102 loans to the FSU. According to USDA, there are too few participants in the secondary market and they can easily manipulate the market. Thus, USDA said, none of its reviewing offices believe the secondary market is a reliable indicator of the value of FSU debt paper. In addition, USDA said that the attributes of debt traded in the secondary market might be materially different from the GSM debt. We disagree with USDA on these points.

As discussed in a previous GAO report,[1] we concluded that the secondary market provides the best available risk-based valuations of sovereign debt of countries that do not have well developed financial systems. More specifically, we found that the secondary market provides the same characteristics of many functioning securities markets. Generally speaking, the market is (1) self-correcting; (2) appears to have minimal outside forces operating on it other than the risk-reward evaluation by a large number of participants—banks, insurance companies, pension funds,

[1]See GAO/GGD-93-45. The report used secondary market data to estimate the actual value of GSM-102/103 guaranteed loans for all outstanding GSM debt, including accounts receivable from loan guarantee payouts on delinquent GSM-102/103 loans.

and private investors; (3) has substantial volume and appears to be efficient; (4) and has a wide variety of instruments with varying lengths of maturity and other characteristics.

USDA seems to ignore the emergence of the secondary market as a major financial market.[2] According to a World Bank 1992 study, the total volume of secondary market trading rose from an estimated $4 billion in 1985 to $100 billion in 1990. The bank noted that as a result of improved market efficiencies, secondary market prices were increasingly used as indicators of a country's creditworthiness and as benchmarks in debt reductions/restructuring packages.[3] According to more recent studies, secondary market trading increased enormously in 1992 and 1993, reaching volumes of $773.7 billion and $1.9 trillion, respectively.[4] As concerns FSU or Russian paper, it has become one of the more popularly traded assets in the secondary market. According to the Emerging Markets Traders Association, Russian debt ranked eighth on trading volume out of 42 countries for which the group reported data for 1993. Trading volume in Russian debt increased more than 35-fold—from $678 million in 1992 to $24.7 billion in 1993.

Although we feel confident about our use of secondary market data to estimate expected losses on the value of outstanding GSM-102 loans to the FSU, we developed a second method for estimating such losses after receiving USDA's comments on our draft report.[5] As discussed in chapter 5, we used Euromoney country risk ratings to estimate the risk of default and, in turn, the expected cost of GSM-102 loans to the FSU and Russia as of June 1994. The results were very similar to the results obtained from our use of the secondary market prices and, thus, increase our confidence in the secondary market method.

As noted previously, USDA also commented that the attributes of secondary market debt may be materially different from the GSM debt. USDA did not cite any examples of how the debt might be materially different or explain how such differences might affect the use of secondary market prices to reflect the risk of default on GSM-102 loans. GSM debt is different in the

[2]For example, see Kevin Muehring, "Emerging-markets Debt Comes of Age," Institutional Investor (April 1994).

[3]World Debt Tables 1992-93.

[4]1992 Trading Volume Survey and 1993 Trading Volume Survey.

[5]Secondary market prices for FSU loans was only one of a variety of types of information and analysis that we used to assess creditworthiness more generally. As discussed in chapter 5, both secondary market prices and other information we analyzed point to a lack of creditworthiness for the FSU.

sense that the U.S. government guarantees most, if not all, of the principal in the event that the borrower defaults on its loans. Since lending banks are guaranteed that USDA will repay at least 98 percent of defaulted GSM-102 loans, lenders to Russia would presumably have little reason to trade the debt on the secondary market when Russia defaults on such debt. However, this characteristic of GSM-102 loans does not reflect on the likelihood of whether Russia will default on its payoff of GSM-102 debt.

Creditworthiness

In its comments on our draft report, USDA said that it disagreed with our conclusion that all of the FSU successor states are not creditworthy. USDA indicated that between August 1993 and February 1994 it had found Ukraine, Uzbekistan, and Turkmenistan to be creditworthy; it noted that each of these states had been found qualified to receive modest amounts of GSM-102 credits during that period. (USDA also said that each program was driven by market development objectives.) However, in May 1994 USDA officials advised us that the office responsible for preparing creditworthy assessments had rated Ukraine as not creditworthy during the previous year and still considered Ukraine as uncreditworthy. Thus, USDA had made credit guarantees available to Ukraine in fiscal year 1994 even though its own analysis indicated the country was uncreditworthy.[6]

In addition to Ukraine, other successor states identified by USDA as still not creditworthy in May 1994 were Russia, Armenia, Azerbaijan, Belarus, Georgia, Kyrgyzstan, Moldova, and Tajikistan. Thus, USDA classified 9 of the 15 successor states as not creditworthy. Creditworthy successor states at that time, according to USDA, included the three Baltic states (Estonia, Latvia, and Lithuania) as well as Kazakhstan, Turkmenistan, and Uzbekistan.

Creditworthiness evaluations involve a multidimensional analysis of a variety of factors and some subjective judgment. As a result, evaluations by different parties may not always fully agree. This is best evidenced in chapter 5, where we compare the country risk evaluations of three different private rating services (see table 5.8). Consequently, it is not necessarily surprising that USDA did not agree with the conclusion in our draft report that all of the successor states were not creditworthy. After considering USDA's comment, we decided to restate our conclusion as follows: Most, if not all, FSU successor states are not creditworthy and all

[6]As discussed in chapter 2 of this report, in October 1992 USDA announced an allocation of $200 million in credit guarantees for Ukraine even though USDA's risk rating at that time indicated the country was not creditworthy. Ukraine's lack of creditworthiness was clearly evidenced on June 2, 1994, when it began defaulting on its GSM-102 loans.

should be considered at least high risk from a creditworthiness perspective.[7]

We believe our restated conclusion is well supported by the information and analyses presented in the report, especially by the material presented in chapters 4 and 5. The most recent summary information in support of our restated conclusion is found in tables 5.10 and table 5.11. As table 5.10 shows, in March 1994 both Euromoney and Institutional Investor rated nearly all of the FSU successor states among the bottom one-third of all the countries they rated on creditworthiness, and most of the rated successor states were in the bottom quartile. As table 5.11 shows, Euromoney's actual risk ratings for the 15 successor states for March 1994 imply risks of default ranging between about 66 percent (Latvia) to about 82 percent (Armenia). We believe it is reasonable to characterize countries that rank among the bottom one-third of all countries on country risk and that have an implied risk of default equal to or greater than 66 percent as being either uncreditworthy or at least highly risky from a creditworthiness perspective.[8]

Additionality Issue

As discussed in chapter 2, whether and to what extent GSM-102 exports lower domestic commodity support program costs depends importantly on the availability of alternative markets for the exports. This is referred to as the "additionality" issue. For example, if one assumes that in the absence of the GSM-102 credit guaranteed exports to the FSU and its successor states alternative export markets would not exist, this is characterized as 100-percent program additionality. If one assumes that 75 percent of the commodities could be exported to other countries, the program additionality would be only 25 percent.

