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Iraq's Participation in U.S. Agricultural Export Programs

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The Honorable Charles E. Schumer
Chairman, Task Force on Urgent Fiscal Issues
Committee on the Budget
House of Representatives

Dear Mr. Chairman:

At your request, we have examined Iraq's participation in the U.S. Department of Agriculture's Export Credit Guarantee Programs (GSM-102/103) which promote U.S. agricultural exports. Under these programs, the Commodity Credit Corporation (CCC) guarantees that U.S. exporters or their assignees[1] will be repaid for a credit sale made to a foreign buyer in an eligible country. If the buyer defaults, the exporter can file a claim with CCC for the loss. Under GSM-102, CCC guarantees repayment for credit sales of 3 years or less; under GSM-103, CCC guarantees repayment for credit sales of more than 3 but less than 10 years.

This report 1) provides information on the development of Iraq as a U.S. agricultural export market and the extent to which Iraq has benefited from U.S. government agricultural export programs since its inclusion in the GSM program in 1983; 2) examines agricultural, trade, and foreign policy considerations that influenced decisions to continue offering guarantees to Iraq under the GSM program despite a growing concern about Iraq's creditworthiness;[2] and 3) discusses GSM program irregularities recently surfaced by the Justice Department's investigation of a bank's unauthorized and unreported loans to Iraq and a subsequent administrative review by the Department of Agriculture.[3]

[1] An assignee may be any financial institution in the United States desiring to participate in these programs. This allows the exporter to obtain immediate payment on the credit sale by assigning the account receivable and the repayment guarantee.

[2] As used in the context of this report, creditworthiness is defined as a country's ability and intention to make payments on debts. This ability can be influenced by economic, political, and financial factors.

[3] On October 16, 1990, we testified before the House Committee on Banking, Finance and Urban Affairs on Iraq's participation in the Commodity Credit Corporation's GSM-102/103 export credit guarantee programs: Report on the Commodity Credit Corporation's GSM-102/103 Export Credit Guarantee Programs and Iraq's Participation in the Programs (GAO/T-NSIAD-91-01).

Results in Brief

On August 2, 1990, the President announced a trade embargo on Iraq, including a prohibition on granting credits for the purchase of U.S. agricultural commodities. At that time, the CCC had a $2 billion liability under its export credit guarantee programs (GSM-102/103) covering loans to Iraq. Under current conditions these loans are not being repaid, and CCC may have to cover its guarantees.

Increasingly larger export credit guarantees were approved for Iraq from fiscal year 1983 through fiscal year 1989, eventually totaling approximately $4.5 billion. Another $500 million was approved for fiscal year 1990. Even though Agriculture's risk analysis documents for fiscal years 1989 and 1990 rated Iraq as a high-risk market for granting substantial credit guarantees, Agriculture continued to approve credit guarantees through fiscal year 1990. It seems that the U.S. desire to build a strategic and agricultural trade relationship with Iraq outweighed the apparent financial risks involved and discounted evidence of Iraq's human rights violations.

In addition, Iraq participated in other agricultural export development programs. Under the Export Enhancement Program U.S. exporters received an estimated $157.2 million in bonuses to facilitate Iraqi purchases of about $509.8 million in agricultural commodities from fiscal years 1986 through 1990. Moreover, over the same time period the Targeted Export Assistance and Cooperator Foreign Market Development Programs together provided $1.9 million in market development assistance to U.S. commodity groups targeting the Iraqi market.

Beginning in June 1988, Iraq's participation in the GSM program came under the scrutiny of Agriculture and Justice Department investigators. At that time, Agriculture's Office of the Inspector General began an investigation of the export of foreign origin tobacco to Iraq, which was later turned over to the Justice Department. Then in August 1989, the Office of the U.S. Attorney for the Northern District of Georgia was notified that officials at the Atlanta branch of the Italian-owned Banca Nazionale del Lavoro had been keeping a second set of books and had advanced unauthorized and unreported loans to Iraq. This discovery led to the initiation of a grand jury investigation by the Office of the U.S. Attorney, U.S. Department of Justice, focusing on bank fraud and evasion of bank regulatory requirements. Agriculture's Office of the Inspector General joined the investigative team in September 1989, when it learned that approximately $750 million of these loans were guaranteed by CCC. By October 1989, Agriculture had initiated a separate administrative review of Iraq's participation in the GSM-102/103 program.

As a result of the preliminary findings of the Banca Nazionale del Lavoro investigation and the implications of GSM program irregularities, Agriculture adopted a more cautious approach to providing additional GSM guarantees to Iraq. Agriculture offered only one-half of the requested $1 billion in credit guarantees for fiscal year 1990, with the remainder dependent on the results of the ongoing Justice investigation. This initial $500 million was quickly exhausted, and in February 1990 Iraq requested additional guarantees. Review of this request was still underway when Iraq's August 1990 invasion of Kuwait and the subsequent trade embargo brought to a halt all forms of assistance to Iraq, including credit guarantees. Appendix I contains a chronology of events that have affected U.S.-Iraqi agricultural trade relations and foreign policy and that have influenced the extent of Iraq's participation in U.S. agricultural export development programs.

Background

Iraq is heavily dependent on agricultural imports because of its high population growth rate and limited arable land. By 1990, Iraq was importing more than 75 percent of its food needs. The United States had been a major food supplier to Iraq, accounting for about one-third of its total $2.9 billion in agricultural imports in 1988 and $2.5 billion in 1989. Iraq ranked as the 12th largest market for U.S. agricultural products. Australia, Canada, the European Community, and Turkey have also been major suppliers of agricultural commodities to Iraq.

The availability of foreign credit has been an important factor in Iraq's agricultural import decisions because of foreign exchange shortages and a large external debt. Iraq has been consumed with economic reconstruction as a result of its 8-year war with Iran. To date, Iraq has focused on modernizing its military capabilities and its oil-exporting facilities. The oil sector had provided about 95 percent of Iraq's foreign exchange earnings. War damage to its oil export facilities, restrictions on its ports and pipelines, and a decline in oil prices due to overproduction by other suppliers constrained Iraq's ability to generate revenue. As a result, Iraq turned to extensive external borrowing. Total external debt owed to creditors in non-Arab countries increased from about $8 billion in 1984 to estimates of between $30 billion to $50 billion in 1990. In addition, Iraq owed an estimated $50 billion to Arab Gulf states. Many of the major debts have been rescheduled at least once.

More than 90 percent of total U.S. agricultural exports to Iraq can be directly attributed to the GSM-102 credit guarantee program. In fiscal year 1982, the year before Iraq first participated in the GSM-102 program, Iraq's agricultural imports from the United States totaled less than $135 million. In fiscal year 1983 Agriculture approved $401.9 million in export credit guarantees for Iraq. At that time, the United States and Iraq were working on reestablishing diplomatic relations, which had been severed in 1967. Also during that time, Iraq was in the middle of its 8-year war with Iran, and the United States was seeking ways to assist Iraq. For fiscal year 1989 Agriculture approved $1.1 billion in guarantees. Iraq had become the largest export market for U.S. rice. Other major exports have been wheat, feed grains, oilseed products, cotton, sugar, dairy products, poultry, and tobacco.

