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Status Report on GAO's Reviews of the Targeted Export
Assistance Program, the Export Enhancement
Program, and the GSM-102/103 Export Credit
Guarantee Programs

Statement of
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Before the
Task Force on Urgent Fiscal Issues
Committee on Budget
House of Representatives



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Mr. Chairman and Members of the Task Force:

I am pleased to be here today to discuss with you the status of our work on several programs administered by the Department of Agriculture's Foreign Agricultural Service (FAS): (1) the Targeted Export Assistance Program, (2) the Export Enhancement Program, and (3) the GSM-102/103 Export Credit Guarantee Programs. All of these programs have been part of the effort to increase U.S. agricultural exports. In the course of our work, we have identified program management problems that need to be addressed.

The present leadership at the U.S. Department of Agriculture is taking a constructive approach to the management problems GAO identified and is in the process of taking responsive action. For example, it has developed proposed regulations for the Targeted Export Assistance Program and the Export Enhancement Program to make them more structured and accountable. It is also recouping bonus overpayments identified during our review of the Export Enhancement Program and is developing and implementing a new computer program to better administer the bonus payment process. In addition, as part of a recently approved reorganization, more staff will be assigned to the Regulations, Procedures, and Reports Branch of the Commodity Credit Corporation's Operations Division. Their function will be to improve the branch's operations, including Export Enhancement Program activities such as bid receipt

and program activity reporting. Furthermore, a new Planning and Evaluation staff was established to evaluate FAS market development programs.

Department of Agriculture officials have also taken actions to improve operations and management of the GSM-102/103 programs by better accounting for the amount of loan guarantees outstanding and establishing a permanent compliance review effort for these programs. Other actions now being considered by Agriculture officials include recognizing estimated losses from its GSM-102/103 programs in the Commodity Credit Corporation's financial statements and amending the GSM-102/103 program regulations to include suspension and debarment rules.

Despite these actions, problems still exist. I would now like to discuss these three programs in more detail.

THE TARGETED EXPORT ASSISTANCE PROGRAM

As you requested, we reviewed the extent to which FAS has implemented the recommendations made in our May 1988 report on the Targeted Export Assistance (TEA) Program. The results of our work are contained in our June 1990 report to you, Agricultural Trade: Improvements Needed in Management of Targeted Export Assistance Program (GAO/NSIAD-90-225). We found that since May 1988, FAS has taken steps to address some of our concerns, such as formalizing

its application procedures, developing evaluation guidelines, and requiring that evaluation planning be incorporated in the activity plans. It has also established a new Planning and Evaluation staff and charged it with responsibility for analyzing all participant evaluations, conducting certain limited program evaluations, and analyzing market development trends across commodities and across markets. In addition, FAS has drafted proposed regulations for the TEA program which are currently out for public comment.

However, we found that FAS still does not have an adequate system of internal controls to effectively manage this program. TEA guidelines are not clearly understood by participants, and several have expressed confusion, particularly in such areas as contracting out, authorized expenditures, contributions, and evaluation requirements. Minimal documentation exists on major program decisions, leaving FAS vulnerable to questions of accountability and fairness. There is little coordination of funding and activities between the Targeted Export Assistance and Cooperator Foreign Market Development Programs, even though approximately half of the TEA participants also participate in the Cooperator Program.

FAS exercises minimal oversight of program participants, particularly those private firms and organizations promoting their own brand. Branded promotional activities receive approximately 35 percent of annual TEA funding, and such activities need to be more

closely managed by FAS to ensure accountability and fairness. FAS delegates responsibility for administering branded funds to the nonprofit agricultural trade organizations (Cooperators), but exercises minimal oversight over these organizations. Without adequate oversight, there are no assurances that the guidelines on allowable promotional expenses, required documentation, and financial procedures are being followed. There is also no assurance that activities are being conducted in the most appropriate way to benefit the industry as a whole.

FAS guidance to program participants on conducting evaluations remains unclear and is not consistently applied. Although FAS has taken several steps to assist participants in understanding and meeting their evaluation requirements, FAS needs to continue its efforts in promoting evaluation as a management tool useful for planning more effective future activities. In the past, FAS has not adequately monitored nor consistently enforced compliance with evaluation requirements. It has, however, recently improved its tracking system to monitor compliance with participant evaluation requirements. FAS also needs to improve its documentation to clearly show how and why evaluation results affect subsequent funding decisions.

The Program Evaluation Office, established in August 1988, served mainly to advise the Commodity Divisions on evaluation requirements. It conducted no evaluations of the program overall

nor analyses of participant evaluation results. As part of its recent limited reorganization, FAS established a new Planning and Evaluation staff which, officials tell us, will be more involved in conducting some program evaluations, making long-range plans based on participant evaluation results, and doing cross-commodity and other types of analyses. This office, however, does not appear to have a mandate to evaluate the success of the overall program, and FAS officials can only cite increased sales as proof that the program is a success.

FAS does not adequately coordinate funding decisions nor approval of marketing activities for both the TEA and Cooperator Programs. We believe that there is an opportunity for FAS to better utilize its resources and to improve the management of its market development programs. This could be done, if the TEA Program is reauthorized, by combining the TEA and Cooperator Programs into one market development program, with one set of criteria and guidelines. We believe that FAS would then be in a better position to more effectively manage market development activities and make more efficient use of its management resources.

THE EXPORT ENHANCEMENT PROGRAM

Our review of the Export Enhancement Program (EEP) was conducted at your request and at the requests of the Chairman, House Committee on Agriculture, and Congressman Silvio Conte, the

Ranking Minority member of the House Committee on Appropriations. We testified on our preliminary findings on three occasions before Senate and House agriculture committees and subcommittees. We also issued a series of three reports based on our work: (1) a fact sheet on program activity, (2) a report on bonus overpayments and internal control weaknesses, and (3) a report on program operations and recent changes, EEP's effect on world agriculture trade, and its use as a trade policy tool during the ongoing agricultural trade negotiations.

Responding to concerns raised by GAO and Agriculture's Office of Inspector General concerns, FAS has been working to improve program operations. For example, criteria for determining the overall program level and for selecting commodities and countries to target for sales have been revised and were published in the Federal Register in November 1989.

In addition, FAS has drafted proposed regulations dealing with program operations, developed written guidelines for determining price and bonus levels, and instructed Commodity Divisions to document all relevant price and bonus calculations. FAS is also improving its internal controls over the bonus payment process to preclude future bonus overpayments. While we believe that these changes will improve program operations, more can be done.

- FAS does not centrally track a proposal for a new program initiative until a Commodity Division forwards it for higher-level review. We believe that the central tracking system should be expanded to include proposals under analysis in the Commodity Divisions so that top management can be aware of all proposals under consideration and can systematically monitor their progress to ensure timely and equal treatment.

- Exporters are required to certify their program eligibility by submitting documents related to their business activities. Eligible exporters must then provide details of a sales contract to participate in the bidding process. FAS does not verify all categories of information needed to prove exporter eligibility, nor does it verify sales contract information, even on a random basis. We believe that FAS should randomly verify this information to help ensure that only eligible exporters with valid sales contracts participate in the bidding process.

As of May 1990, over \$2.7 billion worth of surplus commodities had been made available as bonuses to U.S. exporters for sales to 69 countries. The program has helped to increase U.S. agricultural exports, particularly wheat, to many countries. While the extent of the program's effect is generally difficult to quantify, in a few cases, the program was critical to making sales in certain markets, specifically wheat sales to the Soviet Union and China.