In chapter 2, we raised questions about USDA's approach, which largely relied on an assumption of 100-percent additionality. We expressed the view that analyses should consider a range of additionality levels. In commenting on our draft report, USDA provided mixed views on this issue. On the one hand, USDA agreed that one should consider a range of additionalities. In fact, USDA cited a third estimate,[9] provided to the

[7]As discussed in chapter 5, USDA's classification scheme includes four categories for creditworthy countries: (1) below average risk, (2) average risk, (3) above average risk, and (4) high risk.

[8]As we were nearing completion of this report, we reviewed the two raters' September 1994 country risk ratings for the successor states. The ratings were consistent with those they reported in March 1994.

[9]As discussed in chapter 2, USDA originally provided us with information on two estimates.

Secretary of Agriculture in February 1993, in which two levels of additionality were assumed for $2 billion in credits to the FSU—50-percent additionality and 100-percent additionality. According to USDA, the estimate indicated deficiency payment savings of $0.7 billion to $1.4 billion. However, USDA further assumed a loan concessionality of 60 percent, or $1.2 billion, to cover loan defaults, freight costs, EEP bonus payments, and other unspecified factors. USDA estimated that the net budget costs of $2 billion in credits (after subtracting estimated deficiency payment savings from the loan concessionality cost) would vary between a cost of $500 million to a savings of $200 million. Although USDA's comments cited a third estimate that included a 50-percent additionality case, USDA went on to say that an assumption of 100-percent additionality with regard to the FSU and its successor states seemed reasonable. In support of the latter view, USDA said it is likely that without the GSM-102 coverage the FSU would not have been able to purchase substantial quantities of U.S. commodities. This is illustrated, USDA said, by the sharp decline in U.S. exports to the FSU after it was suspended from the program. In addition, USDA said there were few alternative opportunities for the use of the credit guarantees in other countries.

In chapter 2, we questioned USDA's assumption that alternative export markets would not be available on the grounds that special features of the GSM-102 program made available to the FSU and its successor states should be attractive if offered to other importing nations. One special feature we noted was USDA coverage of 100 percent of the value of the commodities. However, in commenting on our draft report, USDA indicated that it does not like and would be unlikely to provide 100-percent coverage. In addition, USDA said, our analysis presumes there are creditworthy countries in the world marketplace that are interested in participating in a large-scale GSM-102 program. According to USDA, during fiscal years 1991 and 1992 principal markets not targeted for the GSM-102 program included China, Cuba, Iran, Libya, and Japan. With the exception of China and Japan, USDA said, there were few alternative markets that could exert the same amount of influence on U.S. domestic prices as that exerted by the FSU market; and both China and Japan purchased heavily from the United States during the time period without credit guarantees.

We do not believe that 100-percent additionality is the most reasonable assumption. As discussed in chapter 2, we estimated that the combination of freight cost financing and EEP bonus payments, alone, made the additionality attributable to the GSM program for the FSU and its successor states in fiscal years 1991 and 1992 equal at most to about 77 percent. In addition, the issue of what assumed additionality level is most appropriate does not depend simply on whether the FSU could have purchased the U.S. commodities without the GSM-102 guarantees. If the United States had not provided the guarantees, other exporting countries might have provided credits or credit guarantees to assist the FSU. Doing so could have reduced those countries' exports to third countries, enabling the United States to increase its exports to the latter. Even if the United States had not provided the guarantees and other countries had not provided additional guarantees, it is not obvious that the 100-percent additionality case should be applied. A decline in sales to the FSU would tend to lead to reduced prices on world markets, which, in turn, could result in increased demand.

We have not advocated providing 100-percent loan guarantee coverage. However, we believe that if one wants to consider to what extent credit guarantees to the FSU and its successor states increased U.S. exports, a fair comparison should consider what would have happened if comparable terms had been offered to other countries. We are not aware of any single country with a market comparable to that of the FSU that would have been interested in GSM-102 credit guarantees. However, it is possible that a number of countries with smaller markets might have been interested in credit guarantees or additional guarantees if the terms were comparable to those extended to the FSU. Any guarantees or increase in guarantees provided to other countries would, of course, further detract from the realism of a 100-percent additionality assumption.

Views on Matters for Congressional Consideration

USDA did not express any view regarding our suggestions in chapter 5 on how Congress could reduce future exposure of the GSM-102 portfolio to default. A USDA official told us that it had been examining the issue but had not yet reached any conclusions.

USDA approved of our suggestion that if Congress concludes the United States needs to ensure continued U.S. agricultural exports to Russia and/or other successor states but decides additional GSM-102 guarantees are not appropriate at this time, it may want to consider authorizing additional foreign aid money to finance export sales. USDA said that ongoing agricultural exports to the FSU are essential to the American farm community and to U.S. geopolitical interests and provide needed foodstuffs to a market of enormous potential.

We agree that the American farm community may benefit from ongoing exports to the FSU. We also agree that broader U.S. interests may be served by U.S. agricultural exports to the successor states but do not believe that such exports automatically advance such interests. For example, the United States has favored economic reforms in the FSU that promote development of a free market economy. Yet, as USDA itself noted in commenting on our draft report, western assistance (credits and food aid) to the FSU has probably had a detrimental impact on FSU economic reforms—including increased debt and continued state control of agricultural marketing.