In addition, Iraq has benefited from other agricultural export development programs, including the Export Enhancement Program. Under this program, U.S. exporters received an estimated $157.2 million in bonuses to facilitate Iraqi purchases of an estimated $509.8 million in wheat, wheat flour, feed grains, and other agricultural products. These bonuses allowed U.S. exporters to lower their prices and make their goods competitive with other countries' subsidized agricultural exports. The combination of the Export Enhancement Program with GSM guarantees allowed Iraq to buy U.S. agricultural commodities at competitive prices on credit. Agriculture's Targeted Export Assistance and Cooperator Foreign Market Development Programs have also focused on the Iraqi market in their efforts to promote U.S. agricultural commodities. Between fiscal years 1986 and 1990, these programs together provided $1.9 million in market development assistance to U.S. commodity groups targeting this market. Appendix III provides more detail on these other export development programs targeted to Iraq.

Since the GSM export credit guarantee program began, Mexico, South Korea, and Iraq have received the largest loan guarantees of all participating countries. Agriculture's Foreign Agricultural Service (FAS) administers CCC export credit guarantee programs. FAS determines which countries may participate based on their long-term agricultural needs, the market development opportunity for U.S. agricultural commodities, and the ability to repay any credit extended. Because the programs also provide economic benefit to foreign governments, their use can be influenced by U.S. foreign policy considerations.

As part of the decision-making process for determining GSM program allocations, FAS staff develop country risk profiles that in the past have been mainly qualitative in nature. These profiles discuss a country's economic, financial, and political strengths and weaknesses.

Since the program began in 1983, FAS has approved Iraq's participation in the GSM programs based on its enormous market development potential for U.S. agricultural exports and its long-term ability to repay its debts due to extensive oil reserves. Because of increasing concern about limiting CCC's exposure, FAS developed new risk analysis procedures which were used for fiscal year 1991 program allocations. These new procedures are more quantitative and focus on financial risk. FAS views the new procedures as a means of specifying the tradeoff between credit risk and market development. Appendix IV provides detail on the GSM decision-making process, including risk analysis.

Evolution of Iraq's Participation in the GSM-102/103 Programs

Since the inception of the GSM-102/103 programs and continuing through fiscal year 1990, Iraq has received approximately $5 billion in GSM export credit guarantees. Its participation in the program grew from 8 percent of the total credit guarantees approved in fiscal year 1983 to a high of 25 percent in fiscal year 1988, when Iraq received over $1 billion in credit guarantees, making it the second largest guarantee recipient for that year. The same program level was provided for fiscal year 1989, despite growing concerns over Iraq's creditworthiness.

For fiscal year 1990, Iraq requested over $1 billion in GSM-102/103 export credit guarantees. Agriculture took a more cautious approach and only offered $500 million in credit guarantees. This reduced amount reflected 1) concerns about Iraq's creditworthiness raised in risk assessment documents and during consultations with members of the National Advisory Council on International Monetary and Financial Policies and 2) Agriculture's apprehension about findings of possible program irregularities surfacing in ongoing investigations and their implications for the integrity of the overall GSM program.

The National Advisory Council is an interagency group that gives advice and recommendations to government agencies, such as Agriculture, on international financing matters including Agriculture's decisions to extend GSM credit guarantees. (See app. V for more detailed information on Council operations.) Final decision authority for providing GSM credit guarantees rests with the Department of Agriculture. Council members include the Departments of Treasury and State, the Federal

Reserve Board, and the U.S. Export-Import Bank. Council members discuss GSM-102/103 proposals from each of their perspectives, highlighting issues dealing with foreign policy, financial risk, and trade considerations.

In the case of Iraq, the U.S. desire to build a strategic and agricultural trade relationship with Iraq seemed to have outweighed the apparent financial risks involved with providing credit guarantees and to discount evidence of Iraq's human rights violations. Over the last few years, several U.S. executive branch agencies stated to Congress and to other groups their concerns about Iraq, including its creditworthiness, its practice of repaying countries that offer further credits while ignoring repayments to countries that do not offer further credits, and its human rights violations. Despite these concerns, Agriculture continued to place a high priority on Iraq as a market for U.S. agricultural products.

In the summer of 1988, Congress was considering imposing economic sanctions on Iraq for its use of chemical weapons against its Kurdish population. At the same time, Agriculture was seeking approval to reallocate $36.5 million in fiscal year 1988 export credit guarantees to Iraq from the existing credit lines of other countries. On September 22, 1988, eight senior level FAS program staff addressed a memo to the CCC General Sales Manager expressing strong concern over CCC's vulnerability should Congress impose sanctions on Iraq. They warned the General Sales Manager that further extension of credit guarantees could expose CCC to additional liability should sanctions be approved. The staff believed that, based on past Iraqi statements and actions, Iraq would stop payments on its outstanding credit guarantees in retaliation for such congressional action. Despite these concerns, the reallocation was approved by the General Sales Manager because 1) Iraq was current on payments to the United States, 2) Iraq was a growing U.S. agricultural market, and 3) Agriculture had no concrete evidence that the Iraqi government had used chemical weapons against the Kurds. Ultimately the sanctions legislation, which was opposed by U.S. agricultural interests, was defeated. Appendix II provides more detailed information on the evolution of Iraq's participation in the GSM program.

Investigations Into Program Improprieties

Since June 1988, there have been several investigations of the GSM-102/103 programs to Iraq. The investigations have included those conducted by Agriculture's Office of the Inspector General and its Foreign Agricultural Service, the Justice Department, the U.S. General Accounting Office, and Italy's Senate.

In June 1988 the Office of the Inspector General began an audit to determine whether or not foreign origin tobacco was being exported under the GSM-102/103 programs to countries, including Iraq, and being represented as U.S. origin tobacco. Its findings led to a criminal investigation of the matter conducted by the Department of Justice's U.S. Attorney in Raleigh, North Carolina. The investigation resulted in eight tobacco exporting companies pleading guilty to filing false statements with either Agriculture or U.S. Customs regarding the export of tobacco to Egypt or Iraq.

In August 1989, allegations were raised that led to an investigation of the banking activities of the Atlanta branch of the Banca Nazionale del Lavoro, an Italian-owned bank operating in the United States. This investigation is being conducted by a task force of federal agencies and is being led by the U.S. Attorney in Atlanta, Georgia. It has been reported that the Atlanta branch of Banca Nazionale del Lavoro made some $2 billion in loans to Iraq without higher level Banca Nazionale del Lavoro bank authorization. Approximately $750 million of these loans had repayment guarantees under the GSM-102/103 programs. The investigation is still ongoing, and little information has been made public. Banca Nazionale del Lavoro is largely owned by the government of Italy, and a special investigative committee of the Italian Senate has been formed to conduct its own investigation into the affair.

