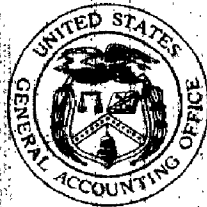


October 1993

AGRICULTURAL LOAN GUARANTEES

National Advisory Council's Critical Views on Loans to Iraq Withheld



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General Accounting Office
Washington, D.C. 20548

General Government Division

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October 27, 1993

The Honorable Patrick J. Leahy
Chairman, Committee on Agriculture, Nutrition, and
Forestry
United States Senate

The Honorable Henry B. Gonzalez
Chairman, Committee on Banking, Finance and Urban Affairs
House of Representatives

The Honorable Charles E. Schumer
Chairman, Subcommittee on Crime and Criminal Justice
Committee on the Judiciary
House of Representatives

The Honorable Charlie Rose
House of Representatives

As requested, we examined how the National Advisory Council on International Monetary and Financial Policies (NAC) advised the U.S. Department of Agriculture (USDA) on its agricultural export credit guarantee programs to Iraq, particularly regarding the issue of country risk.¹ The case of USDA credit guarantee proposals for Iraq reveals that misconceptions exist among NAC member and participating agencies about the role and responsibilities of NAC.² In this report, we discuss both the history and the process that enabled NAC members to approve over \$6 billion in USDA loan and credit guarantee proposals for Iraq despite Iraq's poor creditworthiness.

Specifically, we reviewed (1) the major issues debated in NAC regarding USDA's agricultural loan and credit guarantee proposals for Iraq, (2) the mechanism NAC used to determine a position on USDA's proposals, (3) the way in which the NAC voting and approval process affected the outcome of NAC positions, and (4) the changing role and responsibilities of NAC since its inception in 1945.

¹"Country risk" is the risk that adverse economic, social, or political circumstances may prevent foreign borrowers from making timely and complete repayment; country risk assessments evaluate the "creditworthiness" of the borrower.

²NAC membership consists of the Secretaries of the Treasury (who also serves as the Chair), State, and Commerce; the U.S. Trade Representative; the Chair of the Board of Governors of the Federal Reserve System (Fed); the President and Chair of the Board of Directors of the U.S. Export-Import Bank (Eximbank); and the Director of the International Development Cooperation Agency.

Results in Brief

NAC debate about USDA proposals of agricultural credit guarantees to Iraq focused upon three issues: (1) USDA market development goals in Iraq, (2) U.S. foreign policy toward Iraq, and (3) the creditworthiness of Iraq. From fiscal years 1987 to 1989, NAC support for USDA's market development objectives—bolstered by Bush administration foreign policy goals—outweighed certain NAC members' concerns about Iraq's creditworthiness. In fiscal year 1990, on the basis of White House foreign policy goals, NAC approved further credit guarantees for Iraq despite certain members' strengthened objections. These objections were based upon Iraq's poor creditworthiness and were further reinforced by then-current allegations of impropriety in the Iraq export credit guarantee program.

NAC approvals, or "positions," are determined by a simple majority vote of its seven members. NAC members with primary responsibility for monetary and financial matters (i.e., the Department of the Treasury, the Eximbank, and the Fed), however, make up a minority in NAC. In the case of Iraq, although at least two of these members consistently opposed increased levels of credit guarantees, the remaining NAC members approved USDA's proposals for Iraq—based on the majority vote. Therefore, NAC formally advised USDA that it offered no objection to USDA's proposals.

While individual NAC members' views on Iraq diverged, the NAC approval process and the final NAC letter of approval did not reveal the concerns of certain members. First, certain members refrained from expressing their full views on Iraq's creditworthiness in order to avoid opposing USDA's proposals for Iraq. Second, high-level (deputy-secretary) meetings on Iraq revealed that other NAC members disagreed on whether creditworthiness should be a consideration for NAC approval. Lastly, USDA represented NAC approvals as an endorsement by NAC members of the financial aspects of USDA's decisions to extend credit guarantees to Iraq, even though NAC minutes reflected clearly articulated creditworthiness objections to these approvals.

The role and responsibilities of NAC have diminished since its inception following the 1945 Bretton Woods Agreements Act. Although NAC was initially empowered with the authority to direct U.S. participation in international financial institutions, successive actions by Congress and the President removed this power in 1965. In the case of USDA proposals for Iraq, NAC provided nonbinding advice to USDA; USDA used this information in its decision-making processes. Following the case of Iraq, however, the Bush administration changed this procedure and announced the extension

of agricultural export credit guarantees to the former Soviet Union before USDA presented this program for NAC review.

Background

The USDA's agricultural export loan and credit guarantee programs are administered by the General Sales Manager (GSM) of the USDA's Foreign Agricultural Service (FAS), under the auspices of the Commodity Credit Corporation (CCC). The CCC's principal export credit guarantee program provides 1- to 3-year export credit guarantees and is referred to as the "GSM-102" program. From the inception of the GSM-102 program in 1981 through June 30, 1992, USDA provided a total of about \$40.9 billion in export credit guarantees to more than 40 countries. USDA also provides some longer-term export credit guarantees under the Intermediate Export Credit Guarantee Program (GSM-103). Until 1985, USDA also extended direct credit sales under its GSM-5 and blended credit programs. (See app. I for further details on these programs.)

Congress created NAC under the Bretton Woods Agreements Act 1945 to coordinate the policies and operations of U.S. government agencies that participate in foreign financial transactions and to provide guidance to U.S. representatives to international organizations. Since then, both legislation and executive orders have altered significant portions of NAC responsibilities.³ Currently, NAC responsibilities include (1) convening member and interested agencies weekly, or as needed, to provide each member's respective expertise upon an agency's international finance proposal; and (2) providing both Congress and the President with an annual report of U.S. participation in international financial organizations. NAC operations are coordinated by the Secretary of NAC (a position filled by the Department of the Treasury) and are conducted by Staff Committee representatives.⁴ NAC member agencies' representatives cast their votes on behalf of their principals to ensure that appropriate high-level attention is focused on the particular policy issues or proposals. (See app. II for additional information on NAC.)

³Reorganization Plan Number 4 of 1965 transferred NAC functions to the President. By the following year, Executive Orders Number 11238 and 11269 reestablished NAC, but transferred the power to approve, consent, or agree to acts done by international financial organizations to the Secretary of the Treasury. Subsequent legislation has amended NAC's annual reporting responsibilities.

⁴The daily work of NAC is handled by the NAC Staff Committee composed of economists and other professionals from the NAC member agencies. On an ad hoc basis, when the Staff Committee is unable to agree, a member agency may request a meeting of NAC Alternates, composed of representatives of the member agencies at the assistant secretary level. However, in the case of Iraq, deputy secretaries acted as agency representatives when the first NAC Alternates meeting was called.

During the 1980s, Iraq rapidly became the second largest participant in USDA's export credit guarantee programs (Mexico is the largest). In those years, annual USDA credit allocations (GSM-102/103) to Iraq increased from \$402 million in fiscal year 1983 to nearly \$1.1 billion in fiscal year 1989 (a 174-percent increase). NAC approved approximately \$5.45 billion in USDA loan and credit guarantee proposals for Iraq during this time. However, by 1989, due to Iraq's defaults on its international financial obligations, few official export credit agencies other than CCC continued to extend new credit to Iraq.⁵ Iraq used such defaults as a deliberate strategy in managing its international debt. (For information regarding Iraq's participation in CCC programs, see app. III.)