In addition, the program, coupled with U.S. export credit guarantees, was essential to U.S. sales in Algeria and Egypt.

Agriculture has reiterated the EEP's importance as a trade policy tool to maintain pressure on some trading partners during the final months of the Uruguay Round of multilateral trade negotiations on agricultural trade reform. U.S. officials have given the program much credit for pressuring the European Community to begin negotiations on agricultural reform. To the extent that the program has had an adverse impact on other competitors, including Australia and Canada, its continued existence has increased their resolve to negotiate an agreement on agricultural trade reform. However, the Community has resisted major concessions to the United States on the elimination of agricultural subsidies.

GAO agrees that the program is an important trade policy tool. Abandoning the program now would undermine any progress made thus far. We believe that the Congress, in reauthorizing the program, should condition the level of appropriations on the outcome of the current negotiating round--scheduled to end in December 1990. Once the Uruguay Round is completed, the Secretary of Agriculture and the Congress should reevaluate the program in light of any agreements reached on agricultural subsidy issues.

GSM-102/103 EXPORT CREDIT GUARANTEE PROGRAMS

At the request of the Chairman of the Subcommittee on Tobacco and Peanuts, House Committee on Agriculture, we have reviewed the Department of Agriculture's management of the Commodity Credit Corporation's Export Credit Guarantee Programs. We have testified on our preliminary findings on several occasions before the Senate and House agriculture committees and expect to issue our report soon. Also, at your request, we are reviewing the participation of U.S. financial institutions in these programs. Under these programs, the Corporation provides up to \$6 billion a year in loan repayment guarantees to exporters of U.S. agricultural commodities. The programs are intended to promote exports of U.S. agricultural commodities by helping foreign buyers gain access to private sector financing that, without the U.S. government's loan repayment guarantee, would probably not be obtainable. However, defaults in the programs have caused the Corporation to pay out almost \$3 billion, representing about 20 percent of approved guarantees. Although most of the loans in default have been rescheduled, little has been repaid. In addition, the programs have problems with policies regarding commodity eligibility and exporter compliance.

As I stated earlier, Agriculture officials have improved program management by better accounting for the amount of loan guarantees outstanding and by expanding its compliance review

group and its responsibilities. However, other needed improvements have not yet been implemented.

-- The Corporation still needs to ensure that only U.S. agricultural commodities are provided loan guarantees and that these commodities are reaching their intended destinations. We believe that random, spot-check examinations of commodities being exported should be made to help ensure that only U.S. agricultural commodities are being provided loan repayment guarantees and are actually being exported. We believe similar inspections are also needed at foreign ports to help ensure that the commodities that were provided loan guarantees are actually reaching their intended destinations.

-- The Corporation needs to resolve the issue of the amount and circumstances under which "foreign origin content" in agricultural commodities eligible for loan guarantees under the two programs is permissible. We believe that for certain exports a zero-percent foreign origin content is appropriate, such as for unprocessed bulk commodities. However, for other exports, such as processed agricultural exports, a zero-percent foreign origin content would not be appropriate.

In our previous testimonies on the GSM programs¹ we noted that a major participating financial institution in the United States, the Banca Nazionale del Lavoro, was embroiled in controversy over its unauthorized loans to Iraq. The Justice Department is currently investigating allegations that the bank's Atlanta branch disbursed more than \$2 billion in loans to Iraq, of which only a fraction was authorized by higher-level bank officials. Some of these loans, amounting to approximately \$830 million, were guaranteed under the Export Credit Guarantee Programs and, of that amount, only about \$130 million were authorized. In light of the circumstances surrounding the controversy, we stated that the Corporation needs to more closely review program participation by financial institutions in the United States. It must determine if high levels of participation by a few financial institutions are increasing the risk of noncompliance with program regulations or fraudulent activities.

In May of this year, the Under Secretary of Agriculture for International Affairs and Commodity Programs released the results of an Agriculture Department administrative review of the Export Credit Guarantee Program for Iraq. The review concluded that in some cases commodity prices charged to Iraqi buyers were higher than normal. The extra profit was used to help pay the cost of

¹ Status Report on GAO's Reviews of the Targeted Export Assistance Program, the Export Enhancement Program, and the GSM-102/103 Export Credit Guarantee Programs (GAO/T-NSIAD-90-02, Feb. 21, 1990) and (GAO/T-NSIAD-90-12, Nov. 16, 1989).

shipping the commodities to Iraq. Also, according to Agriculture's report, some U.S. exporters apparently provided Iraq with "after-sales services" such as additional commodities, nonagricultural products, or cash rebates or discounts. According to a Department of Agriculture press release, the U.S. government has not incurred any losses as a result of the GSM sales to Iraq.

In response to your January 4, 1990, request, we reviewed the Corporation's controls over U.S.-based financial institutions participating in these programs. We plan to review the Banca Nazionale del Lavoro-Iraq case, specifically, upon the completion of Justice's investigation. During our review of the Corporation's controls over U.S. financial institutions, we found that current GSM regulations may not be adequate to prevent some less-than-arm's-length transactions in financing the Corporation's guaranteed loans. Program regulations prohibit U.S. financial institutions from being affiliated with the overseas bank issuing the letters of credit. However, these letters of credit are generally backed by the foreign government, through its central or government-owned banks, and affiliations between U.S.-based financial institutions and these banks are not prohibited. We found three cases in which the U.S.-based financial institutions holding GSM loan guarantees are owned by government banks of the countries purchasing the commodities. These less-than-arm's-length transactions may result in a breakdown of the normal commercial

safeguards expected to operate under the GSM program and expose the Corporation to increased risk of loss on its guarantees.

One U.S.-based financial institution participating in these programs is 44 percent owned by nationalized banks of the foreign government purchasing the commodities. The foreign government has defaulted on GSM guaranteed loans and has benefited in the following ways:

- It has bought and received the commodities on credit terms under the GSM programs.
- It has benefited from its own default, through its ownership in the U.S.-based financial institution, when the Corporation paid the guarantee claim.
- It has rescheduled this debt under more favorable credit terms and was reinstated into the program, making it eligible for new GSM-guaranteed loans.

Our preliminary assessment is that this situation appears to be a less-than-arm's-length transaction because the foreign government that makes the decision to default also receives a benefit from the decision through its ownership of the U.S.-based financial institution receiving the guarantee payment. The

Corporation should consider expanding its current regulations to prevent these transactions.

As I mentioned earlier about \$3 billion, or 20 percent, of the GSM loans have gone into default. Most of this amount has been rescheduled. However, of the amount that has come due under these reschedulings, 65 percent, or approximately \$922 million, is in arrears.

In recent years GAO has issued qualified opinions on the Corporation's financial statements because the Corporation has not established in its financial statements an allowance for the uncollectible portion of outstanding loans to countries experiencing financial difficulties. This accounting procedure is needed to more accurately report to Congress the financial condition of the Corporation and the cost of its programs. Establishing an allowance account, however, in no way alters the obligation of the foreign country to repay its debt. For the GSM-102/103 programs, we estimate that the impaired debt will cost the Corporation about \$6 billion of the total outstanding unpaid loan balances of approximately \$12 billion.