Additional Information on Conflicts Affecting Russia and Other Successor States

Azerbaijan and Armenia

Violent conflict has raged since 1988 in Azerbaijan between Azeris, who constitute 83 percent of the population and are mostly Shiite Moslems, and Armenians, who equal about 6 percent of the population and are Christian. In early 1988, Nagorno-Karabakh, an autonomous region that is predominantly Armenian, petitioned to become a part of Armenia.[1] This event touched off ethnic conflict, creating an increasing refugee problem and violence between Armenians and Azeris, primarily in Karabakh but also elsewhere in Azerbaijan, along the Armenia-Azerbaijan border, and in the Nakhichevan Autonomous Republic (part of Azerbaijan but separated by Armenian territory). According to one recent estimate, the fighting has resulted in more than 10,000 deaths and 1.4 million refugees. Concerns have been raised that the conflict could widen to involve Russia and other countries.[2]

Azerbaijan nullified Nagorno-Karabakh's autonomous status in November 1991. However, in December a Karabkh referendum voted for independence. Azerbaijan imposed an economic embargo on Armenia that has taken a heavy toll, since Azerbaijan was the principal supply route into Armenia.[3] In May 1992, Armenians attained complete control over Karabakh and cut a corridor through Azerbaijani territory to link Karabakh to Armenia. According to a recent PlanEcon report, Armenian forces now control a fifth of Azerbaijan's territory.[4]

Russia has sought to mediate a peaceful outcome to the conflict. A cease-fire took place in May 1994, but violations have been reported. Several rounds of peace talks have been held, but the most difficult issues have not been resolved.[5] According to PlanEcon, the conflict could escalate again in 1995.[6]

Baltic States

During 1990, the Baltic republics of Estonia, Latvia, and Lithuania proclaimed their independence from the Soviet Union. The Soviet Union

[1]See Jim Nichol, Azerbaijan: Basic Facts, Library of Congress, Congressional Research Service Report 92-142 F (Washington, D.C.: Dec. 18, 1992).

[2]See Carol Migdalovitz, Armenia-Azerbaijan Conflict, Library of Congress, Congressional Research Service Issue Brief 92109 (Washington, D.C.: Mar. 22, 1993 and Sept. 30, 1994).

[3]According to PlanEcon, Armenian national income fell 10 percent in 1990 and 11 percent in 1991, largely due to disrupted transportation links.

[4]Review and Outlook for the Former Soviet Republics August 1994.

[5]Armenia-Azerbaijan Conflict.

[6]Review and Outlook for the Former Soviet Republics August 1994.

recognized their independence in September 1991, following the failed August coup in Moscow. However, a number of issues remained unresolved. These included, among others, Russian military and security forces that continued to be stationed in the Baltic area; the status of Russian and other minorities in the Baltic countries; the disposition of Soviet assets (for example, the Soviet Union had maintained important Soviet military installations in these countries since the end of the Second World War); and Baltic interest in compensation for decades of Soviet rule.[7]

The Baltic countries pressed for the immediate withdrawal of former Soviet troops. The Russian government wanted to delay a withdrawal because of a lack of housing in Russia for returning officers. In addition, it expressed concern over treatment of Russians in the Baltic states (both Latvia and Estonia have large Russian populations), and at times tied this issue to withdrawal of its military forces from the area. The troop issue was particularly sensitive, since non-Baltic populations in the area who did not support Baltic independence might have pressed for restoration of Soviet/Russian power.[8]

In September 1992, Russia announced it would withdraw forces from Lithuania by August 31, 1993. Russia completed the troop withdrawal at that time. Russian troops remained in Estonia and Latvia, but they were finally withdrawn in August 1994.

Georgia

Georgia declared independence from the Soviet Union in April 1991. One month later, Zviad Gamsakhurdia was elected President, receiving 87 percent of the popular vote. However, owing to repressive policies, he was overthrown by opposition forces in January 1992, after a brief civil war. Following the dissolution of the Soviet Union, Georgia refused to join the Commonwealth of Independent States (CIS), citing its likely domination by Russia and CIS ineffectiveness. Russian armed forces still remain in Georgia, but Russia has proposed to withdraw them by the end of 1995.[9]

[7]See Vita Bite, The Baltic States: U.S. Policy Concerns, Library of Congress, Congressional Research Service Issue Brief 90075 (Washington, D.C.: Mar. 23, 1993).

[8]The Baltic States: U.S. Policy Concerns.

[9]See Jim Nichol, Georgia: Basic Facts, Library of Congress, Congressional Research Service Report 93-619 F (Washington, D.C.: June 30, 1993).

Even before Georgia's independence, two ethnic groups—South Ossetians and Abkhazians—sought to secede from Georgia. The former wanted to unite with North Ossetians in neighboring Russia and become a territorial unit within the Russian Federation. In September 1990, South Ossetia declared itself a sovereign republic. In late 1990, fighting broke out between Ossetian rebels and Georgian nationalist guerrillas. In early 1991, the Soviet Union deployed over 1,000 troops in South Ossetia to keep the fighting in check. In April 1992, Russia agreed to a request of the Georgian government that it withdraw its troops but subsequently reversed the decision. In May 1992, the leaders of North Ossetia, an autonomous Russian republic that borders South Ossetia in Georgia, adopted a resolution threatening that if Russia did not help end the fighting in South Ossetia, North Ossetia would secede from Russia and join with South Ossetia to form a new country. In late May 1992, North Ossetia moved unilaterally to close off the gas pipeline traversing North Ossetia to Georgia and blockade transportation as part of economic sanctions against Georgia. The action further complicated Russian foreign relations with Georgia and even with Armenia, which depended on the gas shipments. A cease-fire agreement was reached in June 1992 by Russia, Georgia, and Ossetia. The cease-fire has been repeatedly reextended, but the underlying issue of South Ossetia's demand to secede from Georgia has not been resolved.[10]

Abkhazians constitute about 18 percent of the population of the Georgian republic of Abkhazia. Although only a minority, they declared themselves a sovereign republic in August 1990. Substantial and protracted armed conflict got under way in August 1992 and has resulted in thousands of casualties and hundreds of thousands of displaced persons. Georgia accused the Russian military of assisting the Abkhazians in order to boost Russian control over the Black Sea (Abkhazia is located next to the sea).[11] A mid-May 1993 ceasefire was repeatedly violated. In mid-September 1993, Abkhazian forces launched a general offensive. Georgia's President Eduard Shevardnadze appealed to Russia for assistance but was reluctant to agree to Russia's sending troops to separate the combatants. By the end of September, Abkhazian forces had taken complete control of the province, including the Black Sea port of Sukhumi.[12]

[10]Jim Nichol, Georgia: Basic Facts, Library of Congress, Congressional Research Service Report 94-608 F (Washington, D.C.: July 28, 1994); The Russian Federation: Will It Hold Together?