As required by law, USDA informs NAC of its proposed international financial transactions. In addition, USDA sought the NAC review of its proposals for interagency consultation with respect to several policy criteria, including a country's creditworthiness. (See app. IV for information on country risk analyses of Iraq.) While NAC majority decisions are not binding, USDA obtained NAC approvals before issuing direct credits and credit guarantees. For example, after proposing \$1 billion in fiscal year 1990 credit guarantees for Iraq, USDA awaited a NAC determination when debate over fraud allegations, involving a CCC-participating bank and Iraqi officials, prolonged NAC deliberations. (See app. V for information on the Banca Nazionale del Lavoro (BNL) affair.) Lastly, according to a USDA official, if key NAC members, such as the Departments of the Treasury or State, are opposed to a proposal, USDA would not go forward with it.

Scope and Methodology

The scope of our work involved an examination of the reasoning and method whereby NAC member agencies approved USDA export credit guarantee proposals for Iraq for fiscal years 1983 through 1990. Our work also included a review of the NAC role and responsibilities as they evolved since NAC's inception in 1945.

In order to identify the major issues debated in NAC and assess the NAC mechanism used to approve USDA loan and credit guarantee proposals for Iraq, we reviewed all NAC minutes and related NAC documents concerning this topic dating from December 1982 to February 1990. We then compared the information derived from the NAC records with relevant agency documents of NAC members and USDA. Furthermore, we compared

⁵Creditworthiness assessments are based upon a borrower's ability and willingness to repay its debt; according to internal Eximbank assessments, Iraq may have had the ability to repay, but demonstrated a clear unwillingness to adopt normal debtor-creditor relations, using the threat of default on existing loans to obtain new and increasing amounts of credit.

the country risk analyses of the Eximbank and USDA. Finally, we reviewed the legislative and executive history of the NAC charter leading up to the case of Iraq.

We interviewed officials from USDA; the Departments of State, the Treasury, and Commerce; and officials from the Eximbank. We also interviewed officials of the French and Italian export credit agencies that provided guaranteed credit to Iraq. In order to identify the final disposition of the USDA program in Iraq, we gathered information about National Security Council (NSC) proceedings in May of 1990 from interviews, documents, and notes obtained from other agencies. These items provided only general information regarding those meetings.

On May 29, 1992, we testified before the House Committee on Banking, Finance and Urban Affairs that our work had been delayed significantly due to the reluctance of government agencies to provide us with timely and complete access to documents.⁶ In June 1992, the necessary NAC documents began to be released.

We did our work from November 1991 to March 1993 in accordance with generally accepted government auditing standards.

Market Development and Foreign Policy Objectives Outweighed Concerns About Iraq's Declining Creditworthiness

Beginning in December 1982, USDA presented NAC with proposals for federally supported export credit for Iraq to promote U.S. agricultural exports. Except for 1 year, USDA proposed annual increases of credit assistance to Iraq from fiscal year 1983 to fiscal year 1988. In January 1983 correspondence with NAC, USDA explained that the agency anticipated that Iraq's demand for agricultural imports would grow. However, because of Iraq's credit problems, increasing U.S. agricultural exports to Iraq would require federally assisted credits. USDA's analysis of Iraq's creditworthiness concluded that GSM program allocations could offer a means to increase U.S. market share in Iraq for certain commodities with moderate risk.⁷ Following the initial extension of GSM credits, the United States removed Iraq from the official list of terrorist countries, reestablished diplomatic

⁶For further information regarding this testimony, see *Agriculture's Export Credit Programs: Delays in Accessing Records Relating to Iraq* (GAO/T-GGD-92-47, May 29, 1992).

⁷The total amount of loan guarantee exposure is controlled through an annual allocation process in which limits are set for specific agricultural commodities and countries. Allocations are based on an individual country's agricultural needs, its market development potential for U.S. commodities, and the ability and likelihood of the country's financial sector repaying the guaranteed loans. An implicit consideration in the allocation process is whether other countries are also providing agricultural credits; the United States often allocates credit guarantees in order to maintain market share if credit guarantees are offered by other countries.

relations with Iraq, and sought nonmilitary ways to assist Iraq during its war with Iran.

For fiscal years 1983 to 1986, NAC unanimously supported most USDA credit guarantee proposals designed to increase the U.S. agricultural export market in Iraq. During that time, NAC members reviewed and approved 22 proposals. Certain members opposed three USDA proposals based upon conflicts with international trade agreements, effects upon U.S. trade relations with certain other countries, and Iraq's poor creditworthiness. However, in February 1985, the Treasury Department specified growing concerns about Iraq's financial prospects in agency correspondence to the Secretary of Agriculture. Treasury advised USDA to cease further increases in CCC credits to Iraq in fiscal year 1985. The following fiscal year, USDA accepted the Treasury representative's recommended limit of \$500 million on total fiscal year credit guarantees to Iraq. For fiscal years 1986 and 1987, NAC unanimously approved USDA's forecasted credit guarantee proposals of \$500 million for Iraq.⁸

However, in January 1987, despite significant NAC member opposition (three against, four in favor), USDA increased fiscal year credit guarantees for Iraq to \$700 million. Three members with primary responsibility in financial matters—the Treasury, Eximbank, and the Fed—opposed increases in USDA's annual credit extensions to Iraq. In an August 1987 letter to NAC, the Director of the Program Development Division of USDA's FAS emphasized USDA's market development goals, saying

USDA has reviewed Iraq's financial situation and is aware that there is a risk of nonpayment ...Because of the importance of Iraq as a United States market for agricultural commodities, we are willing to accept that risk. [Emphasis added.]