Our understanding is that the Corporation has developed a methodology for estimating its losses and is recommending that the Secretary of Agriculture approve the establishment of an allowance

account to recognize these estimated losses. We urge the Secretary to act expeditiously on this recommendation

The situation of the Corporation with respect to loans and loan guarantees to foreign countries is analogous to the situation of the U.S. Export-Import Bank, which makes direct loans and provides loan guarantees to foreign purchasers of U.S. exports. For a number of years, GAO issued adverse opinions on the financial statements of the Export-Import Bank because the bank had not created a loan loss reserve. In January of this year, the Export-Import Bank corrected this problem when it established a \$4.8 billion reserve to cover possible losses on 40 percent of its outstanding loans and loan guarantees.

Finally, Agriculture officials have drafted proposed amendments to its GSM-102/103 program regulations to include procedures for taking suspension or debarment actions against program participants found to have violated program regulations. The proposed regulations were submitted to the Office of Management and Budget for review but were returned by the office because they contained suspension and debarment procedures that are inconsistent with already established procedures. Agriculture officials are now revisiting their proposed suspension and debarment regulations.

Mr. Chairman, this concludes my statement. More detailed information on the three programs is contained in the attached appendices. I will be happy to answer any questions you may have.

THE TARGETED EXPORT ASSISTANCE PROGRAM

Our review of the TEA Program, conducted at your request, examines the extent to which FAS has implemented the recommendations made in our May 1988 report.² The TEA Program was mandated by the Food Security Act of 1985 to counter or offset the adverse effects of foreign competitors' unfair trade practices and thereby increase U.S. agricultural exports. Since the legislation did not specify how this program should be carried out, FAS decided to establish a market development assistance program similar to that of the Cooperator Market Development Program, for commodities and products adversely affected by unfair trade practices.

This program is now in its fifth and final year of funding. In each year of the program, the total authorized amount was allocated. For fiscal years 1986 through 1988, the annual allocations amounted to \$110 million and, for 1989 and 1990, they amounted to \$200 million. Approximately 46 nonprofit agricultural organizations have participated in each year of the program, and more than 200 for-profit private firms and cooperatives have received benefits under the program each year.

²Agricultural Trade: Review of Targeted Export Assistance Program, (GAO/NSIAD-88-183 May 28, 1988).

Over 50 percent of TEA funds for fiscal year 1989 were spent in Asian markets, with promotions in Japan alone accounting for 36 percent of TEA funds. European countries were the next largest targeted markets, with promotions in the United Kingdom accounting for over 12 percent of TEA funds. In each year of the program, the top 15 commodity organizations, ranked by amount of TEA funds received, accounted for over 64 percent of TEA funds. For fiscal year 1990, the branded portion of the TEA Program, in which activities are aimed at establishing consumer loyalty to a particular brand, accounted for approximately 34 percent of the TEA allocation. The generic portion of the program, in which activities are designed to increase the total market for that commodity, with no particular brand being promoted, accounted for the remainder.

Although the types of activities conducted under the TEA Program are similar to those conducted under the Cooperator Program,³ approximately 75 percent of TEA funds go toward consumer promotion, while approximately 81 percent of Cooperator funds go toward technical assistance and trade servicing activities. This use of funds occurs because the TEA Program focuses more on

³TEA and Cooperator foreign market development activities consist of consumer promotion, designed to make consumers aware of the advantages of U.S. agricultural products; trade servicing, or attempts to influence foreign traders, importers, wholesalers, etc. to promote U.S. products; and technical assistance, which addresses technical problems in selling, processing, marketing, or using U.S. agricultural products.

promoting high value products, including such horticultural crops as fruits and nuts, while the Cooperator Program promotes mainly bulk commodities.

A notable difference between the TEA and the Cooperator Programs is that TEA requires that a participant demonstrate that it has been adversely affected by an unfair foreign trade practice. It also has substantially larger funding and uses generic commodity certificates issued by the Commodity Credit Corporation rather than using appropriated funds.

TEA Program Administration Lacks Sufficient Management Control and Accountability

In our May 1988 report on TEA, we made several recommendations relating to management control and accountability. While FAS has made some improvements in program administration, we remain concerned that FAS does not yet have an adequate system of internal controls and is not exercising sufficient oversight of program participants.

Inadequate documentation

FAS has not been sufficiently documenting major program decisions. As we noted in the May 1988 report, FAS was not adequately documenting the decision-making process for funding

allocations. It did not clearly show how the funding criteria were applied and ranked and the basis for those decisions.

Our recently completed review indicated that FAS continues to make funding decisions based on limited written information and relies on its marketing specialists to verbally explain the suitability of the applicants, the rationale for the recommended funding amounts, and other major program decisions. The marketing specialists are primarily responsible for reviewing the applications to the TEA Program and writing summaries on each application. These summaries, which average two to four pages in length, include a brief discussion of what the applicant proposes to do with the requested funding amount. These summaries are then forwarded, with a recommendation from the Assistant Administrator for Commodity and Marketing Programs, through the Administrator, FAS, to the Under Secretary for International Affairs and Commodity Programs for final approval. We have been told by FAS officials that these summaries are the main source of documentation for their TEA allocation decisions.

A review of all TEA summaries for funding for fiscal years 1989 and 1990 provides little insight on how FAS applies and ranks the criteria. We recognize that the decisions are based not only on the application criteria but also on such factors as balancing the needs of all Commodity Division requests. FAS officials told

us that they do not have time to fully document program decisions. We believe that such documentation is essential to ensure accountability and fairness. Without adequate documentation, the opportunities for or risks of inconsistent, inequitable, and inappropriate funding decisions increases.

As currently written, the summaries do not address the importance of the various criteria to funding decisions. For example, some participants that lack prior market development experience were denied participation in the program, while others with a similar lack of experience received TEA funds. This is not to suggest that only those with experience should receive TEA funds, but that sufficient rationale should be provided for approving or denying participation and to explain variations in funding amounts approved.

The TEA summaries were improved for fiscal year 1990 by incorporating, on a more consistent basis, information on evaluation results and findings from the FAS Compliance Review Office. However, not all summaries included this information. We do not know whether there were no evaluation results or findings from the Compliance Review Office or whether they were not significant enough to be included in the decisions. Since FAS officials told us that these summaries are the main source of documentation for the decision-making process for funding

allocation, we believe that sufficient information should be included to enable an objective observer to understand how the process works and why decisions are made.

These summaries also do not include information on funding received through the Cooperator Program. Approximately half of the 46 nonprofit TEA participants also receive funding through the Cooperator Program; we saw little coordination of funding decisions or approval of marketing activities between the two programs. Also, for fiscal year 1990, the TEA summaries do not include information on past allocations, approved budgets, expenses, and contribution amounts for each participant. While this information may be discussed in closed door-meetings with the Assistant Administrator, we believe that it should be included in the summaries to ensure that the histories of the applicants are apparent.

Documentation is an essential part of an adequate system of internal controls that all agencies are required to maintain. The standards for internal controls call for agencies to provide reasonable assurance that the use of resources is consistent with applicable laws, regulations, and policies; that resources are safeguarded against waste, loss, or abuse; and that reliable data are maintained and fairly reported. We believe that better

documentation of the funding process and of other major program decisions is essential for program accountability.