[11]Georgia: Basic Facts.

[12]See Jim Nichol, Georgia in Transition: Situation Update, Library of Congress, Congressional Research Service Report 93-1039F (Washington, D.C.: Dec. 10, 1993).

While the Abkhazian offensive was under way, a new threat to Georgia's integrity arose when former President Gamsakhurdia returned from exile and led a revolt from his native province of Mingrelia to overthrow President Shevardnadze. In October 1993, Georgia requested Russian military assistance. Georgia announced that it would join the CIS and signed agreements with Russia legalizing the indefinite presence of Russian troops and allowing Russian use of various airfields, ports, and railway lines. In late October and early November 1993, Russia provided key military support that ended most resistance and forced Gamsakhurdia to flee the country.[13]

In May 1994, Russia brokered a cease-fire between Georgia and Abkhazia. Under the agreement, Russian troops (formally acting as CIS "peacekeepers") were deployed in late June in a security zone that divides Abkhazia from Georgia proper.[14]

Moldova

Moldova is populated by people of mostly Romanian origin and might eventually become part of Romania. On August 27, 1991, Moldavia declared its independence from the Soviet Union and became the Moldova Republic. In response, the Dniestr area and the Gagauz region, with the support of the local Russian-speaking population, voted to secede and remain a part of the Soviet Union by forming Soviet Socialist republics. The area that constitutes the Trans-Dniestr region was a part of Ukraine before 1940. It represents the only highly industrialized area of Moldova, and it supplies most of the rest of the country with gas and electricity. The Russian and Ukrainian population feared that a merger with Romania would make them second-class citizens in Romania.[15]

An armed conflict began in March 1992 after Moldovan nationalists stepped up a campaign to unite with Romania. Between then and July 1992, conflict between Slav separatists in the Dniestr region and Moldovan forces led to more than 600 deaths, thousands of wounded, and more than 60,000 refugees. In May 1992, the Moldovan President charged Russia with open aggression and accused the Russian Fourteenth Army of deploying tanks, armored vehicles, and heavy artillery in support of Dniestr separatists. The Moldovan Parliament also condemned the army,

[13]See Jim Nichol, Georgia: Basic Facts, Library of Congress, Congressional Research Service Report 94-608 F (Washington, D.C.: July 28, 1994). Georgia in Transition: Situation Update.

[14]Georgia: Basic Facts.

[15]See Sergiu Verona, Moldovan Crisis, Library of Congress, Congressional Research Service Issue Brief 92100 (Washington, D.C.: July 23, 1992).

characterizing it as an occupation force. On May 23, 1992, Moldova appealed to the United Nations for support against what it called Russian-led aggression. In June 1992, the Russian Minister of Defense declared that Russia would never abandon Russians in the Dniestr region. The Russian Foreign Minister suggested that the region could potentially be included in Russia, even though the area has no border with Russia. However, relations between the two countries improved following visits by the Moldovan President to Moscow in June and July 1992. At that time, agreements were reached to try to settle the conflict peacefully.[16] A July 1992 cease-fire has been upheld, but a peace agreement has not yet been concluded. Important differences remain about the degree of autonomy to be given to the Dniestr region.[17]

In southern Moldova, the Gagauz (a minority of Turkish origin, about 153,000 people) negotiated with Moldovan authorities about the future of the region. (Both the Gagauz and the Dniestr areas are physically separate from each other and from Russia.) On July 28, 1994, the Moldovan Parliament adopted a law, negotiated with Gagauz officials, establishing a national-territorial autonomous unit for the Gagauz. The region will have its own legislature and executive and will be entitled to secede from Moldova if the latter unites with Romania.[18]

Tajikistan

Tajikistan has been embroiled in a civil war between former Communists on one side and democratic and Islamic fundamentalist groups on the other. According to a September 1994 estimate, the conflict has created over 350,000 refugees, about 60,000 to 100,000 of whom have fled to neighboring Afghanistan. Iran and Afghanistan are said to have aided the Islamic fundamentalists and Russia and Uzbekistan the old guard Communist forces.[19]

Following the failed August 1991 coup in Moscow, the chief of the Tajik Communist Party was forced to resign; he had supported the coup. Under pressure from the democratic and Islamic opposition, the Tajik legislature declared the republic's independence in September 1991 and suspended the party's activities. The latter action prompted a backlash from former

[16]Moldovan Crisis.

[17]Sergiu Verona, Moldova Republic: Basic Facts, Library of Congress, Congressional Research Service Report 94-656 F (Washington, D.C.: Aug. 12, 1994).

[18]Moldova Republic: Basic Facts.

[19]Kenneth Katzman, Tajikistan: Basic Facts, Library of Congress, Congressional Research Service Report 94-697 F (Washington, D.C.: Sept. 2, 1994).

Communist deputies, who reconstituted the party in the parliament and elected Rakhmon Nabiyev as President. He had headed the Tajik Communist Party until 1985. In November 1991, Nabiyev won a popular election for the presidency. In April and May 1992, opposition forces demanded Nabiyev's resignation and the election of a new legislature. After gun battles, in which the opposition seized most of the capital, Nabiyev agreed to form a coalition government. In September 1992, the opposition stormed the presidential palace and forced Nabiyev to resign. A new government was formed in which the nationalist and Islamic opposition received key posts. However, in October 1992, supporters of the former Communists pushed into the capital and installed a new government.[20] An offensive against retreating opposition forces reportedly left 20,000 to 40,000 dead.[21]

During 1992, Russia sent progressively more forces into Tajikistan, largely at the request of Nabiyev and the urging of other Central Asian leaders, to keep order and protect already committed forces and ethnic Russians. Reports persisted that Russian troops had sided with the former Communists in overturning the brief opposition regime. There were also reports that Uzbekistan had intervened on behalf of the former Communists with helicopter gunships and aircraft. The Uzbek President closed his country's border with Tajikistan and launched a major crackdown against dissent in Uzbekistan.

Since the military victory of the former Communists in the winter of 1992-93, opposition forces have regrouped in the mountainous regions of Tajikistan and Afghanistan, mounting an insurgency effort against the Tajik government. They have also led attacks on border military posts, attacking Russian military officers and border guards. According to a CRS report, some analysts fear that the involvement of outside powers threatens to provoke a wider regional war. Reportedly, Russia is concerned about the spread of Islamic fundamentalism along the Central Asia periphery, and Russian and Uzbek officials have pressured the Tajik government to seek a democratic solution to the conflict.[22]

Ukraine

Ukraine, the second largest of the former Soviet republics in terms of population and size of the economy, has had acrimonious disputes with

[20]Kenneth Katzman, Tajikistan, Library of Congress, Congressional Research Service Report 93-305 F (Washington, D.C.: Mar. 10, 1993).