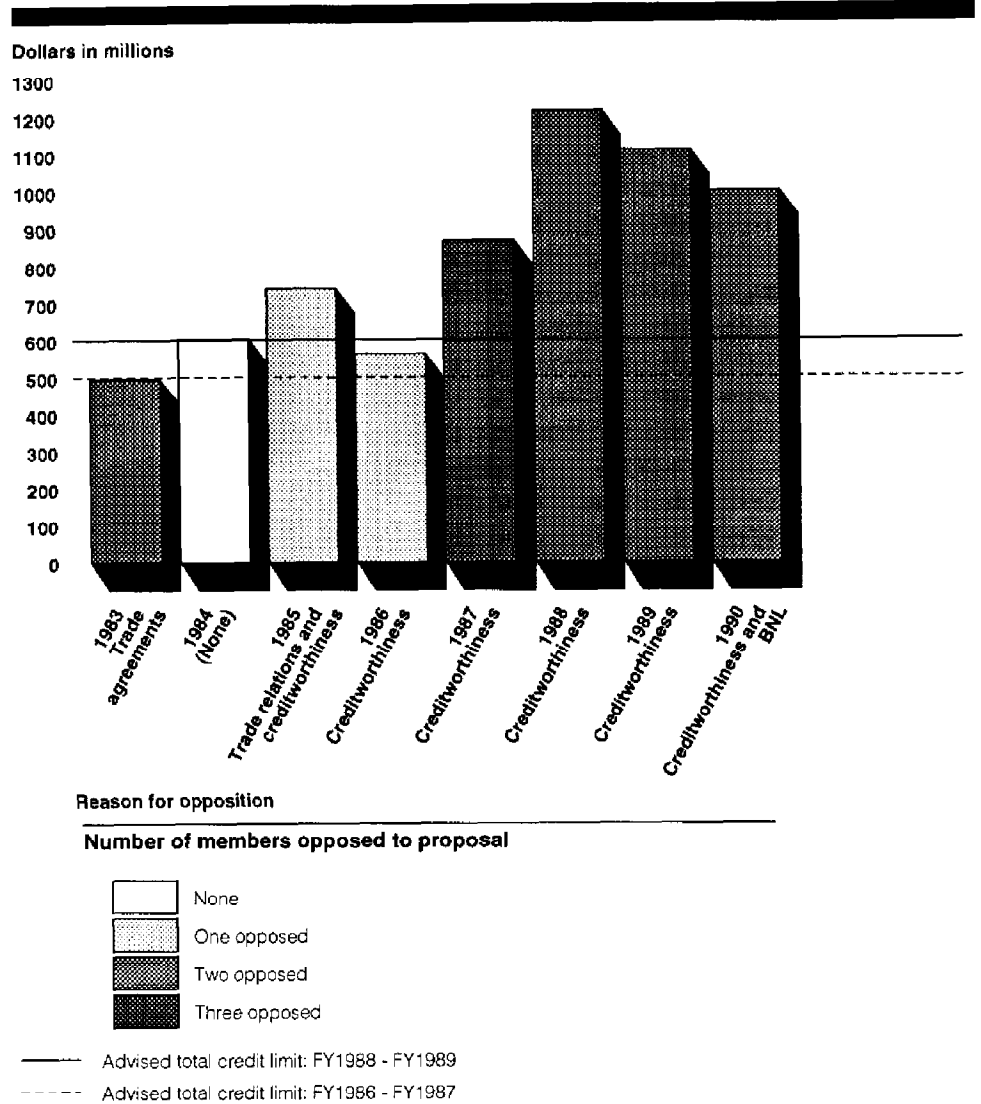
Figure 1 shows total USDA fiscal year proposals for Iraq between 1983 and 1990 relative to credit limits (credit exposure) advised by certain NAC members.⁹ For fiscal years 1986 and 1987, the three NAC members with primary responsibility in financial matters advised USDA to limit total fiscal year credit guarantees to \$500 million; for fiscal years 1988 and 1989, the

⁸In May 1986, Eximbank opposed a direct credit sale proposal (GSM-5) for Iraq, stating that Iraq was not creditworthy.

⁹"Credit exposure" is the cumulative amount owed to the creditor. According to CCC, as of August 1, 1990, USDA's credit exposure to Iraq was about \$1.9 billion. This figure is based upon estimates of Iraqi payments compiled by CCC, since CCC does not derive payment data from actual receipts of the banks themselves.

Treasury and Fed continued to advise a limit of \$600 million.¹⁰ When USDA's program proposals exceeded advised limits, these NAC members opposed USDA's proposals on creditworthiness grounds. However, a simple majority of NAC members approved these proposals, and USDA continued to implement the Iraq program.

Figure 1: USDA's Cumulative Fiscal Year Credit Proposals for Iraq, and NAC Member Opposition, 1983-90



¹⁰In fiscal year 1988, Eximbank reversed its opposition to USDA export credit guarantees to Iraq. This change is discussed later.

NAC Members' Views on Iraq's Creditworthiness

NAC members who opposed USDA's proposals on creditworthiness grounds focused their concern upon Iraq's unwillingness to responsibly repay its debts to other creditors. For fiscal years 1988 and 1989, USDA proposed GSM programs for Iraq in excess of \$1 billion each year, arguing that Iraq would repay the loans because it was current on its payment obligations to CCC. In addition, U.S. foreign policy interests supported credit guarantee proposals for Iraq at about \$1.1 billion for these years.

However, while Iraq was repaying CCC-guaranteed debt, this fact did not mean that Iraq was creditworthy. NAC members with primary responsibility in financial matters concluded that Iraq was not able to meet its outstanding international debt obligations with other countries. Eximbank country risk assessments observed that Iraq's debt payment problems with official creditors had begun as early as 1983. CCC's experience with Iraq merely reflected one aspect of Iraq's overall debt-management strategy. By July 1988, Eximbank concluded that Iraq was pursuing a deliberate debt-management strategy composed of two parts. For those creditors willing to provide new loans in excess of those falling due, Iraq was continuing to meet its outstanding debt obligations. However, for those creditors who would not extend new credit to Iraq, Iraq ceased servicing existing debt.

NAC member agencies with primary responsibility in financial matters determined that Iraq used these defaults as part of a deliberate effort to pressure creditors into granting debt relief through bilaterally negotiated debt reschedulings—effectively leaving its debt unpaid. In a September 1989 NAC meeting, the Fed representative underscored his agency's assessment of Iraq's intent by explaining that “as money was fungible, new bank letters of credit could be used to pay old debts in a ‘Ponzi-type scheme,’”¹¹ according to NAC minutes.¹² Despite these longstanding concerns, NAC majorities continued to approve the proposals, and USDA continued to implement the Iraq program.

¹¹According to Webster's Dictionary, a “Ponzi” scheme is an investment swindle in which some early investors are paid off with money put up by later ones in order to encourage [the early investors] to take more and bigger risks.

¹²According to NAC minutes, NAC discussed the possibility of Iraq's using new loans—covered by CCC credits—to free up Iraqi funds for other uses only in terms of repaying previous loans. NAC did not discuss the use of new loans to free up Iraqi funds to purchase military equipment.

Foreign Policy Bolsters USDA Market Development Objectives for Iraq

Although allegations regarding a major banking scandal implicated Iraqi government officials, White House foreign policy goals to promote relations with Iraq convinced NAC to approve a third \$1-billion proposal for fiscal year credit guarantees for Iraq. In August 1989, U.S. government investigators discovered that an agency of an Italian bank in Atlanta, Georgia, called the Banca Nazionale del Lavoro, had allegedly provided over \$2 billion in loans to Iraq over several years without authorization from higher-level bank officials in Rome. Subsequently, U.S. government investigators found that unauthorized BNL loans totalled over \$4 billion: the GSM-102/103 programs had guaranteed nearly one-half of these loans.¹³ Due to concerns regarding these allegations, the Treasury and the Fed immediately requested that USDA postpone discussion of the fiscal year 1990 Iraq program while the Office of the U.S. Attorney (OUSA) in Atlanta, Georgia, conducted its investigation of the possibly fraudulent BNL loans.¹⁴

Despite this advice, USDA persisted with its \$1-billion fiscal year 1990 proposal for Iraq, prompting NAC to hold a series of meetings between September 1989 and February 1990. The first two staff-level meetings following news of the BNL affair focused upon (1) the potentially damaging implications for CCC resulting from the BNL affair; and (2) "Iraq's generally uncreditworthy state," according to NAC minutes. In October 1989, NAC would not approve the \$1 billion USDA initially proposed, but a NAC majority did approve an alternative CCC proposal of \$400 million.

The Treasury and the Fed opposed even the \$400-million proposal, stating that their agencies would oppose any additional CCC programs to Iraq until allegations of the BNL affair were resolved. However, a NAC majority approved the \$400-million fiscal year 1990 proposal, and USDA presented Iraq with this program. Iraqi officials rejected the \$400-million offer the following week as an act of bad faith, and USDA resubmitted its original \$1-billion proposal in a third "special," or ad hoc, NAC meeting on Iraq. In that meeting, the Treasury representative then requested the issue be

¹³BNL bank in Atlanta (BNL-Atlanta) operated as an agency of BNL, headquartered in Rome, Italy. BNL-Atlanta participated as a major lender under USDA's GSM-102/103 programs, and Iraq became one of USDA's largest participants.