In October 1989 FAS initiated an administrative review of the GSM-102 program for Iraq. Its review was limited to transactions made by Banca Nazionale del Lavoro, and focused on four issues: (1) the actual arrival in Iraq of agricultural commodities shipped under the GSM program, (2) the payment of certain Iraqi domestic taxes on GSM sales, (3) unusually high commodity prices charged for GSM-guaranteed sales to Iraq and financed through Banca Nazionale del Lavoro, and (4) the provision of after sales services[4] in connection with GSM sales.

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

In May 1990 Agriculture released the results of its administrative review. It found no evidence of diversion of commodities sold to Iraq. In addition, it announced that Iraq had agreed to exempt GSM credit guarantee program transactions from its domestic tax policy. However, the review identified two key areas for further review—the extent and reason for high commodity pricing in certain GSM transactions, and the extent to which after sales services were provided and properly reported in connection with GSM sales. The administrative review was not a comprehensive analysis of all GSM transactions with Iraq but rather an examination of a limited number of transactions and issues that were identified as a result of the Banca Nazionale del Lavoro investigation. Consequently, Agriculture asked its Office of the Inspector General to conduct a more thorough review of all GSM sales to Iraq. Appendix VI provides greater detail on the Banca Nazionale del Lavoro investigation and Agriculture's administrative review.

Scope and Methodology

We examined the extent of Iraq's participation in all agricultural export development programs and reviewed the history of events leading to the extension of export credit guarantees to Iraq. We also reviewed the risk analysis procedures employed by Agriculture as well as the interagency process it uses to receive guidance on proposals. Finally, we examined the extent of Iraq's involvement in recent GSM program violations and the irregularities uncovered during Justice Department and Agriculture investigations.

We interviewed officials from the Departments of Agriculture and State in order to determine their roles and positions concerning Iraq's participation in the GSM programs. We also interviewed the former CCC General Sales Manager. We reviewed pertinent files on Iraq's participation in agricultural promotion programs.

Our review was somewhat limited because the Departments of State and Treasury denied us access to National Advisory Council minutes and some key documents, stating that they contained information that was deliberative in nature. However, we did obtain information about National Advisory Council discussions from interviews with other member agency officials and by reviewing informal notes taken at the meetings.

As requested, we did not obtain agency comments on this report. We performed our work from August 1990 to October 1990 in accordance with generally accepted government auditing standards.

As arranged with your office, unless you publicly announce its contents earlier, we plan no further distribution of this report until 20 days from the date it is issued. At that time, we will send copies to the Secretaries of Agriculture, State, and Treasury. Copies will also be made available to other interested parties upon request.

This report was prepared under the direction of Allan I. Mendelowitz, Director, International Trade, Energy, and Finance Issues. He can be reached on (202) 275-4812 if you or your staff have any questions. Other major contributors to this report are listed in appendix VII.

Sincerely yours,

Frank C Conahan

Frank C. Conahan
Assistant Comptroller General

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Abbreviations

BNL	Banca Nazionale del Lavoro
CCC	Commodity Credit Corporation
FAS	Foreign Agricultural Service
NAC	National Advisory Council on International Monetary and Financial Policies

Chronology of U.S.-Iraqi Agricultural Trade Relations and Foreign Policy, 1983-1990

1983	Iraq begins participating in Agriculture's GSM program, with an initial allocation of $401.9 million in export credit guarantees.
1984, March	U.S. Department of Commerce embargoes shipments to Iraq of several chemicals usually used in agriculture but which could be used to make chemical weapons.
1984, November	Diplomatic relations between the United States and Iraq, which were broken off in 1967, are restored. Iraq is removed from the State Department's list of countries supporting terrorism, on which it was placed in 1979.
1988	Iraq's GSM-102 approved guarantees rise to a high of $1 billion for fiscal year 1988.
1988, March	During a 3-day battle over the city of Halabja, an Iraqi Kurdish village about 150 miles north of Baghdad, Iran and Iraq use chemical weapons and kill between 4,000 and 5,000 civilians.
1988, June	Agriculture initiates an investigation into the export of foreign origin tobacco to Iraq. This inquiry was later turned over to the Justice Department.
1988, August	Iraq and Iran accept a U.N. Security Council cease-fire to end their 8-year war and begin peace negotiations.
	In interagency meetings of the National Advisory Council on International Monetary and Financial Policies (NAC), two members oppose the proposed $1 billion for fiscal year 1989 in GSM-102 credit guarantees and recommend a limit of $600 million, citing Iraq's huge deficit and its practice of rescheduling its debt bilaterally. Another member favors the $1 billion program level and even discusses the possibility of increasing it.
	The U.S. Export-Import Bank experiences arrearage problems with Iraq.
1988, September	Less than 1 week before the scheduled fiscal year 1989 GSM consultations with Iraq are to take place, the U.S. Senate passes chemical warfare legislation directly targeting Iraq. As a result, Iraq cancels the consultations. The legislation is weakened in conference but still targets Iraq. Iraq says the cancellations will jeopardize the GSM program and the servicing of past debt. Because of agricultural and foreign policy considerations, the sanctions are removed from the legislation, which passes in late December 1988.
	Agriculture announces an increase in Iraq's fiscal year 1988 GSM credit guarantees by $36.5 million.
1988, October	Consultations on fiscal year 1989 GSM program allocation for Iraq are held in Baghdad.
1989	Iraq is allocated $1 billion in GSM-102 and $50 million in GSM-103 for fiscal year 1989.
1989, August	Only the United States and Great Britain offer agricultural export credit to Iraq.
	The Office of the U.S. Attorney for the Northern District of Georgia receives allegation of Banca Nazionale del Lavoro (BNL) improprieties.
1989, September	Agriculture's Office of the Inspector General joins the BNL investigation.
	Agriculture submits a proposal to the NAC for an additional $30 million in GSM-102 for Iraq for fiscal year 1989 and $1 billion in GSM-102 for fiscal year 1990. Members request that this proposal be withdrawn until more information on the BNL investigation is available.
1989, October	Agriculture resubmits its proposal to the NAC for $1 billion in GSM-102 guarantees to Iraq for fiscal year 1990. Two NAC members oppose the $1 billion amount. Other council members approve this amount.
	Agriculture and Iraq hold consultations in Washington, D.C., to discuss a GSM-102 program for fiscal year 1990. Agriculture offers $400 million in GSM-102. Iraq rejects this offer because it wants the full amount approved and does not want to be tied to the BNL investigation unless concrete evidence of complicity is found. Agriculture withdraws the $400 million offer.
1989, November	Agriculture officials go to Iraq to continue negotiations on fiscal year 1990 GSM allocations. An offer of $500 million in GSM-102 is made, with the possibility of another tranche of $500 million after successful conclusion of the BNL investigation. Iraq accepts the first $500 million, but again does not want to accept any conditions on further GSM allocations.
1990, February	Iraq requests an additional $573 million in GSM-102 for fiscal year 1990. Agriculture will not announce a further allocation until the BNL investigation and the Office of the Inspector General review are completed.

