

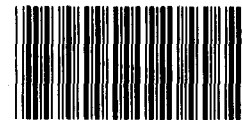
GAO

Report to the Chairman,
Subcommittee on Defense,
Committee on Appropriations,
U.S. Senate

September 1991

THE U.S. EXPORT- IMPORT BANK

No Evidence of Financing Restricted Chemical Exports to Iraq



144935

**National Security and
International Affairs Division**

B-245009

September 30, 1991

The Honorable Daniel K. Inouye
Chairman, Subcommittee on Defense
Committee on Appropriations
United States Senate

Dear Mr. Chairman:

As you requested, we have reviewed U.S. Export-Import Bank (Eximbank) transactions involving chemicals exported to Iraq from January 1987 to August 1990. Specifically, we examined (1) whether there was any evidence that the Eximbank financed the export of dual-use chemicals to Iraq and (2) what the Eximbank's role was in monitoring and controlling chemical exports.

Our results are based primarily on a review of documents provided to us by the Eximbank. We did not verify the Eximbank data or corroborate it with the records of the banks or exporters involved in the transactions.

Results in Brief

There was no evidence in the documents we reviewed to suggest that the Eximbank financed the export of dual-use chemicals (chemicals with both commercial and military applications that could be used for chemical weapons)—as defined by the Department of Commerce—to Iraq between January 1987 and August 1990. There were approximately 190 transactions between Iraq and the Eximbank during this period. We focused our review on the eight transactions involving pesticides.¹

The Eximbank has no responsibility or authority for monitoring or controlling the export of chemicals or any other commodities: the Departments of Commerce and State and the U.S. Customs Service share those responsibilities.² Nevertheless, the Eximbank has recently developed specific procedures to review applications for financing chemical exports. However, such procedures were not in place when the Eximbank approved the applications for seven of eight pesticide transactions that occurred between January 1987 and August 1990.

¹We use the term "pesticide" to include related products, such as insecticides and herbicides.

²See Export Controls: U.S. Controls on Trade With Selected Middle Eastern Countries (GAO/NSIAD-91-193FS, Apr. 12, 1991).

Background

The Eximbank made available short-term financing programs to Iraq in 1984 just prior to the resumption of diplomatic relations between the United States and Iraq. (See app. I for a chronology of the Eximbank's relationship with Iraq.) Based on its evaluations of Iraq's creditworthiness, the Eximbank decided to restrict its financing to short-term insurance coverage (up to 360 days) through its insurance agent, the Foreign Credit Insurance Association (FCIA). In 1987, the Eximbank decided to limit FCIA coverage for Iraq to \$200 million a year. The Eximbank consistently provided only short-term insurance for Iraq despite public and private sector pressure to expand to medium-term financing. After media reports in September 1988 that the Iraqi government used chemical weapons on its Kurdish population, the Eximbank began a review of its Iraqi transactions. The Eximbank officially closed its FCIA coverage to Iraq 1 week after Iraq invaded Kuwait on August 2, 1990.

There Is No Evidence That the Eximbank Financed Exports of Dual-Use Chemicals to Iraq

In our review at the Eximbank, we found no evidence that the Eximbank financed the export of dual-use chemicals to Iraq. We also found that the Eximbank had conducted a review of all its Iraqi transactions since 1987. The Eximbank review focused on transactions involving pesticides because Eximbank officials believed pesticides were most likely to have potential dual-use chemical applications. Of the approximately 190 transactions between the Eximbank and Iraq since 1987, the Eximbank identified 8 that involved pesticides. The Eximbank's Engineering Division evaluated the eight pesticides for potential dual use by obtaining and analyzing product information on each of the pesticides and consulting chemistry literature and officials at other agencies. The Engineering Division concluded in June 1990 that it was "unlikely" that any of the eight pesticides could have been used to produce chemical weapons.

The Department of Commerce has established foreign policy export controls for chemical weapons precursors. Commerce has adopted worldwide export controls on a list of 50 dual-use chemicals identified as precursors by the Australia Group,³ which seeks to control the proliferation of chemical weapons. The Department of Commerce requires a validated license to export these chemicals to all countries that are not members of the Australia Group. Commerce's general policy is to deny

³Member countries of the Australia Group include Australia, Austria, Belgium, Canada, Denmark, Germany, France, Greece, Iceland, Ireland, Italy, Japan, Luxembourg, the Netherlands, New Zealand, Norway, Portugal, Spain, Switzerland, Turkey, the United Kingdom, and the United States.

applications to export or reexport chemicals controlled under this list to Iran, Iraq, Libya, and Syria.⁴

We found that none of the eight Eximbank-financed pesticides exported to Iraq is considered to be a chemical weapons precursor, based on our review of Commerce's restricted export list of 50 dual-use chemicals. Most of the eight pesticides the Engineering Division analyzed are used in the United States for pest control, and some are even available in local garden stores. Although some of the eight pesticides could, technically, be altered to develop dual-use chemicals, doing so would be a complicated, costly, and time-consuming process, according to the Engineering Division.

The Eximbank Has No Responsibility or Authority for Export Controls

The Eximbank has no official role in controlling or monitoring exports—those responsibilities fall to the U.S. Customs Service and the Departments of Commerce and State. Consequently, the Eximbank has no formal written policy for monitoring or controlling exports. However, the Eximbank has recently developed procedures for reviewing applications for financing chemical exports.