¹⁴Evidence obtained by the U.S. Attorney raised USDA's concerns that Iraqi officials had participated in alleged improprieties and prompted USDA to suspend its fiscal year 1990 negotiations with Iraq on October 12, 1989. However, in NAC meetings the following month, USDA representatives—supported by the State Department representative and a written statement by the USDA Inspector General—claimed there were no proven allegations nor evidence against Iraqi officials to warrant withholding approval and that USDA's country risk analysis of Iraq supported continuation of its fiscal year 1990 proposal.

elevated to an ad hoc meeting of the NAC Alternates; however, the meeting was elevated further still to representatives at the deputy-secretary level.¹⁵

In the fourth NAC (Deputies) meeting discussing the fiscal year 1990 Iraq program, NAC representatives supported the \$1-billion proposal, deferring to USDA's market development objectives and Bush administration foreign policy goals, according to November 8, 1989, NAC minutes.¹⁶ NAC approved USDA's proposal to extend 1990 credit guarantees to Iraq in two \$500-million "tranches," or portions, with the second tranche dependent upon USDA improvements in monitoring and safeguarding its export credit guarantee programs, and the developments of the OUSA investigation of BNL. According to NAC minutes, most representatives expressly set aside their reservations regarding Iraq's creditworthiness in deference to the foreign policy goals defined by National Security Directive #26, issued the previous month.¹⁷ Minutes of the November 8 NAC Deputies meeting record the Fed representative's position as follows:

While he stated that he understood the need to make a sale to a customer, it was just as important that the customer pay. He cautioned that extending 20 percent of the CCC's guarantee authority for a fiscal year to one country was not desirable in terms of risk management—especially when that country was engaged in unilateral debt reschedulings. [Emphasis added.]

Summarizing the sense of the meeting, the Chairman of the NAC Deputies meeting—the then-Deputy Secretary of the Treasury—stated that "absent compelling agricultural export and foreign policy interests, this proposed [fiscal year 1990 CCC program for Iraq] probably would not go forward."

¹⁵According to the Secretary of NAC, NAC convenes a "special" meeting of NAC Alternates on an ad hoc basis composed of assistant secretary-level representatives. The NAC Alternates meet to discuss a proposal when fundamental differences may exist on a particular aspect of U.S. policy, or when a member believes the issue requires higher-level attention. In the case of Iraq, NAC held its first ad hoc meeting on November 3, 1989, at the staff level; however, to decide upon USDA's fiscal year 1990 proposal, NAC held a highly unusual meeting at the deputy-secretary level on November 8, 1989.

¹⁶In the November 8 NAC meeting, USDA and the State Department agreed to send letters to the Secretary of the Treasury, in his capacity as Chairman of NAC, outlining the agricultural trade and foreign policy reasons for proceeding with the CCC program for Iraq. The letter from the then-Acting Secretary of State focused upon the importance of the CCC program toward improving relations with Iraq, as ordered by National Security Directive (NSD) #26, and the enormous potential of the Iraqi market. The letter from the then-Secretary of Agriculture highlighted the foreign policy initiatives of the State Department, as well as the size of the Iraqi market, and cited Iraq's "solid record of repaying their GSM guaranteed loans."

¹⁷President Bush signed NSD #26 on October 2, 1989. It defined U.S. policy toward the Persian Gulf and specified objectives for relations between the United States and Iraq. NSD #26 directed the U.S. government to propose economic and political incentives for U.S. firms to participate in Iraq's reconstruction.

On February 22, 1990, NAC held a fifth and final NAC (Alternates) meeting on the fiscal year 1990 Iraq program. The NAC Chairman opened by stating that the meeting was called for informational purposes, according to NAC minutes. NAC members did not take a vote, since USDA did not propose a second loan tranche.

It is our understanding that from that point on, NSC conducted all formal interagency discussion on the 1990 CCC program for Iraq. On May 29, 1990, an NSC Deputies Committee concurred with USDA's decision not to extend the second \$500-million tranche.

Basis for NAC Approval Is Not Limited to Monetary and Financial Issues

Despite its title, there is no requirement for the "National Advisory Council on International Monetary and Financial Policies" to base its positions only upon monetary and financial concerns in reviewing an agency proposal. NAC meetings are conducted on an informal basis, allowing members to vote based upon their respective agency interests, expertise, and alliances. NAC approvals, or positions, are determined by a simple majority vote of its seven members. Of the seven, only three members—Treasury, Eximbank, and the Fed—hold primary responsibility in monetary and financial matters.

In the case of Iraq, from fiscal years 1987 to 1990, NAC repeatedly overrode the concerns of its members with primary responsibility in monetary and financial matters. From fiscal year 1987 onward, at least two members with primary responsibility in financial matters opposed increased levels of credit guarantees for Iraq due to Iraq's poor creditworthiness. In January 1987, when all three of these NAC members opposed a USDA proposal in a 4-to-3 split committee vote, the Treasury representative specified six financial and economic reasons why USDA should not go forward with additional credits for Iraq. The remaining NAC members without comparable responsibility for financial matters composed the majority that approved USDA's proposal to increase guarantees for Iraq. Thus, these agencies overrode expert-member concerns about Iraq's financial problems.

NAC majorities provided USDA with broad support for CCC credit guarantee programs for Iraq. Although NAC determinations are not binding, USDA emphasized that the decision to extend lines of credit to foreign countries was made only after consultation with NAC, according to a December 1989

statement by the then-General Sales Manager of FAS.¹⁸ In the case of Iraq, USDA anticipated certain NAC member opposition about Iraq's creditworthiness and sought to persuade other NAC members to support USDA proposals to obtain sufficient votes in its favor. Although minority objections existed, the NAC position, or "action," letter stated that NAC "offers no objection to [CCC] export credit sales guarantees."

NAC Voting Process Inhibited Member Discussion; NAC Approval Letter Did Not Reveal Significant NAC Member Concerns About Iraq

The case of Iraq revealed weaknesses in NAC's deliberative and approval processes. First, in reviewing USDA proposals for Iraq, an Eximbank representative stated that the agency withheld its views on Iraq's creditworthiness from fiscal year 1988 onward so as not to criticize USDA's proposals. The agency did so in order to reduce the possibility of receiving similar opposition when their agency's proposals were reviewed by NAC.

According to NAC minutes, Eximbank initially voted twice to oppose increasing USDA's credit guarantees to Iraq for fiscal years 1986 and 1987 and stated in May 1986 that Iraq was not creditworthy. In the following 3 fiscal years, USDA's proposals increased to even higher amounts, at or above \$1 billion; however, Eximbank reversed its position either to abstain from or approve of these proposals. Finally, in October 1989, during NAC debate, the Eximbank representative stated for the NAC record that Eximbank considered Iraq creditworthy. However, internal creditworthiness assessments prepared by the agency throughout those same years documented Iraq's declining credit status. Furthermore, an April 1989 Eximbank document stated that "Iraq is not creditworthy by any reasonable standard."

Second, deputy-level NAC members disagreed about whether a country's creditworthiness was a valid consideration for NAC discussion and approval. According to NAC minutes, during both NAC Deputies meetings in November 1989 and February 1990, the Fed representative emphasized that any NAC review of USDA's proposal required a discussion of Iraq's creditworthiness. However, in the November meeting, the Eximbank representative stated that he viewed "NAC as a forum for consideration of political, not country creditworthiness, issues."