(continued)

1990, April	Senate bill 2480 is introduced, stating that no assistance (grant, sale, loan, lease, credit, guarantee, or insurance) may be furnished to Iraq unless the President certifies that Iraq has opened its nuclear, chemical, and biological sites to international inspection. Also, Iraq's most-favored-nation status will be revoked. (Bill does not pass Senate.)
	House bill 4585 is introduced calling for the prohibition of sales to Iraq, through foreign military sales or commercial means, of military, dual use, chemical or nuclear equipment, devices, or technology. (Bill passes House, but not Senate.)
1990, May	Agriculture releases a report based on an administrative review of the GSM program to Iraq. The report focuses on a limited set of transactions and issues identified as part of the BNL investigation. Results suggest further study by Agriculture's Office of the Inspector General.
	House bill 4918 is introduced calling for a ban on U.S. assistance to Iraq unless the President determines Iraq has opened its nuclear, chemical, and biological sites to international inspection and has improved its human rights practices. The bill also directs Treasury to oppose loans to Iraq by international financial institutions, revokes Iraqi air carrier landing rights in the United States, and ends most-favored-nation trade status. (Bill does not pass House.)
1990, June	Assistant Secretary of State for Near Eastern and South Asian Affairs testifies before the Senate Foreign Relations Committee that the administration opposes congressionally imposed sanctions against Iraq for the following four reasons: 1) They would not achieve U.S. goals in Iraq; 2) other nations would not join the embargo, making it a weak move; 3) the administration's policy is to avoid using agricultural trade to pursue foreign policy goals; and 4) the sanctions would increase the U.S. foreign trade deficit.
	Senate bill 2779 is introduced. It prohibits U.S. funds, credits, guarantees, or insurance to be used for Iraqi imports into the United States; names Iraq a terrorist nation; bans Export-Import Bank assistance for Iraq; and directs the President to conduct a study on Iraqi military capability, transfers of nuclear, biological, chemical, and ballistic missile technology to Iraq, and other nations' economic sanctions against Iraq. (Bill does not pass Senate.)
	Senate bill 2787 is introduced, directing the President to enforce all laws imposing sanctions for Iraq's violations of human rights and banning financial credits and assistance for Iraq unless Iraq complies with certain international agreements. (Bill does not pass Senate.)
1990, July	The Foreign Agricultural Service's (FAS) new risk analysis procedures lead to a recommendation of limiting Iraq to $200 million in GSM-102 guarantees for fiscal year 1991. FAS also recommends that this amount only be provided if there is a successful resolution of the BNL investigation and if Iraq agrees to pay its arrearages to the Export-Import Bank.
	Iraqi President Saddam Hussein accuses Arab oil producers of exceeding their Organization of Petroleum Exporting Countries oil production quotas, which, according to Hussein, decreased oil prices and deprived Iraq of much-needed oil revenues.
	The United States puts its Persian Gulf naval force on alert.
	Senate bill 2830 is introduced, amending the Food, Agriculture, Conservation, and Trade Act of 1990. The bill instructs the President to enforce laws that would impose sanctions on Iraq, denying credits, assistance, or financial benefits until the President certifies that Iraq abides by international law. It also directs the President to report to Congress on the economic consequences of banning oil imports from Iraq. (Bill passes both Senate and House, awaiting President's signature.)
	House bill 3950 is introduced. It calls for denial of agricultural promotion programs for countries that do not respect human rights; that acquire chemical, biological, or nuclear weapons; and that support international terrorism. (Bill is incorporated into Senate bill 2830 above.)

(continued)

1990, August	Iraq invades and occupies Kuwait.
	Senate Resolution 318 is passed, urging the President to seek international cooperation in imposing sanctions on Iraq.
	President George Bush imposes economic sanctions against Iraq.
	Iraq ceases payment on all debts to U.S. creditors, including $2 billion in export credit guaranteed loans.
	House bill 5431 is introduced which freezes Iraqi assets in the United States; bans trade, transportation links, munitions sales, and foreign assistance for Iraq; and directs the President to prevent any international financial institutions from providing loans to Iraq. (Bill passes House but not Senate.)
	The United Nations Security Council votes 14 to 0, with Yemen abstaining, to pass a resolution condemning the Iraqi action and demanding the immediate withdrawal of Iraqi forces from Kuwait.
	An Arab League emergency meeting of foreign ministers condemns the Iraqi invasion and calls for an immediate Iraqi withdrawal from Kuwait.
	The United States announces that air, sea, and ground elements of U.S. defense forces have been sent to Saudi Arabia and surrounding waters to deter an Iraqi attack against Saudi Arabia.
1990, September	Iraq is again placed on the Department of State's list of states aiding and abetting terrorism.

Source: This chronology was largely adapted from a Congressional Research Service report entitled "Iraq: U.S. Economic Sanctions," IB90109, (Washington, D.C.: updated Aug. 8, 1990).

Evolution of Iraq's Participation in the GSM Program

Iraq's participation in Agriculture's GSM program grew from 8 percent of the total export credit guarantees approved in fiscal year 1983 to a high of 25 percent in fiscal year 1988. In that year Iraq received over $1 billion in GSM-102 guarantees, making it the second largest recipient of GSM credit guarantees during that year. The same program level was provided for fiscal year 1989, despite growing concerns over Iraq's creditworthiness. Based on the Foreign Agricultural Service's rationale for providing such large amounts to Iraq, it appears likely that Iraq would have received the same program level ($1 billion for fiscal year 1990) were it not for the BNL investigation and the discovery of other program irregularities involving Iraq. It also appears that foreign policy played at least as large a role in determining Iraq's GSM program levels as did market development potential, according to conversations we had with FAS and State Department officials.

The GSM Program to Iraq

Export credit guarantees approved for Iraq increased from about $400 million in fiscal year 1983 to about $1.1 billion in each of fiscal years 1988 and 1989. Another $500 million was approved for fiscal year 1990. (See table II.1.)

Table II.1: Iraq's Participation in CCC's GSM Export Credit Guarantee Programs

Dollars in millions

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

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

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

FAS based approval of Iraq's increased GSM participation on Iraq's enormous market potential for U.S. agricultural exports (due to Iraq's heavy dependence on imports for nearly all its food needs) and on its long-term ability to repay its debts (due to its huge oil reserves).

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

Country Risk Analysis

Agriculture's country risk analysis for Iraq in 1988 indicated that its economic situation had improved somewhat in 1987 and was expected to continue to get better in 1988. However, it was noted that Iraq faced severe economic difficulties because of its ongoing war with Iran. Iraq was also expected to keep on deferring non-U.S. debts. From the mid-1980s on, Iraq had pursued a policy of rescheduling old debt and remaining current only on debt to those countries willing to extend new credits. Despite concerns over such actions, FAS concluded that the risk facing the Commodity Credit Corporation from Iraq's credit initiatives was likely to remain minimal.