[21]Tajikistan.

[22]Tajikistan: Basic Facts.

Russia over the division of FSU property, foreign debt, nuclear weapons, and military forces. In addition, Crimea, which was part of Russia until 1954, has tried to assert its independence from Ukraine. Many Russians feel that Crimea rightfully belongs to Russia, and some influential Russian officials have advocated raising a territorial claim. Energy supplies have also been a divisive issue. Russia, which supplies most of Ukraine's oil, has increased fuel prices substantially and plans to bring them eventually to world market levels. In January 1993, Russia said it could guarantee to supply less than half of Ukraine's oil needs for 1993. In February, the Russian Deputy Prime Minister said Russia would charge world market prices for gas and oil unless Ukraine made concessions to Russia in negotiations over the distribution of the FSU's debts and assets and on the costs of maintaining the Black Sea fleet. In response, Ukrainian officials said they would charge world market prices for use of the gas and oil pipelines that supply almost all of Russia's oil and gas exports to Western Europe.[23]

Russia, North Ossetia, and Chechen-Ingushetia

A few ethnic conflicts in the Caucasus region of the FSU and Russia have been associated with separatist movements, violence, and the use of armed force by the government.

In October 1991, 2 months before the dissolution of the Soviet Union, a Chechen nationalist movement, led by Major General Dzhakhar Dudayev, overthrew the existing government in the Chechen-Ingush Autonomous Republic. Dudayev declared the republic's independence and was elected president by the republic's voters. Subsequently, President Yeltsin declared a state of emergency and deployed Soviet Internal Ministry police troops in the republic. However, the troops were surrounded and disarmed by Chechen militiamen and subsequently withdrawn. In March 1992, the Chechen parliament adopted a constitution that declared the republic's independence, and in mid-1992, Ingushetia separated from Chechnya. Negotiations between Chechen and Russian officials focused on Chechnya's demand for complete independence.[24]

The Russian parliament decided to form an Ingush republic but did not fully implement its decision. For example, the republic's borders were not demarcated (including borders with the newly proclaimed republic of

[23]Steven Woehrel, Ukraine, Library of Congress, Congressional Research Service Issue Brief 92072 (Washington, D.C.: Apr. 7, 1993).

[24]The Russian Federation: Will It Hold Together? Jim Nichol, Chechnya Confrontation, Library of Congress, Congressional Research Service Report 95-79 F (Washington, D.C.: January 6, 1995).

Chechnya) and a capital was not chosen. In late October 1992, fighting broke out in North Ossetia. The fighting was between Ossetians and Ingush who lived in North Ossetia and the neighboring Russian region of Ingushetia and Chechnya. On October 27, armed Ingushes declared that North Ossetian areas with a high concentration of ethnic Ingushes were part of the Ingush Republic and demanded that Russian interior troops be withdrawn from North Ossetia. (Parts of North Ossetia and the Chechen-Ingush Republic had existed within an autonomous Ingush province that existed until its people were deported from the region in 1944.)

On October 31, 1992, Russia's Deputy Defense Minister, an official of the Russian Ministry of Internal Affairs, and 3,000 special purpose militia flew into North Ossetia's capital. The troops were ordered to separate the warring sides and to prevent armed forces from entering North Ossetia from Ingushetiya and South Ossetia. Shortly thereafter, rebels were reported to have taken hostage 80 Russian Interior Ministry soldiers. In early November 1992, the Russian President declared a state of emergency in both North Ossetia and Ingushetia. He warned that the warring nationalists were waging a direct attack against Russia's constitutional system, its security, and territorial integrity. Ingush and Ossetian negotiators agreed to a cease-fire and to allow Russian paratroopers and Interior Ministry forces to set up a buffer zone between the opposing forces.

During 1994, Russia hardened its stance against Chechnya's demand for independence and sponsored clandestine armed Chechen opposition to Chechen President Dudayev. In late November, Dudayev's forces captured several Russian soldiers, and President Yeltsin demanded that the Chechens disarm or face a forced state of emergency. When Dudayev's forces refused to comply, President Yeltsin issued an edict on December 9, 1994, authorizing the government to use all means available to the state to disarm armed groupings on the territory of the Chechen Republic and in the area of the Ossetian-Ingush conflict and to restore consitutional order. On December 10, Russian military and police forces numbering up to 40,000 entered Chechnya and began to move on the capital, Grozny. On December 11, President Yeltsin issued a statement that the government's action was prompted by a threat to Russia's integrity, to the security of her citizens, both inside and outside Chechnya, and by the possibility of economic and political destablization. The Russian forces met substantial Chechen resistance. Massive Russian bombardment of Grozny began after December 21 and by January 4, 1995, some sections of the city were reportedly occupied by Russian troops. The conflict has reportedly resulted in thousands of military and civilian deaths and injuries.[25]

Many Russian legislators have condemned the Russian military assault and deemed it unconstitutional since the parliament did not approve a state of emergency. Several high-ranking Russian military officials have also opposed the assault, and Russian polls and surveys reportedly also indicate widespread opposition by the Russian people. Concerns have been raised within and outside Russia that the conflict could (1) evolve into a guerilla war in the Caucasus region, accompanied by Chechen terrorism in Russian cities; and (2) seriously and adversely affect Russia's transition to democracy and a market economy. War costs are expected to add to Russia's budget deficit and inflation and could adversely affect international financial support for Russia's efforts to stabilize and reform its economy.[26]

[25]Regarding developments in 1994 and early 1995, see Chechnya Confrontation; and "Troops Enter Chechnya to 'Restore Order,'" Moscow Itar-Tass World Service (Dec. 11, 1994), as reported by the Foreign Broadcast Information Service.

[26]Chechnya Confrontation; Center for Post-Soviet Studies, "Reactions to the Events in Chechnya," Focus (Chevy Chase, MD: December 1994).