Lastly, NAC majority approvals enabled USDA to report interagency support for its decisions to extend credit guarantees to Iraq without clarifying the

¹⁸In October 1989, USDA's General Counsel sent to the White House Deputy Assistant to the President a copy of a paper prepared by FAS describing the approval process for the GSM credit guarantee program. The FAS report stated that NAC reviews USDA credit guarantee proposals "as part of the financial analysis of each country's program."

basis for these approvals. In a February 20, 1990, letter addressed to the Chairman of the Senate Committee on Agriculture, Nutrition, and Forestry, USDA said it allocated to Iraq \$1 billion of GSM-102 guarantees for sales of agricultural commodities in fiscal years 1988 and 1989—in consultation with NAC. USDA's letter to the Chairman did not reveal that NAC members with primary responsibility in financial matters had warned USDA against and had firmly opposed such high credit guarantee levels for 4 years. USDA's letter instead asserted that USDA had pursued a prudent "go-slow" approach to Iraq under the present circumstances. This statement conflicts with NAC minutes showing that USDA had twice proposed a full \$1-billion fiscal year 1990 program for Iraq, despite the BNL affair. Moreover, the same letter directly denied that foreign policy "pressures" had influenced the decision to extend fiscal year 1990 credit guarantees to Iraq. This statement contradicts the NAC Chairman's statement, summarizing the November 1989 NAC Deputies meeting, that absent compelling agricultural export and foreign policy interests, or NSD #26, the 1990 GSM Iraq program would not go forward. Finally, USDA represented NAC approvals as an endorsement by NAC members of the financial aspects of USDA's decisions to extend credit guarantees to Iraq. Although NAC minutes reflected clearly articulated creditworthiness objections to these approvals, USDA presented NAC approvals to Congress as support for its decisions to extend credit guarantees to Iraq from agencies concerned with international credit policy.

NAC Role Has Diminished Significantly

Congress established NAC in 1945 to coordinate and decide upon U.S. government participation in the reconstruction of Europe and other countries at the end of World War II. However, in 1965, executive reorganization legislation abolished NAC as a statutory entity. The following year, an executive order reestablished NAC, but transferred its sole decision-making power—the power to officially approve, consent, or make agreement for the United States in international financial organizations—to the Secretary of the Treasury. NAC continues to poll its members to determine a NAC position (i.e., approval) on proposals by U.S. agencies, such as Eximbank and USDA.

In the case of Iraq, USDA sought NAC advice before extending credit guarantees to Iraq. For example, in fiscal year 1990, USDA repeatedly sought NAC approval before extending any guarantees to Iraq. However, following the case of Iraq, the Bush administration changed this procedure by announcing credit guarantees to the former Soviet Union before NAC reviewed USDA's proposals for the program. From 1990 through 1992, the

Bush administration announced a series of GSM-102 commitments totalling nearly \$6 billion in export credit guarantees for the former Soviet Union and its successor republics. According to a USDA official, in at least three cases, USDA submitted a proposal for NAC review after the administration had already announced its decision. This change raises further questions about the usefulness of NAC advice and approvals.

In order to assess matters of domestic and international economic policy, the President, on January 25, 1993, signed Executive Order #12835 establishing the National Economic Council.¹⁹ Its primary functions include the coordination of the economic policy-making process with respect to domestic and international economic issues. All executive departments and agencies are required to coordinate economic policy through the National Economic Council.

Conclusions

The NAC use of majority voting to decide issues, coupled with NAC's approval letters, left no publicly available record of dissent on issues reviewed by NAC. Instead, NAC's approval letters provided USDA with documented support enabling USDA to continue increasing its programs in Iraq with the appearance of full ("no opposition") interagency backing for its credit decisions.

Second, the NAC review and approval process cannot be construed as essentially an analysis of financial considerations. Although financial issues may be considered in NAC reviews, they do not wholly determine NAC decisions. Nevertheless, USDA represented NAC as a financial analysis review process to describe its credit guarantee program in Iraq.

Lastly, the role of NAC experienced further diminishment following the case of Iraq, when the Bush administration did not consult NAC before announcing USDA export credit guarantees to the former Soviet Union.

¹⁹According to the order, the membership of the National Economic Council is comprised of the President (who serves as Chairman), the Vice President, the Secretary of State, the Secretary of the Treasury, the Secretary of Agriculture, the Secretary of Commerce, the Secretary of Labor, the Secretary of Housing and Urban Development, the Secretary of Transportation, the Secretary of Energy, the Administrator of the Environmental Protection Agency, the Chair of the Council of Economic Advisers, the Director of the Office of Management and Budget, the U.S. Trade Representative, the Assistant to the President for Economic Policy, the Assistant to the President for Domestic Policy, the National Security Adviser, the Assistant to the President for Science and Technology, and such other officials of executive departments and agencies as the President may, from time to time, designate.

Recommendation to the Assistant to the President for Economic Policy

We recommend that the Assistant to the President for Economic Policy, as head of staff of the National Economic Council, evaluate the usefulness of the NAC interagency review process and generally assess the need for NAC. Other existing mechanisms available to the administration, such as the National Economic Council, may effectively address the issues that NAC currently reviews.

Recommendation to the Secretary of the Treasury

If NAC is to remain an interagency review body, we recommend that the Secretary of the Treasury, in the capacity as chair, develop a method for conveying NAC views that includes the full range of concerns raised by the members.

Agency Comments and Our Evaluation

We obtained oral comments on a draft of this report from the Secretary of NAC in the Department of the Treasury. In a meeting on September 22, 1993, the Secretary stated that though he had no substantive differences with the text, he wished to present two areas of concern regarding the conclusions and recommendations of this report. First, he said that those interested in the full range of NAC views can already look them up in the NAC minutes. He noted that access to NAC minutes are restricted since they can only be released upon consent of the individual NAC agencies, but expressed the opinion that presenting minority views in the letter would be redundant given the record in the minutes. We continue to believe that the proposing agency would be better served by an alternative method that highlights the salient points of NAC members' advice and concerns. Such an approach would provide a more readily available source than the minutes and would also emphasize that the responsibility for the final decision remains with the proposing agency.

Second, the Secretary said that if a minority-voting member is concerned about the outcome of a vote, that representative can raise his or her concerns to a higher level within the NAC structure. He pointed out that this had been done in 1989. We recognize that this possibility is a feature of the NAC process, but we do not believe that the process works well in the face of controversy. For example, when significant disagreement first arose in the case of Iraq, the Treasury Department chose to raise its concerns outside the NAC forum. On the other hand, Eximbank later chose not to reveal its concerns, rather than escalate the proposal into further controversy. Such examples illustrate how the diminished role of NAC hinders its ability to deal with contentious issues, and why the National Economic Council may be the appropriate alternative. In general, NAC serves best as a forum for interagency information sharing.

We also requested comments from the Office of the Assistant to the President for Economic Policy; however, officials from that office declined to provide their views.

As you requested, unless you publicly announce its contents earlier, we plan no further distribution of this report until 30 days after its issue. At that time, we will send copies to the Secretaries of Agriculture, State, the Treasury, and Commerce; the U.S. Trade Representative; the Chair of the Board of Governors of the Federal Reserve System; the President and Chair of the Board of Directors of the Eximbank; the Director of the International Development Cooperation Agency; and the Assistant to the President for Economic Policy. We will also make copies available to others upon request.