Participant contributions

We continue to be concerned that FAS is not requiring participant contributions and is not documenting the rationale for the amount and type of contributions participants are encouraged to provide to the program. Contributions may be in the form of cash or goods and services and may come from a third party as well as from the TEA participant. FAS officials continue to stress that contributions are not legislatively required and that a uniform standard cannot be applied to TEA participants, since their ability to contribute varies. We believe, however, that since FAS is providing significant funding to the participants, FAS officials should explain in writing how they determine contribution amounts for each participant and should formally require contributions from all participants.

FAS officials had told us that they were trying to establish a greater degree of consistency in setting contribution amounts without limiting participation; however, these contributions continued to vary substantially. Beginning with fiscal year 1989, FAS policy for the generic portion of the TEA program has been that all TEA participants should contribute at least 5 percent in cash.

FAS has incorporated such a requirement in its proposed regulations.

In the branded portion of TEA, reimbursement rates have varied among commodities in the past. In its proposed regulations, FAS has established a standard reimbursement rate of 50 percent for all branded participants.

Proposed Regulations for the TEA Program

In response to concerns raised by GAO, USDA's Office of Inspector General, and the Office of Management and Budget that program guidelines were unclear and there was no formal mechanism for communicating guideline changes to the participants, FAS drafted proposed regulations. These are currently out for public comment in the Federal Register. We believe that such regulations are necessary to ensure fairness and consistency in the application of program criteria.

More Oversight of Program Participants Needed, Particularly in the Branded Program

FAS does not adequately monitor the administration of the branded program⁴ to ensure proper accountability of the resources made available. Although there are guidelines on how funds should be administered under the branded program, FAS appears to pay little attention to assuring that these guidelines are followed. FAS has delegated responsibility for administering branded funds to the nonprofit agricultural organizations and regional groups but exercises minimal oversight over these organizations. Without adequate oversight, there are no assurances that the guidelines on allowable expenses, required documentation, and financial procedures are being followed and that activities are being conducted in the most appropriate way to benefit the industry as a whole.

In addition, unlike commodity organizations that participate in the generic program, private firms and organizations in the branded program are not required to conduct evaluations of their activities. Branded participants need only submit end-of-year sales data. FAS officials believe that, because these firms are

⁴There are two ways that private firms can participate in the branded portion of the TEA Program: (1) through the Export Incentive Program, where FAS directly enters into agreements with private firms; and (2) through branded promotion programs administered by nonprofit agricultural organizations or state regional groups.

contributing up to 50 percent of their own funds, their self-interest will ensure successful promotions. Nevertheless, we believe that although a firm may be motivated by business incentives, it still is paying only 50 percent or less out of its own pocket, while the government is picking up the rest of the cost of promotion. Therefore, it is possible that a firm would consider conducting a promotional activity even if the value of such activity were only worth the 50 percent that the firm is contributing.

FAS believes that sales data are sufficient to ensure additionality (that is, a rise in total sales of a commodity or product rather than a redistribution of market shares among the different firms representing a commodity or product). FAS also believes that it is not prudent to allow TEA funds to be used by individual private firms to evaluate the relative success of their brand as compared to other U.S. brands in the market.

We believe that, at a minimum, FAS should require all nonprofit Cooperator groups who are administering the activities of private firms in the branded program to conduct evaluations of the overall success of their branded activities. This information, in addition to sales data, is important to ensure that private firms in the branded program are held accountable for TEA funds received

and to provide FAS with more information in order to make future program decisions that affect all commodities and products.

FAS Efforts to Evaluate the TEA Program

Our May 1988 report pointed out that (1) FAS was not uniformly requiring participants to evaluate their activities, (2) the TEA guidelines provided no guidance on how to make evaluations, and (3) FAS was not systematically tracking and using evaluation results.

Subsequently FAS established evaluation guidelines, effective for fiscal year 1989. To indicate its commitment to evaluating market development activities, FAS has been delaying approval of participants' activity plans until those plans include an explanation of how the participants will measure the effectiveness of their activities. While the new guidelines indicate types of evaluations and who is responsible for conducting them, they are not specific enough to prevent confusion among many participants. FAS application of the evaluation guidelines does not appear to be consistent. For example, some participants must submit quarterly evaluations, while others are required to submit them only once a year.

In August 1988, FAS established an evaluation branch within the Marketing Programs Division. This branch was over a year old before it was fully staffed with six professional positions. FAS established this branch to oversee program evaluation of the TEA and Cooperator Programs. While it did establish general evaluation guidelines, this branch did little to track and analyze evaluation results. The branch had no substantial coordinating or enforcing role with respect to the evaluation requirements, and it did not attempt to evaluate the TEA Program's overall success.

As part of FAS' limited reorganization, a new Planning and Evaluation staff was established. FAS officials expect this new office to conduct some program evaluations, make long-range plans based on participants' evaluation results, and do cross-commodity and other types of analyses. However, this office does not appear to have a mandate to evaluate the success of the overall program and FAS officials continue to cite increased sales as proof that the program is a success. While some level of increased exports would be expected as a result of a large infusion of resources into a targeted market, a simple increase in exports--which can be caused by a large number of other variables--is not sufficient proof of the success of the program.

We believe such an office should be involved in evaluating the success of the overall program. It should provide guidance to both

the Commodity Divisions and the participants on using evaluations as an oversight and management tool. By continuously analyzing the impact of the TEA and Cooperator Programs in the various markets, FAS may be in a better position to alter program direction to reflect current market conditions.

With the management problems we have identified, we have concerns that FAS can continue to manage the TEA Program at its current funding level of \$200 million. We believe that any increase in funding would exacerbate such problems.

Combine the TEA and Cooperator Programs

One way for FAS to improve the management of its market development programs could be to combine the TEA and Cooperator Programs. Combining the two programs would probably be a more efficient use of FAS resources. Marketing specialists and other FAS officials presently spend their time dealing with the two programs separately, since they operate under different deadlines. Little coordination exists between the two programs. When TEA funding levels are being discussed, there is no documentation on Cooperator funding received by the applicant or on the applicant's performance in the Cooperator Program. FAS officials said that their staff is so busy with day-to-day operational and administrative issues that they have little time for documentation.

Combining the two programs, or possibly establishing a new program to replace them, may help to overcome such inherent problems.

A combined TEA and Cooperator Program would be able to maintain the same types of activities (consumer promotion, technical assistance, and trade servicing) but would continue to tailor them to the commodity or product being promoted. Such a combined program could provide more complete and accurate information to management concerning the scope of market development activities worldwide.

Finally, combining both programs could help prevent duplication of effort, if all activities were under one program with one set of criteria. This action, coupled with other corrective efforts on the part of FAS concerning management oversight, would inevitably lead to a more efficiently managed and more effective program.

Combining the two programs can only be done in the event that the TEA Program is reauthorized. A major difficulty in combining the two programs would be that TEA requires the demonstration of an unfair trade practice. However, in the current version of the proposed House and Senate Agriculture Committees' 1990 Farm Bill legislation, TEA would be reauthorized, although under a different name. Also, both versions have removed the unfair trade practice

requirement as a prerequisite for participation, but would provide priority assistance to those who could demonstrate adverse effects from such practices. Removal of the unfair trade practice rule as a requirement for participation makes the TEA Program, or its replacement, even more similar to the Cooperator Program and would facilitate combining the two programs.