Debt Burden of Countries Compared With Payment Delays, IMF Arrangements, and Debt Relief Agreements

Country	Level of debt burden, 1989-91	Arrears in 1991	IMF arrangements as of August 1992	Debt relief agreements, 1987-91: Commercial debt	Debt relief agreements, 1987-91: Official debt
Angola	Moderate	√			√
Antigua & Barbuda	Low	√			
Argentina	Severe	√	E. standby	√	√
Bangladesh	Moderate		E. structural adj.		
Barbados	NR		Standby		
Benin	Moderate	√			√
Bolivia	Severe	√	E. structural adj	√	√
Brazil	Severe		Standby	√	√
Bulgaria	Severe	√	Standby		√
Burkina Faso	Low	√	Structural adj.		√
Burma (Myanmar)	Severe	√			
Burundi	Severe		E. structural adj.		
Cameroon	Moderate	√	Standby		√
Central African Rep.	Moderate	√			√
Chad	Low	√			√
Chile	Moderate			√	√
Colombia	Moderate			√	
Congo	Severe	√		√	√
Costa Rica	Moderate	√	Standby	√	√
Côte d'Ivoire	Severe	√	Standby	√	√
Cuba	Severe	NR		√	√
Czechoslovakia[a]	Low		Standby		
Dominican Republic	Moderate	√	Standby	√	√
Ecuador	Severe	√	Standby	√	√
Egypt	Severe	√	Standby		√
El Salvador	Moderate		Standby		√
Ethiopia	Severe	√			
Gabon	Moderate	√	Standby	√	√
Gambia	Low			√	√
Grenada	Low	√			
Guatemala	Moderate	√			
Guinea	Severe	√	E. structural adj.	√	√
Guinea Bissau	Severe	√			√
Guyana	Severe	√	E. structural adj.	√	√
Haiti	Low	√			
Honduras	Severe	√		√	√
Hungary	Moderate		E. standby		

(continued)

Country	Level of debt burden, 1989-91	Arrears in 1991	IMF arrangements as of August 1992	Debt relief agreements, 1987-91	
				Commercial debt	Official debt
India	Moderate		Standby		
Jamaica	Moderate	√	Standby	√	√
Jordan	Moderate		Standby	√	√
Kenya	Severe		E. structural adj.		
Korea, DPR	Low			√	
Lesotho	Low		E. structural adj.		
Liberia	Severe	√		√	√
Madagascar	Severe			√	√
Malawi	Severe		E. structural adj.	√	√
Mali	Moderate				√
Mauritania	Severe				√
Mexico	Severe		E. standby	√	√
Mongolia	Severe	NR	Standby		
Morocco	Severe		Standby	√	√
Mozambique	Severe		E. structural adj.	√	√
Nicaragua	Severe	√	Standby	√	
Niger	Severe			√	√
Nigeria	Severe	√		√	√
Pakistan	Moderate				√
Panama	Low	√	Standby	√	√
Papua New Guinea	Low		Standby		
Paraguay	Low	√			
Peru	Severe	√		√	√
Philippines	Moderate		Standby	√	√
Poland	Severe	√	E. standby	√	√
Romania	Low		Standby	√	√
Rwanda	Moderate		Structural adj.		
Sao Tomé & Principe	Severe	√			
Senegal	Moderate			√	√
Sierra Leone	Severe	√		√	√
Somalia	Severe	√			√
South Africa	Low	√			
Sri Lanka	Moderate		E. structural adj.		
St. Lucia	Low	√			
Sudan	Severe	√		√	√
Suriname	Low	√			
Syria	Severe	√			
Tanzania	Severe	√	E. structural adj.		√

(continued)

Country	Level of debt burden, 1989-91	Arrears in 1991	IMF arrangements as of August 1992	Debt relief agreements, 1987-91	
				Commercial debt	Official debt
Togo	Moderate		E. structural adj.	√	√
Trinidad & Tobago	Low			√	√
Turkey	Moderate			√	√
Uganda	Severe	√	E. structural adj.		√
Uruguay	Moderate			√	
Venezuela	Severe		E. standby	√	
Vietnam	Severe	√			
Zaire	Severe	√		√	√
Zambia	Severe	√		√	√
Zimbabwe	Low		E. standby		

Legend: IMF arrangements:
E. standby = Extended standby arrangements
Structural adj. = Structural Adjustment Facility
E. structural adj.= Enhanced Structural Adjustment Facility
NR = Not reported

Note: Blank spaces indicate none were reported.

[a]In 1992 Czechoslovakia divided into two independent states, the Czech Republic and Slovakia.

Sources: Debt burden and debt relief arrangements data are from World Debt Tables 1991-92 and 1992-93, The World Bank. Debt burden level is based on the classification method reported in the 1991-92 edition. Arrears are from Exchange Arrangements and Exchange Restrictions, Annual Report, International Monetary Fund, 1991. IMF arrangements data are from International Financial Statistics, IMF, October 1992.

Comments From the Department of Agriculture

Note: GAO comments supplementing those in the report text appear at the end of this appendix.

DEPARTMENT OF AGRICULTURE
OFFICE OF THE SECRETARY
WASHINGTON, D.C. 20250

2 [illegible]

Mr. Allan I. Mendelowitz
Managing Director
International Trade, Finance,
and Competitiveness
General Accounting Office
Washington, D.C. 20548

Dear Mr. Mendelowitz:

Thank you for the opportunity to review the draft report, "Former Soviet Union: Creditworthiness of Successor States and USDA Export Credit Guarantees." It was reviewed by a number of offices in the Department of Agriculture, and the prevailing opinion appears to be that the report is well-researched and presented.

See p. 144.

In a report of this size there were numerous comments, but most were minor. Our principal disagreements with the report had to do with the methodology for assessing costs and benefits, particularly with reference to GAO's use of the secondary market as a means of estimating losses. I am enclosing Department comments, which were developed by the principal agencies involved in the review: the Foreign Agricultural Service, the Agricultural Stabilization and Conservation Service, and the Economic Research Service.

Sincerely,

Eugene Moos

Eugene Moos
Under Secretary
International Affairs
and Commodity Programs

Enclosure

AN EQUAL OPPORTUNITY EMPLOYER

Enclosure
USDA Comment on GAO Draft Report, "Former Soviet Union - Creditworthiness of Successor States and USDA Export Credit Guarantees"

See p. 144.