For applications for short- and medium-term loans, guarantees, and insurance, Eximbank loan officers decide which cases the Engineering Division should review on a case-by-case basis. All applications for long-term loans and guarantees are automatically reviewed by the Engineering Division. The Engineering Division reviews product information and sometimes consults with other agencies (such as the Department of Commerce and the U.S. Customs Service) in evaluating the chemical in question. The review includes determining if the chemical is on the list of chemical weapons precursors that the Department of Commerce compiles. The Engineering Division began using the list as a reference in October 1990. If the chemical under review appears on the list, the loan, guarantee, or insurance application would be denied, according to Eximbank officials.

Scope and Methodology

We reviewed records for all of the approximately 190 transactions between the Eximbank and Iraq that occurred from January 1987 to August 1990, focusing on transactions involving chemical exports. We also interviewed Eximbank officials and examined Eximbank documents

⁴See GAO's September 1991 report on chemical weapons, Arms Control: U.S. and International Efforts to Ban Chemical Weapons (GAO/NSIAD-91-317).

and information on the exporters, importers, and insured parties (such as banks) involved in the transactions. We analyzed information on the eight pesticides to determine their use, handling precautions, and toxicity based on the product information the Eximbank obtained during its review. In addition, we compared the chemicals contained in the 8 pesticides to chemicals on the Commerce Department's list of 50 chemical weapons precursors. We did not verify Eximbank data or corroborate it with the records of the banks or exporters involved in the transactions.

Eximbank officials reviewed a draft of this report and commented that the Eximbank processes all transactions, including the export of chemicals, in accordance with the Eximbank's military sales policy. We are aware of the Eximbank's policy on military sales.⁵ The Eximbank is prohibited by law from financing the export of defense articles to less developed countries and by policy has chosen not to finance their export to any country. Under this policy, the Eximbank reviews applications involving items with a possible military use prior to authorizing financing. However, as noted above, the Eximbank did not conduct such a review of seven of the eight pesticide applications prior to their approval. Further, at the time of the approval of all but one of the applications, the Eximbank had no specific procedures for reviewing applications for financing chemical exports.

We conducted our review between March 1991 and June 1991 in accordance with generally accepted government auditing standards.

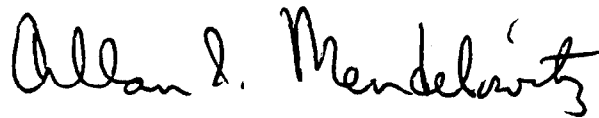
Appendix I contains a chronology of the Eximbank's relationship with Iraq since 1980.

We are sending copies of this report to the Chairman of the Subcommittee on Defense, House Committee on Appropriations; the Chairwoman of the Subcommittee on International Development, Finance, Trade and Monetary Policy, House Committee on Banking, Finance and Urban Affairs; the Chairman of the Subcommittee on International Finance and Monetary Policy, Senate Committee on Banking, Housing, and Urban Affairs; and other interested parties. Copies will also be made available to others on request.

⁵In May 1991, GAO testified on the Eximbank's role in financing military exports. See The U.S. Export-Import Bank: Review of a Proposal to Finance Military Exports (GAO/T-NSIAD-91-16).

Please contact me on (202) 275-4812 if you or your staff have any questions concerning this report. Major contributors to this report were John E. Watson, Assistant Director; Susanne E. Wood, Evaluator-in-Charge; Debra L. Logan, Evaluator; and Samuel L. Hinojosa, Evaluator.

Sincerely yours,



Allan I. Mendelowitz, Director
International Trade, Energy,
and Finance Issues

Chronology of the U.S. Export-Import Bank's Relationship With Iraq

September 1980	Iraq invades Iran.
February 1984	The U.S. Export-Import Bank (Eximbank) begins providing short-term insurance coverage in Iraq on a case-by-case basis.
November 1984	The United States restores diplomatic relations with Iraq.
March 1986	The Eximbank suspends insurance coverage in Iraq because Iraq's payments to the Eximbank are in arrears.
February 1987	Iraq's payments to the Eximbank become current.
March 1987	Iraq again falls into arrears.
April 1987	Iraq becomes current on its payments to the Eximbank.
May 1987	The Eximbank resumes coverage in Iraq with two provisions: (1) a limit of \$200 million a year in short-term insurance coverage and (2) the Central Bank of Iraq as the sole guarantor. In late May, Eximbank coverage is suspended because of the Iraqi missile attack on the U.S.S. <u>Stark</u> .
July 1987	The Eximbank resumes insurance coverage in Iraq.
September 1988	After reports that Iraq used chemical weapons on its Kurdish population, the Eximbank begins a review (completed in June 1990) of all of its Iraqi pesticide transactions since 1987.
February 1989	At a meeting with State Department and Eximbank officials, the U.S. Ambassador to Iraq encourages the Eximbank to begin extending medium- and long-term credit to Iraq. However, the Eximbank continues its short-term-only insurance policy toward Iraq.
September 1989	The Eximbank suspends insurance coverage in Iraq because payments are in arrears.
December 1989	Congress passes legislation prohibiting Eximbank programs for Iraq.
February 1990	The President waives the December 1989 legislative prohibition on Eximbank programs for Iraq. However, the Eximbank continues its suspension of insurance coverage because of existing Iraqi payment arrearages.
March 1990	The Eximbank lifts the suspension of its short-term insurance program after Iraq's payments become current.
June 1990	The Eximbank completes its review of its Iraqi pesticide transactions. The Eximbank's Engineering Division determines that it was "unlikely" that any of the eight reviewed pesticides "could be used in the production of chemical weapons."
August 1990	Iraq invades Kuwait on August 2. The Eximbank suspends short-term insurance coverage for Iraq. On August 9, the Eximbank's Board of Directors formally suspends coverage for Iraq.

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