Interagency Deliberations on Iraq's Participation in GSM

FAS consistently presented Iraq as a low-risk, high-potential market in meetings of the National Advisory Council on International Monetary and Financial Policies. While NAC members raised various concerns about Iraq, the majority necessary for a NAC recommendation to grant guarantees to Iraq was always present. As early as January 1985, one member went on record against granting credit guarantees to Iraq. This member cited concern about Iraq's creditworthiness and strongly questioned Iraq's capacity to service additional debt. In that meeting, another member added that Iraq's short-term debt had increased over the last 2 years to the point where Iraq might be incapable of rescheduling it.

Meanwhile, a third member of the NAC continued to express support for additional credit guarantees while downplaying Iraq's human rights violations. Through fiscal year 1989, the NAC continued to support extending export credit guarantees to Iraq. Agriculture believed that it was necessary to continue granting high guarantee levels to Iraq in order to maintain Iraq as a major market for U.S. agricultural goods.

In 1989 and 1990, Agriculture temporarily suspended Iraq's line of credit due to nonpayments on guaranteed loans. On at least two occasions, the problems involved bank transfer difficulties. However, in early 1990, a member of Agriculture's Office of the General Counsel admitted that "there is growing feeling within the U.S. government that these repeated problems indicate more than simply bank transfer problems, and raise fundamental issues of creditworthiness." Nevertheless, it appears that decisions to extend export credit guarantees were based on the belief that developing and sustaining the Iraqi market for both agricultural trade and foreign policy considerations outweighed Iraq's questionable creditworthiness.

In 1988, Iraq had used chemical warfare against Iran and the Iraqi Kurds. Nevertheless, the NAC approved continued allocation of export credit guarantees to Iraq. In September 1988, when Congress was considering legislation that would have imposed sanctions on Iraq for its use of chemical weapons, both Agriculture and State opposed these sanctions. In a September 13, 1988, letter to the Chairman of the House Foreign Affairs Committee, a senior State Department official reported that Iraq had used chemical weapons in its campaign against the Iraqi Kurdish population but noted that the United States attached great importance to its bilateral relations with Iraq. This official also noted that the United States had more to gain from maintaining a cooperative relationship with Iraq than from isolating the country. Ultimately the proposed sanctions were not enacted, partly due to foreign policy interests and pressure from U.S. agricultural trade groups.

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

> However, we also note the strong likelihood that Iraq will not make scheduled payments for these purchases if the United States proceeds with economic/political sanctions against Iraq, as is currently being strongly considered in Congress. Until

> the specifics of this move toward sanctions are better known, we believe that the immediate issuance of this press release would constitute an inordinately high financial risk to the Corporation, with potential for program repercussions from Congressional reaction.

Despite these concerns, approval was granted by the General Sales Manager. According to FAS, this decision was made because (1) Iraq was current on its payments under the GSM program; (2) without additional credits, Iraq could not have maintained its import requirements, given the higher commodity prices; and (3) the State Department's official position at that time was that no evidence existed linking the Iraqi government with the gassing of the Kurds. (This position conflicts with that presented in the State Department official's letter to the Chairman of the House Foreign Affairs Committee.)

FAS approved a program level of $1 billion in GSM-102 and $50 million in GSM-103 for Iraq for fiscal year 1989 based on Iraq's long-term ability to pay and on the market potential for U.S. agricultural exports. When the NAC considered this funding level in August 1988, two members opposed the large size of the program and stated that $600 million was a reasonable credit limit for Iraq, given its huge deficit and its policy of bilateral rescheduling of debt. Another NAC member favored the $1 billion level and suggested the possibility of increasing it.

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

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

Limited Fiscal Year 1990 Allocation for Iraq

FAS proposed an additional $30 million in GSM-102 for Iraq for fiscal year 1989 and $1 billion in GSM-102 for fiscal year 1990. It submitted this proposal to the NAC in September 1989. Because of preliminary findings from the BNL investigation and the discovery of possible improprieties in the Iraqi GSM program, two members of the NAC requested that discussion of the GSM program for Iraq be delayed pending the outcome of the investigation.

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

One member of the NAC supported the $1 billion level, noting that Iraq had great strategic importance to the United States. Further, in NAC discussions about the fiscal year 1990 allocation, this member offered several comments: (1) Although allegations concerning Iraq raised concern, this member saw no reason to disapprove the fiscal year 1990 program and (2) clear-cut Iraqi government involvement in any wrongdoing was not evident, but some uncertainty did inevitably exist. This member recommended going ahead with a fiscal year 1990 allocation to Iraq, seeing "...no financial difficulties looming where CCC guarantees would be called ...."

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

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

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

In meetings with FAS officials in October 1989, Iraqi officials rejected FAS' $400-million offer, saying that this level was not sufficient to meet its import needs and that they did not want further guarantees to be linked to the outcome of the BNL investigation. Agriculture officials representing the FAS and the Office of the General Counsel went on a fact-finding trip to Atlanta in October 1989 to review the preliminary findings in the BNL case and their possible relevance to the GSM program. They concluded that there was no reason to delay the Iraqi program. In November 1989 Agriculture officials travelled to Iraq and offered $500 million, with additional guarantees contingent on not finding evidence of Iraqi complicity in the BNL scandal. Iraq agreed to the $500 million but again would not accept conditions on further guarantees. In effect, the fiscal year 1990 allocation was limited to $500 million, half of the preceding year's allocation.

By February 1990, Iraq had exhausted nearly all of its fiscal year 1990 GSM allocations and requested an additional $573 million. FAS was still asserting that although there was considerable risk involved in granting more credits to Iraq, there was also tremendous opportunity for increased agricultural exports. However, FAS knew there would be strong interagency opposition to a proposal for further credit guarantees for fiscal year 1990 while questions remained unanswered in Agriculture's ongoing administrative review.

As the $500 million in credit guarantees were exhausted, Iraq no longer considered commodity offers from the United States. Instead, it began purchasing commodities from Argentina, Australia, Canada, the European Community, Saudi Arabia, Thailand, and Vietnam. Australia, Canada, and Thailand provided some new credit; the remainder of the purchases were for cash. To clear the way for further negotiations, Agriculture asked for consultations with Iraqi officials to discuss program irregularities and to review pertinent documents. These discussions were held in April 1990. Nevertheless, consideration of additional GSM guarantees was deferred because the BNL investigation was still ongoing and Agriculture's Office of the Inspector General had not yet finished its review of unresolved issues raised in the administrative review—high pricing in certain transactions and the extent to which after sales services had been provided in connection with GSM sales.

State Department Position on Iraq

During hearings before the Senate Foreign Relations Committee in June of 1990, the State Department's Principal Deputy Assistant Secretary for Human Rights and Humanitarian Affairs testified:

> Human rights, as such, are not recognized in Iraq ... the ordinary Iraqi citizen knows no personal security against government violence. Disappearances, followed by secret executions, appear to be common. In some cases, a family only learns that one of its loved ones has been executed when the security services return the body and, in line with the Iraqi regime's view of justice, require the family to pay a fine.