In general, all USDA agencies found the draft to be a very well written report, which accurately presents USDA source materials, the GSM-102/103 decision making process, and the interviews conducted pursuant to this investigation. USDA would, however, offer several general comments regarding GAO's assumptions/conclusions, followed by specific editorial comments that GAO may find useful.

Comments Regarding Assumptions/Conclusions.

See pp. 2, 144-146.

1. On page 2 of the Executive Summary GAO states that it took account of secondary market valuations of FSU debt in assessing risk involved in lending to the FSU. None of the USDA review agencies believe that the secondary market is a reliable indicator of the value of FSU paper. There are too few participants in the secondary market who can easily manipulate the market. Another concern is that the attributes of the debt in the secondary market may be materially different from the GSM debt.

Now on p. 3.
See pp. 146-147.

2. On page 4 of the Executive Summary GAO asserts that "the successor states to the FSU are currently not creditworthy." Obviously USDA disagrees with such an unqualified statement, with its blanket indictment of all 15 republics (GAO includes the Baltic States in its analysis). While there unquestionably are severe economic problems in each of these new states -- presented rather thoroughly in the report -- USDA has found that an objective case-by-case analysis of the individual republics has shown some to be viable candidates for modest amounts of GSM-102 credits. Thus far in FY 1994 we have announced allocations for Turkmenistan and Ukraine, and a program for Uzbekistan was fully utilized at the end of FY 1993. All were announced at 98 percent principal coverage, and new NIS programs have required principal repayments at 6 month intervals -- the better to establish repayment history. Each program is driven by the market development objectives portrayed so well in the report, but the conservative nature of USDA's approach to announcing new NIS programs also demonstrates pursuit of programs only where repayment is expected.

See pp. 38-39.

3. It is argued that the four main reasons the West provided credits and food aid to the FSU were to support reform, to minimize expected food shortages and prevent famine, to bolster popular support for reform, and perhaps most importantly, to maintain agricultural exports to one of the world's largest and most important markets. It is important to clarify that there were no food shortages in the sense that the USSR did not produce enough food.

Before the breakup of the USSR, shortages and long lines existed in State stores where prices were controlled, resulting in surplus demand. No shortages existed in the farmer markets where prices were relatively free, but substantially higher than State-set prices. After the breakup of the Soviet Union, price liberalization led to increased availability of food, by decreasing surplus demand. The primary problems facing the FSU in terms of food supply are disruptions due to military conflict and the reduced purchasing power of consumers, which has put some groups (such as the elderly and unemployed) at risk. Humanitarian assistance could and in many instances did address these problems.

See pp. 47,
140-141, 149-150.

However, despite the fact that widespread dislocation in the food supply never occurred, the West continued to provide assistance to the FSU, which accepted it to the likely detriment of economic reforms (increased debt, continued State control of agricultural marketing that lowers productivity, increases waste, and possible undercutting of domestic production). The reliance on imports is not new; prior to the breakup of the Soviet Union, large amounts of grain were imported, rather than pay farmers more to increase domestic procurement and reduce waste. Given that since 1991 most if not all of the FSU agricultural imports were made with credit or some form of assistance, FSU leaders figured it was in their best interest to accept Western assistance since repayment, if any, would likely be delayed.

See comment 1.

4. Regarding GSM and EEP programs: The GAO analysis shows that the United States lost money by selling wheat to the FSU under the GSM-102 and EEP programs, because EEP payments exceeded deficiency payment savings. Consequently, the GAO concludes that the greater the additionality of sales to the FSU, the more money the United States lost. This conclusion is based on statistical results we find questionable.

As is commonly done, GAO employs a basic statistical model to quantify the relationship between commodity use and ending stocks, and prices. The resulting estimates are then used to determine the sensitivity of prices to changes in the stocks-to-use ratio, and ultimately to determine the impact on commodity program costs (primarily deficiency payments) to changes in exports. For example, an increase in the stocks-to-use ratio puts downward pressure on commodity prices and increases deficiency payments. The estimated relationship between the stocks-to-use ratio and commodity price is a critical factor in estimating commodity payments under alternative export scenarios.

The GAO model estimates a weak relationship between the stocks-to-use ratios and commodity prices (also, the overall explanatory power of the model is quite low). Consequently, without FSU exports, the stocks-to-use ratio would increase, resulting in an increase in commodity payments. Savings, by avoiding these higher deficiency payments, are insufficient to offset the costs of EEP bonuses that were also provided to the FSU. Other analysis shows that the relationship between commodity price and the stocks-to-use ratio is actually much larger, implying that without FSU exports, relatively larger increases in commodity payments would result.

See pp. 53-56, 147-149.

Further, GAO makes two implicit assumptions about GSM-102 sales to the FSU. The first is that USDA would have offered the credit guarantees to other countries if USDA had not offered them to the FSU. The second is that USDA would have provided the extraordinary 100 percent coverage of principal extended to exporters to the FSU to exporters to other markets. Both are unlikely (see also comment 5, below). In fiscal 1991 and 1992, 37 other countries besides the FSU, USSR, Russia, and Ukraine were eligible to participate under the GSM-102 and GSM-103 programs. Eligible markets ranged from Korea to Botswana and Namibia. Principal untargeted markets were: China, Cuba, Iran, Libya, and Japan. With the exception of China and Japan, there were few other markets that could exert the same amount of influence on U.S. domestic prices and both China and Japan purchased heavily from the United States during the time period without credit guarantees. Also, GAO did not consider that if 100 percent coverage were to be extended to participants other than the FSU, all participants would have wanted the same coverage.

See pp. 56, 147-149.

GAO is correct to present results for a range of additionalities. However, in the FSU case, the assumption of 100 percent additionality is reasonable. (In this regard we note that in a memo to the Secretary from Charles O'Mara, Acting Under Secretary for International Affairs and Commodity Programs dated February 10, 1993, two levels of additionality were assumed for $2 billion in credits to the FSU, 100 percent and 50 percent. The analysis (inserted on the following page) indicated deficiency payment savings of $0.7 - $1.4 billion.) It is likely that without the GSM-102 coverage the FSU would not have been able to purchase substantial quantities of U.S. commodities. This is illustrated by the sharp decline in U.S. exports to the FSU after it was suspended from the program. As stated above, there were few alternative opportunities for the use of the credit guarantees.

See pp. 131 and 132.

GAO should examine the terms of the rescheduled debt with the FSU. As long as the interest charged exceeds the opportunity cost of funds to the U.S. taxpayer, then the taxpayer does not lose money so long as principal is repaid.