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



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

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The Commodity Credit Corporation's (CCC) Export Loan and Credit Guarantee Programs

The U.S. Department of Agriculture's (USDA) 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. CCC guarantees repayment of bank-financed loans to foreign buyers in order to expand the export of U.S. agricultural commodities. Two programs currently form part of CCC's administrative authority: the General Sales Manager (GSM) 102 and 103 programs.

The credit guarantee that CCC provides assures repayment of the guaranteed loan to the U.S. exporter or its assigned lending institution. If the buyer fails to meet the repayment obligation to the lending institution, then CCC will make the repayment. Generally, CCC will repay 98 percent of the principal amount due and a portion of the interest payable. CCC allocations are based upon an individual country's agricultural needs, its market development potential for U.S. commodities, and its ability or likelihood to repay the guaranteed loans. In December 1992, we estimated the cumulative costs of the GSM-102/103 programs would have been about \$6.5 billion, if the programs had been terminated on June 30, 1992.¹

CCC's GSM-102 and GSM-103 programs provide credit guarantees to foreign countries with market development opportunities so that these countries can obtain access to commercial credit for the purchase of U.S. agricultural commodities. The GSM-102 program began in fiscal year 1981 and guarantees repayment on credit sales having repayment terms of up to 3 years; the GSM-103 program began in fiscal year 1986 and guarantees repayment on credit sales having repayment terms greater than 3 years but not more than 10 years. The Food, Agriculture, Conservation, and Trade (FACT) Act of 1990 requires that CCC make available not less than \$5 billion a year in GSM-102 credit guarantees and not less than \$500 million a year in GSM-103 credit guarantees. CCC is also required by 1990 FACT legislation to make an additional \$1 billion in GSM-102/103 credit guarantees available each year to countries with emerging democracies.

During the 1980s, USDA also made available two currently non-operational GSM programs. One of oldest of these CCC programs was the direct credit (GSM-5) program. In the GSM-5 program, CCC was the creditor, assuming accounts receivable over a stated term. Secondly, during the early 1980s,

¹The cumulative cost of the programs is the difference between the face value and the actual value of both the CCC's accounts receivable and the outstanding guaranteed loans. We based our estimates of the actual value of the accounts receivable and guaranteed loans on the secondary market for less developed country debt. For further discussion of the costs of CCC export credit guarantee programs, see *Loan Guarantees: Export Credit Guarantee Programs' Costs Are High* (GAO/GGD-93-45, Dec. 22, 1992).

Appendix I
The Commodity Credit Corporation's (CCC)
Export Loan and Credit Guarantee
Programs

CCC offered a program combining direct credits (GSM-5) with credit guarantees (GSM-102), called the "Blended Credit Program." Both the GSM-5 and the blended credit programs ended in 1985, and GSM-102/103 programs expanded to become the primary export credit programs administered by CCC.

Lastly, for many years USDA has negotiated direct sales of U.S. agricultural commodities under the auspices of CCC. According to USDA officials, direct sales transactions are executed to eliminate excess inventory of mostly perishable agricultural commodities. In some cases, direct sales transactions include credit terms similar to a GSM-102/103 program. Although NAC reviews direct sales transactions as it would a GSM program (e.g., for their credit terms), direct sales are not a GSM program but an authority established by the CCC charter.

The Operations of the National Advisory Council on International Monetary and Financial Policies (NAC)

NAC Operations and the Case of Iraq

Weekly NAC meetings provide the formal forum for NAC deliberations. The staff-level committee of NAC handles most of NAC's proceedings. Within the Department of the Treasury, the Secretary of NAC chairs the meetings and is responsible for coordinating NAC's operations. NAC meetings allow participants (i.e., member and interested agencies) to discuss each issue for review, representing their respective agency's perspectives, interests, and expertise. In most cases, NAC polls its members to determine a NAC position on a proposal. Then, NAC formally documents the majority's position in a NAC "action" letter. In addition to attending structured meetings, participating NAC agencies maintain regular, intensive, and informal contact at all levels throughout the year. USDA is not a NAC member and does not vote on proposals before NAC; however, it actively contributed to both formal and informal discussion of USDA proposals on Iraq.¹

Although NAC proceedings usually allow members to review a proposal thoroughly, in some cases involving Iraq, USDA pressed NAC for an immediate decision. This situation did not allow time for interagency discussion of the proposal. According to the NAC 1990 Annual Report, in cases requiring immediate attention, or when a full meeting would not be justified because the issues are noncontroversial, NAC member agencies are polled by telephone without a formal meeting. However, in fiscal years 1987 and 1988, USDA presented program proposals for Iraq with such short deadlines that NAC was required to conduct phone polls in place of meetings to determine a position, precluding interagency discussion. For example, in October 1987, USDA's deadline required NAC to conduct a telephone poll on a contentious USDA proposal to increase total fiscal year credit guarantees for Iraq to \$960 million. After approving the proposal—making Iraq the largest CCC-recipient country—one NAC member supplied extraordinary comments for the record, saying that

...USDA gave NAC agencies an unacceptably short deadline for voting on the proposal. At no time was the request for an increase in CCC financing for Iraq adequately presented to NAC agencies, put on the agenda, or discussed at the weekly NAC meeting.²

NAC Deliberations on Iraq

NAC deliberations consider a broad array of policy coordination issues and agency views. For example, between 1983 and 1990, NAC reviewed over 50

¹For purposes set forth under Executive Order 12797 (Dec. 2, 1992) only, NAC is expanded to include the Department of Agriculture and other agencies.

²A NAC majority approved the proposal; however, all three representatives of agencies with primary responsibility in financial matters either abstained from or opposed the proposal.

**Appendix II
The Operations of the National Advisory
Council on International Monetary and
Financial Policies (NAC)**

USDA proposals on Iraq, discussing such issues as the impact of the proposals upon U.S. foreign relations, the coordination of USDA's proposals with existing international trade agreements, and the creditworthiness of Iraq.

While NAC seeks a unanimity of views, consensus is not necessary for NAC approval. According to the 1990 NAC Annual Report,

Where possible, a unanimity of views among NAC member agencies is sought. When split voting occurs, it may indicate that fundamental differences exist on a particular aspect of U.S. policy. This may trigger a special review of the issue in question.

NAC convenes a "special" (or ad hoc) review of the NAC Alternates upon request by a NAC member who believes the issue requires higher-level attention. NAC Alternates are agency representatives at the assistant-secretary level. Differences are normally resolved at this level by the development of a consensus position, rather than a formal poll. In the case of Iraq, disagreement among NAC members in the form of split voting continued for 3 years before the issue triggered a NAC Alternates review.

Iraq's Participation in CCC Programs

Between 1982 and 1988, Iraq became an important market to USDA for the promotion of U.S. agricultural exports. During those years, USDA's annual GSM-102/103 programs for Iraq grew dramatically from about \$400 million to over \$1 billion, a 150-percent growth. During those years, Iraq also participated in other USDA export programs, such as the GSM-5 and blended credit programs.¹ USDA identified Iraq as a growing market for U.S. agricultural exports based upon Iraq's (1) large import needs; and (2) potential for financing significant agricultural imports, given its vast oil reserves. However, as of April 1987, few U.S. banks participated in the CCC program because they viewed the risk as too great even with the CCC guarantee.