The testimony included other words, such as "torture is routine ...," and "there is not even the charade of due process for those charged with security-related offenses." During the testimony, State said, "We bring these issues up; we bring them up forcefully; we bring them up in international fora. We were one of the leaders in trying to get it in the U.N. [United Nations] Human Rights Commission this year, in trying to get a resolution against Iraq." Despite State's articulation of the U.S. government's position, human rights considerations did not surface at NAC meetings, and credit guarantees were not opposed on that basis.

Again, an Assistant Secretary of State testified before Congress in June 1990 that "Iraq's human rights record is an integral part of our agenda with Iraq and will continue to influence the climate of our bilateral relations." Yet this influence did not make its way into the NAC process. Within the NAC, Iraq's human rights violations and the risk they posed in making financial decisions appeared to be outweighed by the U.S. policy of continuing to build an important strategic and agricultural trade relationship with Iraq.

Iraq's Participation in Other Agricultural Export Development Programs

In addition to the Export Credit Guarantee Programs (GSM-102/103), the U.S. Department of Agriculture has three other export development programs that have targeted sales to Iraq. In each case, the importing country receives no direct benefits; rather the programs benefit U.S. exporters, agricultural trade organizations and, ultimately, U.S. farmers.

The Export Enhancement Program

The Export Enhancement Program was established by the Secretary of Agriculture in May 1985 in reaction to continuing decreases in U.S. agricultural exports. Under the program, government-owned surplus agricultural commodities are made available as bonuses to U.S. exporters to enable them to lower the prices of U.S. agricultural commodities and to make these exporters competitive with subsidized foreign agricultural exports, particularly those subsidized by the European Community. As of August 2, 1990, over $2.8 billion worth of surplus commodities had been made available as bonuses to eligible U.S. exporters for sales to 65 countries. These sales totaled about $10.8 billion.

In fiscal year 1985, wheat and wheat flour were the only agricultural commodities exported under the program. Wheat flour sales to Iraq were first targeted under this program in December 1985, 2 years after Iraq began participating in the GSM-102 program. By combining the two programs, Iraq was able to buy U.S. agricultural commodities at competitive prices on credit. Iraqi initiatives under the Export Enhancement Program expanded to include wheat, poultry, barley, barley malt, dairy cattle, and table eggs. Table III.1 shows the total quantity of U.S. agricultural commodities sold to Iraq under this program since 1985. Since the inception of the program, U.S. exporters had received an estimated $157.2 million in bonuses to facilitate an estimated $509.8 million in agricultural sales to Iraq.

Table III.1: Commodities Sold to Iraq Under Agriculture's Export Enhancement Program (as of August 2, 1990)

Commodity	Date of first initiative	Quantity sold
Wheat flour	December 1985	300.0 TMT
Dairy cattle	April 1986	6,028 HD
Poultry	December 1986	70.0 TMT
Wheat	January 1987	2,486.5 TMT
Table eggs	February 1987	177.9 MIL
Barley	August 1987	250.0 TMT
Barley malt	December 1987	5.0 TMT

Legend

TMT = Thousand metric tons
HD = Head
MIL = Million

Source: Foreign Agricultural Service.

The Targeted Export Assistance and Cooperator Programs

The Targeted Export Assistance Program was mandated by the Food Security Act of 1985. Legislation authorizing the program did not specify how it was to be implemented. The Secretary of Agriculture authorized the Foreign Agricultural Service to administer the program as a foreign market development program, modeled after Agriculture's long-standing Cooperator Market Development Program. Both programs provide funding to conduct activities that promote U.S. agricultural commodities and products overseas. A major difference between the two programs is that participation in the Targeted Export Assistance Program is only available for those commodities that have been adversely affected by foreign unfair trade practices. Program participants include private, nonprofit agricultural trade organizations, state-related organizations, and private, profit-making U.S. firms.

Market development activities targeting Iraq under these two programs began in 1986 and continued through 1990. In total, about $1.9 million was provided to Cooperators to develop agricultural export markets in Iraq during that time: $1.2 million under the Cooperator Program and $0.7 million under the Targeted Export Assistance Program. These funds supported activities such as trade servicing; technical assistance, seminars, and workshops; distribution of newsletters and technical literature; trade missions; trade exhibits; point of sale promotions; and consumer and institutional education. Table III.2 shows a funding breakdown by fiscal year and FAS commodity division.

Table III.2: Market Development Activities in Iraq, Fiscal Years 1986-1990

	Fiscal year				
FAS division	**1986**	**1987**	**1988**	**1989**	**1990**
Forest products					
Cooperator	$30,336	$16,996	$43,949	$0	$9,080
TEA	80,850	67,410	0	0	0
Subtotal	**111,186**	**84,406**	**43,949**	**0**	**9,080**
Grain and feed					
Cooperator	313,217	173,903	113,549	82,919	188,493
TEA	177,616	0	219,364	115,200	960
Subtotal	**490,833**	**173,903**	**332,913**	**198,119**	**189,453**
High value products[a]					
Cooperator	2,612	2,101	3,089	0	0
TEA	0	8,199	0	1,034	0
Subtotal	**2,612**	**10,300**	**3,089**	**1,034**	**0**
Horticultural and tropical products			No activity in Iraq		
Oilseeds and products					
Cooperator	24,387	12,564	19,954	19,770	15,700
TEA	0	0	0	0	0
Subtotal	**24,387**	**12,564**	**19,954**	**19,770**	**15,700**
Tobacco, cotton, and seeds					
Cooperator	5,047	10,150	0	47,500	56,000
TEA	0	610	6,990	0	0
Subtotal	**5,047**	**10,760**	**6,990**	**47,500**	**56,000**
Total					
Cooperator	$375,599	$215,714	$180,541	$150,189	$269,273
TEA	$258,466	$76,219	$226,354	$116,234	$960

Legend

TEA = Targeted Export Assistance

[a]These include semiprocessed products (e.g., flour and meat) and highly processed products (e.g., dairy products and soups).

Source: Foreign Agricultural Service.

The GSM Decision-Making and Risk Analysis Processes

Through the Commodity Credit Corporation, Agriculture's Foreign Agricultural Service manages export credit guarantee programs designed to encourage U.S. agricultural exports. Under these programs, about $5.5 billion in loan guarantees are made available annually to exporters or their assigned financial institutions. These guarantees ensure that the exporters, or their assignees, will be repaid for credit sales made to foreign buyers. As with other guarantee programs, the government incurs no direct costs—except for program administration—unless defaults occur and claims for repayments are made.

FAS chooses for participation in the GSM program those countries that have the potential to purchase U.S. agricultural commodities but cannot make such purchases without credit guarantees. The process of determining program funding levels generally begins in May or June of each year, when specific country and commodity proposals are developed. Part of the process in determining program funding levels is a risk assessment that until recently was mainly qualitative in nature. From this assessment, country profiles are developed that examine a country's economic, financial, and political strengths. Effective for fiscal year 1991 program decisions, FAS began using a new risk assessment procedure that involves more in-depth quantitative analyses.