Regardless of whether the two programs are combined or maintained separately, we believe that the following policy issues should be clarified in order for FAS to more effectively use its market development resources:

- the percent of total funding that should be allocated to generic and/or branded promotion;
- the amount of emphasis to place on exports representing high value products and/or bulk commodities;
- the division of funding between new market development and maintaining established markets;
- the question of allowing large, well-established private firms to participate or focusing resources on helping small, and/or new-to-market firms establish a foothold in the market; and

APPENDIX I

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-- the establishment of criteria for the amount of time that participants could remain in the program before they would be expected to maintain their market presence on their own.

THE EXPORT ENHANCEMENT PROGRAM

Our review was conducted at the request of the Chairman, House Committee on Agriculture; Congressman Silvio Conte, the Ranking Minority member of the House Committee on Appropriations; and Congressman Charles E. Schumer. It updated and expanded upon the issues addressed in our March 1987 report.⁵

Since 1987, conditions under which the EEP operates have changed considerably. The number of targeted countries has increased from 40 to 69. Total EEP sales have risen from \$1.3 billion to over \$10 billion as of May 31, 1990, and the market value of EEP bonus awards has grown from \$868 million to over \$2.7 billion. Last year, the world supply of wheat became relatively tight due to adverse weather conditions and decisions by some producing countries to reduce production. World prices for wheat have risen as a result. The U.S. government is now using EEP more selectively, and it continues to emphasize the program's importance as a trade negotiating tool.

Preliminary findings resulting from our EEP review were presented in our July 31, 1989, testimony before the Subcommittee on Wheat, Soybeans, and Feed Grains, House Committee on

⁵International Trade: Implementation of the Agricultural Export Enhancement Program (GAO/NSIAD-87-74BR Mar. 1987).

Agriculture. In September 1989, the Department of Agriculture's Office of Inspector General issued a report⁶ that contained information on EEP's administration and offered recommendations for strengthening program effectiveness. On November 16, 1989, we testified again on our EEP work to date before the Subcommittees on Department Operations, Research and Foreign Agriculture; Tobacco and Peanuts; and Wheat, Soybeans, and Feed Grains, House Committee on Agriculture. On February 21, 1990, we testified before the Senate Committee on Agriculture, Nutrition, and Forestry.

On February 7, 1990, we issued a letter report⁷ to the FAS Administrator on apparent program bonus overpayments resulting from weaknesses in internal controls over the bonus payment process. In addition, on February 12, 1990, we issued a fact sheet⁸ containing information on activity under the program from May 1985 through February 28, 1989, which represents the majority of activity under the program to date. At that time, total EEP sales were valued at \$6.8 billion, of which wheat represented over 80 percent. Five countries--the Soviet Union, China, Algeria, Egypt, and Morocco--had bought approximately 1.4 billion bushels of wheat under the

⁶Audit of the Foreign Agricultural Service Export Enhancement Program, Audit Report No. 07099-18 Hy, September 29, 1989.

⁷International Trade: Export Enhancement Program Bonus Overpayments (GAO/NSIAD-90-83).

⁸International Trade: Activity Under the Export Enhancement Program (GAO/NSIAD-90-59FS).

program, about 74 percent of the 1.9 billion bushels sold. The remaining EEP commodity sales were in wheat flour, barley, barley malt, semolina, rice, vegetable oil, sorghum, frozen poultry, table eggs, poultry feed, and dairy cattle. Seventy-three exporters had received over \$2.6 billion worth of surplus U.S. agricultural commodities as bonuses. Four exporters--Cargill, Continental, Louis Dreyfus, and Artfer--had each received over \$100 million in bonuses (60 percent of all bonus awards); Cargill and Continental each received over \$400 million in bonuses.

In response to concerns raised by GAO and Agriculture's Office of Inspector General, FAS began working to improve the program. For example, criteria for determining the overall program level and for selecting commodities and countries to target for EEP sales were revised and published in the Federal Register on November 27, 1989. In addition, FAS recently drafted proposed regulations dealing with EEP operations and is preparing written policies and guidelines to address some of the identified problems.

On June 14, 1990, we issued a third report⁹ on EEP program operations, its effect on world agricultural trade, and its use as a trade policy tool during the ongoing trade negotiations. The

⁹International Trade: Export Enhancement Program's Recent Changes and Future Role (GAO/NSIAD-90-204)

report discusses recent program changes and the management improvements program and identifies further actions needed.

Program Operations and Management

The difficulty in administering a program as complex as the EEP is evidenced by the number of activities required to carry out its objectives. Our review focused on four of these activities: tracking proposals, ensuring exporter eligibility, setting price and bonus levels, and monitoring bonus payments. We found that FAS did not (1) centrally track all proposals, (2) adequately verify information used in the exporter qualification and bidding processes, and (3) adequately document price- and bonus-setting decisions. In addition, we identified several cases where bonuses had been overpaid.

Not all proposals are centrally tracked

A proposal for a new program initiative is developed in two distinct stages. The first stage involves the recommendation of a new program initiative and its analysis by the appropriate Commodity Division. If the Commodity Division finds that the recommendation meets the program's minimum criteria, the recommendation enters the second stage and is forwarded to FAS management, the Under Secretary for International Affairs and

Commodity Programs and, eventually, the Trade Policy Review Group for review and approval.

We found that while each Commodity Division tracks its own proposals, FAS does not centrally track the progress of a proposal until a Commodity Division forwards it for further review. At that time the Commodity and Marketing Programs section establishes a central file on each proposal, tracks its progress, and compiles a weekly status report containing information on all proposals forwarded by the divisions and currently under review.

We believe that the status report should be expanded to include proposals being analyzed in the Commodity Divisions so that FAS can monitor their progress and ensure their consistent, fair, and timely treatment.

In addition, we found that written justification for rejecting proposals was not always included in the central files maintained by the Commodity and Marketing Programs section. We believe that FAS should require written justification for each decision to reject a proposal for a new program initiative. Without it, FAS is vulnerable to allegations of impropriety and favoritism, particularly by those whose proposals are rejected.

Exporter eligibility requirements

To be eligible to participate in the program, exporters must provide the following types of information no later than 3 days prior to submitting a bid: (1) evidence of having traded in the commodity offered during the preceding 3 years, (2) the name and address of the exporter's U.S. agent, (3) a certified statement of the form of business under which the exporter practices (e.g. U.S. corporation, foreign entity), and (4) evidence of the exporter's financial responsibility. To participate in the bidding process, an exporter is required to have a sales contract with a buyer in the targeted market. A certified statement outlining the details of the sales contract must accompany the bid.

We found that FAS routinely verified experience in trading in the commodity offered and the exporter's financial responsibility but did not verify the form of doing business or the name and address of the U.S. agent, even on a random basis. In addition, we found that sales contract information was generally not verified. Agriculture's Office of Inspector General has recommended that FAS require exporters to submit proof of the existence of the sales contract with each bid. FAS has opposed this action, stating that it would seriously delay the review and award of bonuses and would greatly tax existing staff resources.

We believe that all information required to prove exporter eligibility should at least be randomly verified. Without such verification, FAS cannot ensure that only eligible exporters with valid sales contracts are participating in the program.