After the Iran-Iraq war ended in 1988, USDA analysis anticipated heightened competition from other countries wishing to export agricultural products to Iraq. Iraq also expected it would be able to attract foreign trade and new international lending to finance its imports after the cease-fire; nevertheless, several factors undermined Iraq's ability to secure financing at that time:

- The country's cash reserves fell dramatically below forecasted levels with lower-than-expected oil prices.
- Iraq's military expenditures remained high even after the cease-fire with Iran, leaving its large debt burden unchanged.
- Other official export credit agencies declined to provide additional loans after Iraq employed default as a strategy in order to gain further credit.

By 1988, CCC became one of the last official export credit agencies in the world willing to continue extending credit to Iraq. Most other official export credit agencies had already experienced Iraqi reschedulings and defaults—some since 1983—and had cut Iraq off from new credit.

Although Department of Justice officials informed USDA of possible impropriety by Iraqi officials involved in both negotiating CCC credits and importing agricultural commodities, USDA proposed another \$1 billion in credit guarantees to Iraq for fiscal year 1990. Continuing revelations that supported these allegations contributed to U.S. government curtailment of the CCC program for Iraq in May 1990. Iraq's participation in USDA agricultural export programs officially ended, in accordance with the

¹The blended credit program extended concessionary direct credit sales (i.e., the GSM-5 program) in combination with credit guarantees.

President's Executive Order #12722, when Iraq invaded Kuwait on August 2, 1990.²

USDA Investigations Resulting From Iraq's Participation in the GSM Program With Banca Nazionale del Lavoro (BNL)

In August 1989, a joint U.S. government agency task force initiated its investigation of BNL-Atlanta. The Office of the U.S. Attorney (OUSA) for the Northern District of Georgia led a task force of various agencies, including employees detailed by the USDA's Office of Inspector General (OIG), in its grand jury investigation.³ In October 1989, USDA's Foreign Agricultural Service (FAS) sought advice from both the U.S. Attorney and the OIG officials on the task force about whether either party knew of any evidence that should preclude USDA from extending credit guarantees to Iraq for fiscal year 1990. The officials generally informed FAS of offenses uncovered at that point, including "after-sales services," and recommended a greatly reduced GSM program for Iraq.⁴ Nevertheless, the USDA/OIG in Washington, D.C., advised FAS officials that "we have no evidence to date that would lead us to recommend that [USDA] should not extend the guarantees."

In October 1989, after the BNL investigators alleged possible Iraqi abuse of the CCC program, USDA's then-Under Secretary for International Affairs and Commodity Programs requested that the Office of General Counsel (OGC) and FAS conduct an administrative review of the CCC program for Iraq. The review investigated several issues involving Iraqi officials and U.S. agricultural exporters using the GSM program including: (1) unusually high commodity prices, (2) Iraqi requests for "after-sales services," (3) Iraqi imposition of excise (or "stamp") taxes, and (4) verification of delivery of goods. In May 1990, the USDA administrative review reported evidence that some exporters charged higher than normal commodity prices, provided after-sales services, and paid Iraqi stamp taxes. The report recommended that additional work be done by the USDA/OIG to pursue the findings on after-sales services and high pricing.

In May 1990, at the request of USDA's Under Secretary, the USDA/OIG expanded an existing investigation to determine whether further GSM program violations had occurred with respect to Iraq. The USDA/OIG

²Executive Order #12722 blocked all Iraqi government property in the United States and prohibited transactions with the Government of Iraq, including the granting or extension of loans.

³In September 1989, the BNL investigation task force included officials from the Internal Revenue Service, the U.S. Department of Agriculture, the Federal Bureau of Investigation, the Defense Criminal Investigative Service, and the U.S. Customs Service.

⁴"After-sales services" are defined as the payments, goods, or services provided by the exporter as a condition for making a sale.

specifically addressed certain issues identified in the administrative review and investigated whether these problems had occurred with other countries in addition to Iraq.

In March 1991, the OIG found evidence of problems similar to those raised by the administrative review: (1) high pricing; (2) after-sales services; and (3) stamp taxes, in addition to other concerns regarding Iraq's participation and the GSM program in general. USDA's Foreign Agricultural Service strongly disagreed with portions of the methodology and conclusions of the OIG's audit.

Country Risk Analysis and the Case of Iraq

Until 1990, USDA country risk assessments differed from other U.S. agencies when it concluded Iraq was creditworthy. Country risk is the risk that adverse economic, social, or political circumstances may prevent foreign borrowers from making timely and complete repayment of their debts. Moreover, country risk assessments evaluate the "creditworthiness" of the borrower, based upon the borrower's ability and willingness to repay external debt fully and on time. For many years, U.S. agencies, such as USDA and the Export-Import Bank (Eximbank), have assessed country risk using different methodologies. For several years, USDA analysis found Iraq creditworthy when Eximbank analysis did not.

Background

During the 1980s, Iraq often failed to service its external debt fully. Although Iraq had vast oil reserves, Iraq's high military spending demanded more revenue than oil exports could support at then-prevailing prices. In order to finance its shortfall, Iraq required annual increases in credit amounts from its creditors, declined to participate in multilateral arrangements for loan rescheduling, and systematically threatened creditors with nonpayment on old loans if sufficient new loans were not forthcoming. According to Eximbank reports, such behavior was indicative of Iraq's unwillingness to repay its debts.

USDA and Eximbank Country Risk Assessments of Iraq

USDA Analysis of Iraq

Before 1990, USDA's method of assessing country risk did not use a quantitative-based analysis as is common in financial analysis. The USDA's Trade and Economic Information Division (TEID) prepares a credit risk analysis for each country to which USDA extends export credit guarantees. During the 1980s, USDA employed nonquantitative assessments and allowed substantial subjectivity in reaching conclusions, according to the Director of TEID. Furthermore, FAS officials confirmed that USDA placed financial analysis subordinate to market development goals. In some cases, USDA extended larger credit allocations than those recommended by its own country risk analysts, due to overriding market development objectives.

In the case of Iraq, USDA officials failed to understand the implications of Iraq's systematic unwillingness to repay its debts. In April 1988, USDA's

country risk assessment of Iraq perversely concluded that, because Iraq had defaulted on loans with other official creditors, Iraq was better able to repay U.S. debts and was, therefore, a good credit risk to CCC. At that time, a USDA country risk assessment stated:

Iraq's ability to defer loan repayments which would have come due this year suggests that the balance of payments situation will not be as bad as originally forecast....Other creditors have already limited their credit sales to Iraq.

Iraq is expected to continue its course of deferring non-U.S. debts. The risk facing CCC credit initiatives in Iraq is likely to remain minimal.

[The Trade and Economic Information Division] recommends adequate short-term and medium-term CCC credit initiatives in Iraq with continuous monitoring of the country's economy and the region's war situation....Ex-Im Bank analysts share the same views concerning the risk facing CCC credit activities in Iraq.

USDA, and other agencies, defended Iraq's creditworthiness based upon this deficient analysis. In the November 3, 1989, special meeting of NAC, a participating representative from the Office of Management and Budget (OMB) expressed concerns that the U.S. government not get into a position that required it to extend new credits in order to secure repayments on old ones. The OMB representative cited an Eximbank country risk analysis of Iraq which, OMB said, showed Iraq to be uncreditworthy. In response, the USDA representative stated that, despite its record with other creditors, Iraq's debt-servicing history with CCC had been good and that extensive USDA country risk analysis led USDA to conclude that the GSM program for Iraq should be continued.