The GSM Programs

CCC export credit guarantee programs evolved in the 1970s from the need to find export markets for the increasing levels of U.S. farm production. The two current export credit guarantee programs, GSM-102/103, are designed to increase exports of U.S. agricultural commodities by providing credit for those countries in which significant additional demand would exist if credit were available and by allowing U.S. exporters to meet competition from other countries. The GSM-102 program has been in effect since fiscal year 1981, and the GSM-103 program has been in effect since fiscal year 1986. The principal and most significant difference between the two programs is the length of credit terms available. Under GSM-102, CCC guarantees repayment for credit sales of 3 years or less; under GSM-103, CCC's guarantees cover credit sales of more than 3 but less than 10 years. (See table IV.1 for a list of GSM-102/103 credit guarantees approved since 1981.)

Table IV.1: Total Credit Guarantees Approved Under GSM-102 and GSM-103 Programs, Fiscal Years 1981-1990

Dollars in millions

Fiscal year	GSM-102	GSM-103	Total
1981	$2,082.1	$0	**$2,082.1**
1982	1,543.3	0	**1,543.3**
1983	3,709.3	0	**3,709.3**
1984	3,431.2	0	**3,431.2**
1985	2,512.8	0	**2,512.8**
1986	2,522.4	12.7	**2,535.1**
1987	2,622.5	250.4	**2,872.9**
1988	4,141.4	362.9	**4,504.3**
1989	4,769.8	425.5	**5,195.3**
1990	3,957.4	332.1	**4.289.5**
Total	**$31,292.2**	**$1,383.6**	**$32,675.8**

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

The Food Security Act of 1985 required that CCC make available not less than $5 billion in GSM-102 guarantees annually through fiscal year 1990. For GSM-103, the act specified at least $500 million annually through fiscal year 1988 and not more than $1 billion in each of fiscal years 1989 and 1990. Since the programs began, over 40 countries have participated, receiving guarantees for over 20 agricultural commodities.

These credit guarantee programs provide protection to U.S. exporters or their assignees against nonpayment by foreign banks when export sales of U.S. agricultural commodities are made on a deferred basis. Under these programs, the U.S. exporter pays a fee and receives a payment guarantee from CCC. Usually the exporter will assign the proceeds that may become due under the payment guarantee to a U.S. bank (or other financing institution), which extends credit to finance the export sale. The U.S. exporter, U.S. bank, or other financing institution is then protected by CCC's guarantee if the foreign bank does not repay. If the U.S. exporter assigns the proceeds payable under the payment guarantee, the U.S. exporter can usually sell U.S. agricultural commodities to foreign buyers on deferred payment terms and receive payment immediately after export.

CCC attempts to share some of the credit risk with the exporter or the exporter's assignee by only 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. For example, in the past, CCC has guaranteed 100 percent of the value of commodity sales to Mexico.

CCC's contingent liabilities under the GSM programs totaled about $8.9 billion as of September 30, 1990. CCC has paid out about $3 billion in claims since the programs' inception and is at risk for an additional $2 billion not being serviced by Iraq (see table IV.2).

Table IV.2: CCC's Contingent Liability Under the GSM-102/103 Programs for Iraq

Fiscal year	Contingent liability
1990	$154,336,744
1991	930,144,855
1992	622,021,012
1993	287,593,955
1994	6,971,205
1995	3,817,090
1996	3,593,898
1997	121,227
Total	**$2,008,599,986**

Source: U.S. Department of Agriculture's Foreign Agricultural Service, Financial Management Division.

How GSM Program Decisions Are Made

Each year, FAS identifies a number of countries to be potential participants in the GSM programs. GSM participant countries are those which have potential for making additional agricultural commodity purchases but cannot make such purchases without credit and loan guarantees. According to FAS, determining which countries participate involves evaluating long-term agricultural product needs, interest in the program, market development opportunity for U.S. agricultural commodities, and ability to repay. Since the program began, Mexico, South Korea, and Iraq have received the largest loan guarantees of all countries participating. Because the programs also provide economic benefit to foreign governments, their use can be influenced by U.S. foreign policy considerations.

Program development consists of a three-stage process: identification of the marketing opportunity, analysis of the financial risk, and negotiation and announcement of the program terms and conditions. Generally, this process begins in May or June of each year when FAS commodity divisions develop specific country and commodity proposals to use export credit guarantee coverage to support exports to targeted countries.

Country Credit Risk Analysis

Several Agriculture offices are involved in making GSM program decisions, but a key component in this process is the credit risk analysis that FAS' Trade and Economic Information Division prepares. From the early 1980s through fiscal year 1990, this division prepared country profiles for FAS that were mainly qualitative in nature, analyzing a country's economic, financial, and political strengths. A former FAS official noted that during this time, there were no well-established procedures for including countries in the GSM program. In Iraq's case, market development potential was the number one factor in determining its program funding level. Other FAS officials have confirmed that during the 1980s, the guarantee programs were driven more by market development potential than by credit risk concerns.

The Director of the Trade and Economic Information Division told us that in 1989 Agriculture concluded that its credit risk analysis procedures did not provide the information necessary to make informed decisions. He noted that there was a belief that the analysis allowed for too much subjectivity. A decision was made to develop a more objective procedure, to base it on common commercial practices, and to build in more quantitative analysis.

To put more emphasis on evaluating financial risk, the division began developing new credit risk analysis procedures in January 1990 and started using them in May 1990 for fiscal year 1991 GSM decisions. In developing these new procedures, the division drew upon resources and examples from many organizations, including the International Monetary Fund, the World Bank, the Organization for Economic Cooperation and Development, and the Export-Import Bank. The division director told us that the need for new procedures stemmed from the previous model's inability to predict the future.

The new procedures should provide in-depth financial risk analysis and, as such, will have more influence than before over market development decisions. While these new procedures are more structured and contain more in-depth quantitative analyses, the division has not tested the procedures to determine their reliability or predictive capability. However, the division has compared its results with those of the Export-Import Bank's (also untested) and found them to be similar. According to one program official, the new risk assessment procedures represent a yearlong effort to make explicit the tradeoff between credit risk and market development.

The new risk analysis uses three elements to determine overall credit risk: (1) a country risk letter grade based upon the country's willingness and ability to service its foreign debt in a timely manner; (2) a country profile, which analyzes economic, financial, political, and social conditions within a structured and qualitative framework; and (3) an annual credit exposure guideline, which provides a means of limiting risk based on current economic, financial, and political conditions.

As of September 1990, 45 countries had been assessed under the new procedures for fiscal year 1991. Using the risk analysis procedure, Agriculture decided that some countries should be moved into concessional programs[1] rather than commercial credit programs. Although a risk analysis was not completed on Iraq before it invaded Kuwait, the preliminary recommendation from the Trade and Economic Information Division was to limit CCC's exposure by providing no more than $200 million to Iraq for fiscal year 1991. This sharp decline in the recommended allocation level of $1 billion in the previous year was based on a deterioration in diplomatic relations between Iraq and western countries. The decrease was also due to Iraq's continuing history of payment delays to some creditors and to its refusal to negotiate with the International Monetary Fund.