Setting price and bonus levels

FAS gathers information from a variety of sources to use in calculating price and bonus levels. We interviewed a number of individuals who provide European Community price and world freight information, and we reviewed documents they sent to FAS. We determined that FAS program officials were receiving the information necessary to make informed and effective price and bonus decisions; however, they were not documenting adjustments made to this information when calculating price and bonus levels. Although FAS officials were preparing price sheets that listed each of the figures used in price and bonus calculations, they were not providing either narrative or statistical support to explain how they arrived at these figures. As a result, it was difficult to determine whether bonuses were higher than needed to make sales. This inability was of greatest concern when bonuses exceeded sales prices. For example, in February 1990, we reported that for dairy cattle, the average bonus value was as high as 146 percent of the average sales price in 1986; for semolina, as high as 140 percent in 1987; and for frozen poultry, as high as 111 percent in 1986.

FAS has recently developed written guidelines for determining price and bonus levels and now requires that all relevant price and bonus calculations be fully documented. We support these FAS actions because we believe that price- and bonus-setting determinations must be well documented in order to strengthen the integrity and credibility of the price- and bonus-setting processes. In turn, the bidding process, which relies on price and bonus levels for its criteria, will be less vulnerable to claims of unfair or inconsistent treatment.

Bonus payment procedures

During the initial stages of our review, we found that internal controls over the bonus payment process were not adequate to ensure that bonus payments were properly made. Our February 1990 report to the FAS Administrator outlined the internal control weaknesses and provided the details of the apparent overpayments. FAS is in the process of recouping these overpayments and improving internal controls to safeguard against future overpayments.

EEP's Impact on U.S. Agricultural Exports

In the last several years, U.S. agricultural exports have increased significantly. However, it is difficult to determine

exactly how much of these increases were due to EEP. EEP's effect cannot be easily isolated from that of other policy and economic variables that have contributed to increased agricultural exports --lower loan rates, availability of export financing and other U.S. government assistance, depreciation of the U.S. dollar against major competitor currencies, production shortfalls, and other changes in global economic conditions. Recent studies estimate that U.S. agricultural exports have increased due to EEP, but they differ on the magnitude. The additionality estimates range from 2 to 30 percent and are greatly influenced by the assumptions made and the time period covered.

Furthermore, the fact that the EEP is "targeted" adds more complications in determining its effect. While exports may increase in the targeted markets, the overall effect on U.S. exports worldwide is uncertain. Originally the program's primary targets were countries that made significant purchases of commodities subsidized by the European Community (EC). Over time, the program expanded to include countries that had a small EC market presence and then to countries where the EC was only contemplating a presence. As U.S. sales displaced EC sales in one market, the EC moved into another country's market, making that country eligible for program benefits. The program grew from 4 targeted countries in 1985 to 69 by 1990 and has included 12 commodities.

Perhaps the most controversial aspects of the EEP targeting strategy were the administration's decisions regarding the Soviet Union. That country was initially excluded from the program despite the fact that the EC's share of the Soviet wheat market rose from 5 to 22 percent from the 1981 to the 1985 crop year. Agriculture initially claimed that the Soviet Union was excluded because the nonsubsidizing competitors had about a 48-percent share of the market in crop year 1985. Nonsubsidizers, however, had equal or greater shares of other markets targeted under the EEP, such as Egypt, Iraq, Jordan, and Sri Lanka. The Soviet Union had been excluded from the program until August 1, 1986, for foreign policy reasons. It was then made eligible for EEP sales and has since become the largest importer under the program.

EEP does appear to have been critical to making sales in certain markets, such as wheat sales to the Soviet Union and China. During periods of surplus supplies on the world market, these importing countries took advantage of competition among exporters to obtain the best possible price and terms. Without EEP to make U.S. exports competitively priced, it is highly unlikely that these sales would have taken place. In addition, officials in Algeria and Egypt told us that EEP was essential to enable U.S. exporters to make sales because these countries are "price buyers" (i.e., they buy at the best price available

regardless of the source). They also noted that many EEP sales depended on the availability of U.S. export credit guarantees.

Impact of EEP on Competitors

While the program is aimed at challenging the export markets of subsidizing countries like the EC, it was also designed to avoid competing directly with other competitors not considered direct subsidizers. During our review, Australian and Canadian officials told us that their countries have been adversely affected by EEP, both in terms of lower prices for their commodities and reduced market shares.

Australia

Australia has been most vocal in its opposition to the EEP, stating that EEP has adversely affected its wheat exports. While Australian government and farm industry representatives and U.S. Agriculture officials agree that EEP contributed to the depression of world wheat prices between 1985 and 1988 and, consequently, to the reduction in Australian wheat export earnings, there is no consensus on the extent of EEP's effect.

According to a recently released Australian study,¹⁰ the EEP has cost Australian wheat growers between \$150 million and \$238 million, due to reduced average prices on wheat exports and a consequential decline in wheat production. The study points out that in 1987, the estimated cost to the Australian wheat industry was far greater than to the EC's, because exports to EEP-targeted markets constituted a far larger proportion of Australia's total production.

Australian officials told us that the decline in export prices encouraged producers to move out of wheat production; plantings fell from about 12 million hectares in 1984/1985 to about 9 million hectares in 1988/1989. They acknowledged that the EEP is only one of a number of factors contributing to the decline in Australian wheat export earnings. However, in their opinion, the EEP has clearly had a significant adverse impact on Australian agricultural exports.

U.S. government officials stated that the EEP's effects on wheat prices were minimal and were mitigated by the Australian government's guaranteed price mechanism and devaluation of the Australian dollar in 1985. They attribute recent declines in Australian wheat production to historically high wool prices

¹⁰ U.S. Grain Policies and the World Market, Australian Bureau of Agricultural and Resource Economics, Policy Monograph No. 4, released in October 1989.

during the mid-1980s, which lured farmers out of wheat and into wool production.

Canada

Canadian officials could not demonstrate a loss in market share directly related to EEP; instead, they criticized EEP's price-depressing effect and the resultant decreased revenue from agricultural exports. They also complained that EEP's targeting strategy was inconsistent and questioned its continued use for commodities that were in short supply. For example, the officials noted that Canada, not the EC, had established major wheat markets in Iraq, Colombia, Mexico, and the Philippines, yet they were all targeted under EEP. In addition, Saudi Arabia was a large importer of barley from many sources, not just the EC. When an EEP initiative for barley was announced, the whole balance of the barley trade was upset.

Canadian officials also questioned EEP wheat sales during the last two years, when supplies were greatly reduced due to worldwide drought conditions. In their view, the United States was the "only game in town," yet it sold EEP wheat to China and the Soviet Union, the largest importers of wheat in the world. Canadian officials viewed the use of EEP as "overkill" in these cases.

Despite the perceived negative effects of the EEP on export strategies, world price, and the balance of trade, Canada has derived some indirect benefits. In the last year, Canadian exports of rapeseed oil, or canola, have become very competitive in U.S. markets partly because of high U.S. domestic vegetable oil prices, driven up (or artificially supported) by EEP. According to Canadian officials, annual sales of vegetable oil to the United States have increased sixfold. In addition, U.S. livestock growers have been paying higher feed grain prices, driving up the cost of U.S. meat products. As a result, Canadian pork products are more competitive in the U.S. domestic market.

The Future of EEP

In today's tighter wheat market, we believe that EEP is appropriately being used more selectively. Its continued existence is important as a trade negotiation tool. If market conditions change, the program could again be used aggressively, potentially increasing the cost of the EC's restitution program. More significantly, abandoning the program now would send the wrong signal to U.S. competitors during the final months of the Uruguay Round of multilateral trade negotiations.