Even as recently as May 21, 1992, the then-USDA Under Secretary, the then-Treasury Deputy Secretary, and the then-Acting Secretary of State each cited Iraq's payment record to CCC as evidence that Iraq was creditworthy before 1990. Specifically, in responding to oral questions during a hearing on the BNL affair before the House Committee on Banking, Finance and Urban Affairs, the then-Acting Secretary of State stated that, in going through all the State Department documentation, he had seen no evidence that outstanding CCC loans were in danger of not being repaid unless new CCC credits were extended. However, a State Department document dated October 11, 1989, stated that

during the war years, the Iraqis became notoriously bad creditors, defaulting or unilaterally rescheduling billions of dollars of official and commercial credit and refusing to even

discuss the matter in the Paris and London Clubs....USDA has been disposed to continue the program at the \$1 billion a year level, in part, not to unnecessarily anger the Iraqis and trigger a default that could jeopardize the whole CCC program.

Eximbank Analysis of Iraq

By contrast, Eximbank analysis found Iraq to be uncreditworthy as early as May 1986. Although Eximbank agreed that Iraq would repay CCC under specific conditions, Eximbank refused to extend its own medium-term credit to Iraq. By 1988, Eximbank observed that Iraqi debt strategy deliberately threatened its creditors with default in order to extort increased loans. Moreover, Eximbank analysis determined Iraq would be unable to service existing external debt for the next 5 years. Eximbank determined that only three official export credit agencies—including CCC—were still receiving payments from Iraq and explained:

[they] enjoy favored creditor status because they are all offering large and increasing programs of new medium-term export credits. CCC alone is offering \$1 billion per year. It would be a tactical mistake for Baghdad to miss payments to these creditors. When these export support programs are diminished, and once repayments begin to exceed new credits, Baghdad will find it necessary to seek reschedulings of these debts, in order to secure strategic balance of payments support.

Eximbank concluded that Iraq was only repaying those creditors who provided credits in excess of payments falling due. Given these assessments of Iraq's poor creditworthiness, in July 1987 Eximbank established an overall short-term credit exposure ceiling of \$200 million and denied Iraq any medium-term programs.

Changes in USDA's Country Risk Methodology

In January 1990, USDA's TEID began developing substantive improvements to its country risk assessment system by placing more emphasis upon financial risk analysis in relation to market development goals. FAS officials stated that market development goals had been a primary factor in the decision to extend credit guarantees to Iraq, often taking precedence over credit risk. However, in May 1990, TEID began applying new credit risk procedures to countries under review. According to TEID officials, the agency currently uses a quantitative-based assessment of country risk similar to that used in banking risk analysis, applying a rating to each country exclusive of USDA's market development objectives.

During the period when USDA implemented the new credit risk procedures, USDA's country risk analyses lowered Iraq's creditworthiness based upon

deteriorating diplomatic relations and Iraq's credit record. In March 1990, USDA's country risk analysis cited Iraq's strategy of refusing to make debt payments to those unwilling to advance new credits and determined Iraq to be a moderate credit risk.¹ By July 1990, USDA's analysis assessed Iraq as a poor credit risk and recommended a fiscal year 1991 exposure guideline of \$200 million. TEID based its July 1990 assessment upon three factors affecting Iraq's willingness to repay its debts to the United States: (1) the deterioration of Iraq's diplomatic relations with western countries, (2) Iraq's history of payment delays, and (3) Iraq's refusal to negotiate with the International Monetary Fund. While this assessment recognized the creditworthiness problems of Iraq, Eximbank had reported the substantive data underlying this determination for a number of years.

¹USDA documents record Iraq's unilateral debt rescheduling strategy (i.e., defaulting on debt payments) as early as October 12, 1989.

Summary of the Banca Nazionale del Lavoro Affair

In August 1989, allegations of bank fraud against the Atlanta, Georgia, agency of BNL led to a series of investigations by the Italian and U.S. governments. After two employees of BNL-Atlanta informed U.S. officials of ongoing fraud in their office, a joint U.S. government investigation began, consisting of staff from the Federal Bureau of Investigation, the Internal Revenue Service, the Defense Criminal Investigative Service, the Board of Governors of the Federal Reserve System (Fed), and USDA; this investigation continues as of the date of this report. On June 2, 1992, the manager of BNL-Atlanta entered a guilty plea (later withdrawn) to 60 counts of a 347-count federal indictment in Atlanta. The indictment charged him with a scheme to defraud the parent bank and the U.S. government by arranging for over \$4 billion in unauthorized loans to individuals and entities in Iraq. In the fall of that year, the Central Intelligence Agency (CIA) discovered misplaced internal documents relevant to the BNL case, providing further impetus to ongoing U.S. government inquiries into the BNL affair.

BNL's Operations: Background

BNL is an Italian bank, headquartered in Rome, with operations in five states of the United States and other countries throughout the world.¹ BNL is over 96-percent owned by the Italian government and is the largest Italian bank in terms of deposits worldwide. After opening in 1981, the Atlanta office of BNL operated under the internal supervision of both its Rome and New York-regional headquarters. BNL-Atlanta began its participation in the GSM program in 1985 and used CCC credits to guarantee \$1.89 billion, or nearly one-half of the total \$4 billion in unauthorized "off book" funding to Iraq.²

At the state level, the Georgia Department of Banking and Finance handled primary oversight and licensing responsibilities of the BNL-Atlanta agency. At the federal level, the Fed exercised regulatory control over BNL-Atlanta. BNL-Atlanta had to comply with Federal Reserve requirements to report information concerning its assets, liabilities, contingent liabilities, and country exposure, that is, the amounts of money the agency lent to other countries.

¹"Banca Nazionale del Lavoro" is Italian for "National Work Bank."

²According to the Department of Justice indictment, BNL-Atlanta allegedly maintained a secret set of "grey books" in order to maintain its unauthorized accounts.

BNL: The Criminal Indictment Against BNL's Former Atlanta Branch Manager

On February 28, 1991, a grand jury returned a 347-count indictment charging the former manager of BNL-Atlanta, an Iraqi bank and Iraqi officials, and others with a scheme to provide more than \$4 billion in unauthorized loans to Iraq. According to the February 1991 indictment, BNL-Atlanta officials fabricated, falsified, and distorted their official accounts; maintained a secret set of "grey books" that they stored in their houses and cars; made false reports to the bank's management in New York and Rome; defrauded the bank's internal and external auditors; and lied to the federal and state bank examiners in person and in written reports filed with the regulators. Specifically, the February 1991 indictment charged that BNL-Atlanta had entered into agreements without the knowledge or authority of BNL headquarters-Rome or the bank's New York regional office. BNL-Atlanta's former Branch Manager reached a plea agreement on 60 counts of the indictment with OUSA in June 1992.

Since June 1992, the Justice Department has changed both the indictment and the plea agreement with the BNL-Atlanta Branch Manager. Prior to the sentencing hearing in September 1992, OUSA requested that CIA verify that the agency had no classified documents relevant to the BNL case. CIA did so and responded to OUSA that it had no such documents. However, during the hearing, the defendant's attorneys alleged CIA knowledge of and involvement with a U.S. firm involved in trading with Iraq. At the same time, in response to congressional inquiry about CIA's initial response to OUSA, CIA identified several internal, classified documents—not previously provided to the U.S. Attorney—suggesting that BNL-Rome knew of the Atlanta branch's illegal activities.

By October 1992, OUSA withdrew its opposition to a change of plea motion by the defendant, and the presiding judge allowed the Branch Manager to enter a plea of "not guilty." More recently, in September 1993, the defendant reached another plea agreement with the Justice Department on 3 counts of a 70-count indictment and is again awaiting sentencing.

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Related GAO Products

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