The division also recommended that any allocation to Iraq be contingent on (1) a satisfactory resolution to Justice's BNL investigation and Agriculture's Office of the Inspector General review and (2) indications from Iraq that it intends to pay its arrearages with the U.S. Export-Import Bank.

[1]Concessional programs are those government programs that provide the foreign buyer with credit terms which are more favorable than those obtained in the commercial market. An example of such a program is the Public Law 480 (Food for Peace) Program.

The Interagency Process for Discussing U.S. Loan Guarantees

The National Advisory Council on International Monetary and Financial Policies 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, the NAC ensures, when possible, that the actions of international financial institutions are consistent with U.S. policies and goals. The NAC allows member and interested agencies to meet, consider issues of financial importance to the United States, and present all of the facts available about the risks of a financial decision.

NAC membership principally 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. Also, at the assistant secretary level, there is a Committee of Alternates in the NAC authorized to act for their principals. These alternates represent each of the agencies listed above.

A Staff Committee handles routine NAC business. The Staff Committee is composed of economists and other professionals from the NAC member agencies and occasionally from other agencies such as the Departments of Agriculture and Defense or the Office of Management and Budget. The Staff Committee meets on a weekly basis as necessary. It determines what positions to take or recommendations to make by polling representatives after discussions. If immediate action is necessary, then these polls can take place by telephone. The assumption is, regardless of the procedure employed to take the poll, that representatives cast their votes for their principals, thereby ensuring high-level attention to policy issues and proposals. A majority vote determines NAC positions. However, the Council seeks unanimity of views among its members.

Agriculture submits all GSM-102/103 proposals to the NAC for review. After Agriculture has conducted a risk analysis on the country in question, it forwards a proposal to the NAC. During the NAC session, the members discuss proposals from each of their perspectives, including issues such as foreign policy, financial risk, and trade considerations. The NAC votes on the proposal, with each member's vote recorded on a poll sheet. An official NAC recommendation must carry a majority vote. The NAC makes recommendations that are only advisory in nature. Agriculture does not have to abide by a NAC recommendation. The NAC sends its recommendation, in the form of an "Action Notice," back to Agriculture, which has the option of following or ignoring it. However, Agriculture does not typically challenge NAC recommendations unless Treasury or State are not in the majority. In those cases, Agriculture reassesses the proposal before making its decision.

The Banca Nazionale Del Lavoro and Related Investigations

In September 1989, suggestions of improprieties connected with the GSM-102 program surfaced as a result of a Department of Justice investigation of the Banca Nazionale del Lavoro's making $2 billion in unauthorized and unreported loans to Iraq. Agriculture learned that approximately $750 million of the unauthorized loans to Iraq were guaranteed under its GSM-102 program. Questions raised about possible program irregularities led Agriculture to initiate an administrative review of the guaranteed loans in BNL's portfolio. At the conclusion of the administrative review in May 1990, certain information was turned over to Agriculture's Office of the Inspector General for a more thorough analysis of all GSM sales to Iraq, in order to ascertain the full extent of program irregularities.

The Banca Nazionale Del Lavoro Investigation

In August 1989, the Office of the U.S. Attorney for the Northern District of Georgia was notified that officials at the Atlanta branch of the Banca Nazionale del Lavoro had been keeping a second set of books and had advanced more than $2 billion in unauthorized and unreported loans to Iraq. This discovery led to the initiation of a grand jury investigation by the Office of the U.S. Attorney, U.S. Department of Justice. The investigation focused on bank fraud and evasion of bank regulatory requirements by officials of the Atlanta branch of BNL, a bank largely owned by the Italian government.

Agriculture's Office of the Inspector General joined the investigative team in early September 1989 when Agriculture learned that approximately $750 million of these loans were guaranteed by CCC under its GSM program. Agriculture officials were told that evidence had been uncovered of possible kickbacks, questionable consultant payments, possible transshipped or bartered commodities, high prices, shipment of non-U.S. goods, and other program irregularities. At that time there was no hard evidence of improprieties in the GSM program or wrongdoing by the government of Iraq. Instead, possible misuse was hypothesized based on evidence of apparent wrongdoing uncovered in non-CCC loan transactions. Specifics of the theories being pursued, identity of individual targets, and evidence of any involvement by the government of Iraq are protected by the rules of grand jury secrecy and therefore are not available to Agriculture. Agriculture later decided to launch its own review under its own regulatory authority.

Administrative Review of the GSM-102 Program for Iraq

In October 1989, Agriculture staff from the Foreign Agricultural Service and the Office of the General Counsel went to Atlanta to meet with the Assistant U.S. Attorney in charge of the investigation and two Agriculture Office of the Inspector General staff members assigned to the case. They discussed the Justice investigation's preliminary findings and the findings' possible relevance to the CCC-guaranteed transactions.

The administrative review continued for 7 months and involved the examination of GSM files pertaining to sales to Iraq, associated letters of credit, exporter records, and discussions with bank examiners, Office of the Inspector General investigators, and exporters. It focused on four potential problem areas—unusually high prices negotiated in GSM sales to Iraq, Iraqi attempts to impose certain taxes on GSM transactions, questions regarding the arrival of GSM commodities in Iraq, and Iraqi requests for "after sales services."[1]

In January 1990, Agriculture reported to the NAC that its administrative review had revealed a pattern of unusually high pricing for certain commodities sold to Iraq under the GSM program during 1985-1987. Agriculture stated that further review was needed before it could recommend to the NAC any further allocation of fiscal year 1990 guarantees for Iraq. In April 1990, a team of representatives of the Commodity Credit Corporation, the Foreign Agricultural Service, the Office of the General Counsel, and the Department of State traveled to Baghdad to review relevant documents and to interview Iraqi officials involved in the transactions.

In May 1990, Agriculture released the results to date of the administrative review. The review uncovered no evidence of diversion of commodities sold to Iraq. The fact that bank and exporter files lacked proof of arrival appeared to be linked to the complexity of overland shipment necessitated by the closing of Iraq's Basra port during the Iran-Iraq war. In addition, the review found that Iraq had requested some exporters to pay a domestic Iraqi "stamp tax" in connection with GSM transactions. After discussions with Agriculture officials, Iraq changed its policy and began to exempt GSM transactions from paying the tax.

The review identified two key areas for further review—the extent and reason for high pricing in certain GSM transactions, and the extent to

[1]The issue of after sales services arose independent of the BNL investigation after one exporter complained about requests from Iraq for free, nonagricultural products (e.g., free truck parts, tires, and air conditioning equipment) in connection with GSM sales, and the use of a certain carrier for GSM shipments.

which after sales services were provided and port values properly reported in connection with GSM guaranteed sales. Agriculture turned over to its Office of the Inspector General information it had developed thus far and asked it to conduct a more thorough investigation of all GSM sales to Iraq.[2]

[2]The administrative review was not a comprehensive analysis of all GSM transactions with Iraq but rather an examination of a limited number of transactions and issues that were identified as a result of the BNL investigation.

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