We believe that the Congress, in reauthorizing the program, should condition the level of appropriations on the outcome of the

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Appendix II

current negotiating round, scheduled to end in December 1990.

Once the Uruguay Round is completed, the Secretary of Agriculture and the Congress should reevaluate the program in light of any agreements reached on agricultural subsidy issues.

GSM-102/103 EXPORT CREDIT GUARANTEE PROGRAMS

We are currently conducting a review at the request of the Chairman, Subcommittee on Tobacco and Peanuts, House Committee on Agriculture, of the Commodity Credit Corporation's GSM-102 and 103 Export Credit Guarantee Programs. These programs are intended to maintain or increase U.S. agricultural commodity exports by guaranteeing exporters or their assignees that they will be repaid for credit sales made to purchasers in foreign countries. Should a foreign buyer default, the Corporation will make good on the payment and then try to recoup the loss from the foreign buyer.

The two programs are administered by the Foreign Agricultural Service. In June 1988, we issued a report¹¹ on these programs; we concluded that FAS was not adequately managing them. More specifically, we stated that the Corporation had not adequately (1) accounted for outstanding guarantees, (2) ensured that guarantees were being used for U.S. agricultural commodities, and (3) provided guidance to program users. We recommended that the Secretary of Agriculture direct the General Sales Manager, FAS, to do the following:

¹¹International Trade: Commodity Credit Corporation's Export Credit Guarantee Programs (GAO/NSIAD-88-194 June 1988).

- Enforce compliance with the requirement that exporters submit complete reports of exports to ensure accurate accounting of outstanding guarantees.

- Design, develop, test, and implement internal controls, including random on-site verifications, to ensure that loan guarantees are used to obtain U.S. agricultural commodities.

- Clarify program regulations with specific definitions of a U.S. agricultural commodity and a firm sale and require acknowledgement of these requirements on guarantee applications.

- Provide timely and accurate decisions on document revisions requested by exporters or their assignees.

We are pleased to report that FAS has taken action on some of our recommendations. However, we believe that further FAS action is needed to address our original concerns about implementing internal controls and defining an agricultural commodity. Actions are still needed on our concerns about the timely handling of revisions to GSM documentation. Finally, we have comments to make about the participation of U.S. financial institutions in the GSM programs.

Actions Taken on Previous GAO Recommendations

FAS has acted on our recommendations to improve the accounting of outstanding guarantees and to establish internal controls.

When exporters fail to submit the required export sale loan repayment schedules for GSM-102/103 guarantees outstanding, the Agricultural Stabilization and Conservation Service (ASCS) estimates its own repayment schedules. ASCS officials, who perform the Corporation's accounting services, use the terms identified on the available GSM sale documentation and the current London Interbank Offered Rate (LIBOR) plus one-quarter of 1 percent, to compute the repayment schedule. If the official repayment schedule is later received, ASCS will make adjustments as necessary. According to ASCS officials, only minor adjustments have been required to date.

FAS has established some internal controls over the programs. Effective October 1, 1988, when exporters register a sale, they must certify that none of the value of that sale is foreign. The validity of the certification statements will be spot-checked by the FAS Compliance Review Office, which has been given additional resources for reviewing compliance with this and other GSM-102/103 regulations.

We believe that the actions taken by FAS are important steps in improving management of the GSM-102/103 programs. However, much more is needed before firm control over program operations is achieved.

Further Improvements Needed in Internal Controls

Recent work conducted by the Agriculture's Office of Inspector General and GAO has shown that further internal controls over the GSM-102/103 programs are necessary. A September 29, 1989, Office of Inspector General report¹² stated that compliance review efforts are needed, and that suspension and debarment actions should be used whenever exporters are found to be in violation of program regulations. Our review also indicates that controls are not in place to ensure that exporters are complying with applicable regulations.

Additional compliance review efforts are needed

The Office of Inspector General report stated that "U.S. exporters are participating in a \$6 billion program without FAS or CCC conducting a review, or periodic check, to make sure the program is operating in accordance with applicable laws and

¹²Audit of the Foreign Agricultural Service Exports of the Foreign Commodities Under GSM 102/103, Audit Report No. 07099-21-Hy.

regulations." However, some compliance review efforts have now been undertaken. Nevertheless, our review work indicates that more compliance review efforts are necessary.

Our June 1988 report recommendation on internal controls called for random, on-site verifications to ensure that U.S. agricultural exports are being financed by the guarantee programs. We believe this is an important control because Corporation and FAS officials deal only with the paperwork aspects of the guarantee programs. Without physically inspecting the commodities being exported at both U.S. export terminals and foreign import terminals, at least on a spot-check basis, Corporation and FAS officials cannot be certain that U.S. agricultural commodities are being financed under the programs.

With assistance from U.S. Customs, we made random inspections at U.S. ports holding seven tobacco shipments destined for export under the GSM programs. In one instance, Customs officials believe that over 80 percent of the tobacco in that sale was of foreign origin. In another instance, we visited an exporter who was participating in the GSM-102 program for grocery items and found that he was preparing for shipment several items that contained foreign origin content, including coffee filters manufactured in Canada.

As a further assurance that U.S. agricultural commodities financed under the GSM-102/103 programs are being delivered to their intended destinations, FAS should conduct periodic spot inspections at foreign ports. This requirement could be accomplished by FAS staff assigned overseas or by FAS officials, for example, compliance review staff, in travel status. In the past, FAS officials have stated that time and resources were not available for this type of monitoring and oversight.

According to foreign government officials, random checks at foreign ports are feasible. While conducting work at four overseas locations last year, we asked foreign government officials if it would be possible for FAS officials to inspect the off-loading of GSM commodities. With one exception, we were told that FAS access to the ports for inspection would be allowed. In that one instance, we were advised that obtaining permission for access would be difficult because the port is used for closely guarded military operations as well as civilian operations.

The Corporation should take suspension or debarment actions where appropriate

The Inspector General report stated that FAS should use established compliance measures, such as suspension or debarment, to discourage U.S. exporters from blending or combining foreign origin agricultural commodities or products with U.S. commodities for export under the GSM programs.

Considerable attention has been focused on the suspension and debarment issue because a number of tobacco exporters, who had shipped large quantities of foreign tobacco as U.S. tobacco under the Export Credit Guarantee Programs, continued to participate in the programs. When significant GSM program violations occur, we believe that suspension or debarment proceedings would be the appropriate agency response, and that the Corporation should be prepared to initiate such actions.

Current GSM regulations do not address suspension or debarment procedures. The Corporation has amended the regulations to include such procedures and earlier this year submitted the proposed amendments to OMB for review. OMB returned the package to the Corporation for reconsideration because the Corporation's proposed suspension and debarment procedures is inconsistent with Executive Order No. 12549, which covers suspension and debarment procedures government-wide and to which the Department of Agriculture agreed. According to an FAS official, the Corporation is trying to decide how to handle OMB's response to the proposed amendments. The Department of Agriculture is questioning whether or not OMB has oversight responsibility for the Corporation and, therefore, authority over the Corporation's rulemaking.

An Eligible Agricultural Commodity Still
Needs to be Defined

Our June 1988 report included a recommendation concerning the need for defining eligible agricultural commodities, especially value added products. Agriculture's Inspector General arrived at the same conclusion.