See comment 2
and pp. 147-148.

5. GAO also indicates that EEP bonus payments, possible loan defaults, and freight costs were ignored in USDA's cost estimates of providing GSM credits to the FSU. The February 1993 memo noted above indicated the $2 billion credit package to the FSU would cost taxpayers $1.2 billion before netting out any savings from lower deficiency payments, or a loss equivalent to 60 percent of the loan principal to cover freight costs, EEP bonuses, defaults, etc. Including the savings in deficiency payments, the net cost of the $2 billion in credits ranged from $0.5 billion to a net savings of $0.2 billion.

See comment 3.

6. The report indicates that USDA did not provide GAO with the methodology for analyzing the effect of GSM-102 exports on farm prices. USDA has on several occasions provided its commodity models to GAO and would be willing to do so again. No oral or written request was ever received from GAO asking for the commodity models used to analyze the effects of GSM-102 credits to the FSU.

See comments 1 and 4.

GAO's methodology understates the impact of GSM-102 credits to the FSU on commodity prices and deficiency payments. GAO uses regression analysis to estimate the effects of GSM-102 credits to the FSU on wheat, corn, and soybean prices, use and stocks. The regression equations ignore many relevant variables, such as livestock prices and production, population, disposable income, exchange rates, foreign crop production, loan rates, etc., causing the estimated relationships to understate the impact of changes in stocks and use on farm prices and deficiency payments.

See comment 1.

The GAO methodology results in larger changes in farm prices and deficiency payments than reported by GAO. GAO either misinterpreted their estimated equations for prices and use for wheat, corn, and soybeans, or reported the wrong equations used to calculate the changes in prices. For example, the equations in Appendix I indicate a $0.10 per bushel increase in the price of corn in 1990/91, assuming 100 percent additionality (see analysis next page).

However, GAO reports only a $0.02 increase. Since the price changes are understated, so are the changes in deficiency payments.

See comment 1.

GAO does not use existing, more sophisticated, models of the agricultural sector to analyze the effects of GSM-102 credits to the FSU and fails to validate their results. Several much more sophisticated models of the agricultural sector exist (FAPRI, CBO, WEFA, USDA/ERS) that could be used to analyze the effects of credits to the FSU. These models would support a stronger relationship between commodity prices, stocks, and use, and greater effects on deficiency payments than those estimated by GAO.

Now on pp. 54-56.
See pp. 148-149.

7. On page 70, GAO dismisses USDA's contention that alternative export markets were not available, with the argument that other importing nations would be glad to participate if USDA were to provide 100 percent coverage. This argument spurious for two reasons. First, it discounts the extent to which USDA has insisted on risk-sharing as a central aspect of the GSM-102 program; the fact is, the program has provided 100 percent cover in only four instances in the 14-year history of the GSM-102 program and there is little inclination in USDA to add a fifth. Second, the argument presumes that there are creditworthy nations in the world marketplace that are interested in participating in a large scale GSM-102 program. Perhaps GAO could provide their names.

Now on pp. 3 and 6.
See pp. 75-78 and 80.

8. The report would benefit from an update on the status of debt rescheduling that has (or has not yet) taken place with the Paris and London Clubs of government and commercial creditors. In one part (page 5), it was stated that while creditor nations have provided some debt relief to Russia, it was partially contingent on Russian commitment to further economic reforms. We realize this is true for much of the assistance that is also referenced in this sentence, but we didn't think the Paris Club agreement or the London Club negotiations made further progress in economic reforms a requirement for debt relief. In addition, the Paris Club 1993 rescheduling was extended through the first 4 months of 1994.

Now on p. 142.
See pp. 149 and 150.

9. We applaud GAO's recommendation on page 195 that <u>if</u> Congress concludes that additional GSM-102 guarantees are not appropriate for Russia at this time it consider authorizing additional foreign aid monies to help finance export sales. This conclusion gets to the heart of the matter. Ongoing U.S. agricultural exports to the FSU countries are essential to the American farm community and to the geopolitical interests of the United States. The more export tools that this (or any) Administration has to use in promoting trade, the better able it is to fine-tune its programs to meet the myriad programmatic goals and constraints. And the greater the partnership that exists between Congress and the Administration in matters such as this, the better we all can focus on useful objectives -- in this case, providing needed foodstuffs to a market of enormous potential.

GAO Comments

The following GAO comments on the Department of Agriculture's letter dated February 25, 1994, supplement those that appear in the text of the report.

1. Many of USDA's comments concern a statistical model that we developed and presented in our draft report that was provided to USDA for comment. The model analyzed the impact of GSM-102 exports to the FSU/successor states on U.S. commodity support programs. On the basis of USDA's comments, we found that a technical mistake had been made in applying the model's equations. The effect of the mistake was to underestimate the impact on the costs of commodity support programs. In addition, USDA criticized the model for not including other variables that might be relevant to the issue and for not using other more sophisticated models of the agricultural sector to validate our results. Neither the model nor the results that were discussed in our draft report are presented in this report. Nonetheless, we have reproduced USDA's comments and briefly address some of them in this appendix.

2. The two estimates that USDA originally provided us did not fully consider EEP bonus payments and ignored freight costs and possible loan default costs. USDA's third estimate, provided to us as part of its comments, is reported in chapter 6.

3. In discussing our model that was presented in the draft report provided to USDA for comment, we noted that USDA had not provided us with its methodology for analyzing the effect of GSM-102 exports on farm prices themselves. The two estimates that USDA originally gave us did not describe the methodology. Our records show that we orally requested information on the methodology but did not obtain it. After commenting on a draft of this report, USDA provided us with a copy of the computer model that it said was used to generate the USDA estimates discussed in this report.

4. It is not obvious that the variables cited by USDA would increase the relationships between the impact of changes in stocks and commodity use on farm prices and deficiency payments. It should be noted that USDA's model, which we obtained after USDA commented on our draft report, included only one of the seven specific variables that USDA criticized us for ignoring (i.e., loan rates).

Major Contributors to This Report

General Government Division, Washington, D.C.

Philip J. Thomas, Assistant Director
Wayne H. Ferris, Project Manager
Gezahegne Bekele, Senior Economist

European Office

Paul M. Aussendorf, Assignment Manager
James R. Jones, Sub-Project Manager
David M. Bruno, Evaluator

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