Until September 21, 1988, FAS general policy was to provide export credit guarantee coverage under the GSM-102/103 programs only for those commodities or products containing 100-percent U.S. origin content. Nevertheless, while this policy was in effect, credit guarantees were provided for exports of tobacco that were subsequently revealed to contain substantial amounts of foreign tobacco. Also, other products such as grocery items, leather hides and skins, and soft drink concentrates containing some degree of foreign origin content were provided guarantee coverage under the programs.

On September 21, 1988, FAS announced a new policy that provided credit guarantees for the export of agricultural products that were a mixture of U.S. and foreign origin. The new policy allowed the value of exports under the programs to include up to 25-percent imported agricultural commodities. However, only the value of the U.S. portion of the agricultural commodities could receive the Corporation's guarantee. This proved to be a highly

contentious policy change. Forty members of Congress questioned this new policy and wrote to the Secretary of Agriculture on October 12, 1988, asking that it be reversed.

On February 15, 1989, FAS discontinued the new policy and notified exporters that as of February 16, they would be required to certify that none of the value of their commodities was foreign. Otherwise, the commodities would not be eligible for program coverage. This policy is still in effect and was included in the proposed amendments to the GSM regulations that were submitted to OMB for review.

FAS developed each of these policies largely without input from the affected parties. It also has applied the policies across the board to all commodities. Based on our work, we believe that it is appropriate to apply the zero-percent foreign value content policy to certain exports, such as unprocessed bulk commodities like wheat, corn, and barley. However, we do not believe it is appropriate to apply that policy to other exports, such as processed agricultural products, many of which may contain small amounts of foreign origin ingredients. For example, powdered infant formula, containing foreign origin ingredients that account for only 2 percent of the total value of the product, is excluded from coverage under the current policy, as is soft drink concentrate with a small percentage of foreign content.

Last year, FAS established an internal working group to deal with the issue and solicited comments in the Federal Register. FAS also met once with selected industry representatives to obtain their views on a foreign content policy. The comments they received from the Federal Register notice came primarily from exporters of bulk commodities and exporters of vegetable seeds. The bulk commodity exporters generally favored the zero-percent foreign content policy while the seed exporters opposed it. The meeting that FAS officials convened reportedly produced similar results.

We believe that FAS needs to revisit this issue and obtain comments from a much broader range of commodity exporters before finalizing its foreign origin content policy under the GSM-102/103 programs.

Action Still Needed on the Timely Handling
of Revisions to GSM Documentation

Our June 1988 report suggested that the Corporation be more flexible with exporters and financial institutions when changes to GSM documentation are necessary. We cited an example of a U.S. bank that spent 8 months trying to get the Corporation to correct the name of a foreign bank placed on the guarantee document by Corporation officials. This change was very important to the U.S. bank because a Corporation official had stated that guarantees

could become invalid if the documentation was not properly prepared. The Corporation, rather than making the correction itself, wanted the U.S. bank to obtain written assurance from the foreign bank that it would honor its obligations even though the bank was incorrectly named on the document. Eventually, the Corporation did make the correction, but the U.S. bank officials claimed they spent too much time and effort on an error that was made by the Corporation.

During recent discussions with several exporters and U.S. financial institutions participating in the GSM programs, we were told of several other similar instances that frustrated exporters and bank officials. In one case, documentation prepared by a U.S. bank regarding a repayment due in three equal installments was not accepted by the Corporation because of the way in which the bank rounded the cents on a whole dollar. Apparently the bank showed that 34 cents would be collected as part of the first installment and 33 cents as part of the second and third installments. Corporation officials returned the documentation and requested that 33 cents be shown as part of the first and second installments and 34 cents on the third.

Participation of Financial Institutions
in the GSM Programs

The success of the GSM-102/103 programs depends greatly on the active participation of financial institutions, which disburse the \$4 billion-\$6 billion in GSM loans each year, providing direct credit to the foreign buyers. Despite the important role played by the institutions, the Corporation has only two regulations covering their GSM-related activities.

One of those regulations prohibits a U.S.-based financial institution involved in the GSM export transaction from being affiliated with the foreign bank issuing the letter of credit used by the foreign purchaser to pay for the commodities exported under the GSM program. Although it prohibits participation in transactions by affiliated banks, the regulation does not fully protect U.S. interests from other less-than-arm's-length relationships. The Corporation has guaranteed the financing of exports to foreign governments who were also owners of the lending institutions receiving the GSM guarantees.

During our recent review, we found three U.S.-based banks that were either directly owned by or otherwise affiliated with government-owned banks in GSM customer countries. Those banks had foreign customer ownership ranging from 14 percent to 100 percent. Since inception of the program, the Corporation has guaranteed

close to \$1.3 billion in these related-party transactions. Although these banks are complying with current regulations, should a default occur, any guarantee payment made by the Corporation to these U.S.-based banks would financially benefit the foreign government that is in default. These apparent less-than-arm's-length transactions increase the risk of losses to the Corporation. As discussed earlier, one of these three banks held guaranteed debt on which its foreign government owner defaulted.

In two of the three cases in which there appear to be less-than-arm's-length relationships, there have been no defaults. One of these U.S.-based financial institutions is a branch of the foreign country's national bank and has financed over \$474 million in commodity exports to its own country under this guaranteed loan protection from the United States. The other institution we reviewed is a foreign-owned consortium that has financed about \$588 million in GSM transactions to one of its owner countries. These loans represent about 62 percent of the institution's total GSM portfolio.

Banca Nazionale del Lavoro
Investigation Continues

In previous testimony, we reported that the Department of Justice was investigating allegations that Banca Nazionale del Lavoro's Atlanta branch made more than \$2 billion in loans to

Iraq, of which only a fraction was authorized by higher-level bank officials. Some of these loans, amounting to approximately \$830 million, were guaranteed under the GSM programs and, of that amount, only about \$130 million were authorized. The investigation is still ongoing, and none of the related information has been made available.

Banca Nazionale del Lavoro is Italy's largest state-owned bank. Headquartered in Rome, it has several branches operating in the United States. The New York City branch is responsible for North American operations, and its Atlanta, Georgia, branch has provided the GSM loans. In recent years, Iraq has imported about \$1.0 billion worth of U.S. agricultural commodities annually under the GSM-102/103 programs. Since Iraq began participating in the programs in 1983, sales of agricultural commodities guaranteed by the Corporation increased from \$214 million to over \$1.0 billion in 1989. For fiscal year 1990, allocations to Iraq were set at \$500 million, and nearly all of that allocation has been registered for guarantees.

In a recent administrative review of the Iraqi GSM-102 program, USDA found practices of charging high prices and paying for "after-sales services" by certain exporters, which, in its view, may have constituted violations of program regulations. However, these practices did not result in losses to the

Corporation or the U.S. Government because Iraq had repaid the loans that were the subject of this review. USDA plans further inquiry on these potential violations at the conclusion of the Banca Nazionale del Lavoro investigation when more information becomes available.

There may be lessons to be learned from the Banca Nazionale del Lavoro investigation and, once it is complete, we plan to begin a study responding to your earlier request to evaluate the extent to which individual financial institutions participate in GSM programs and to assess the potential impact that such participation may have on the Corporation's guarantee liability. In particular, we will look at the Bank's involvement with Iraq and whether it is wise to allow one bank to participate to such a large extent in the GSM programs, especially if that bank's loan exposure is concentrated in a single country.