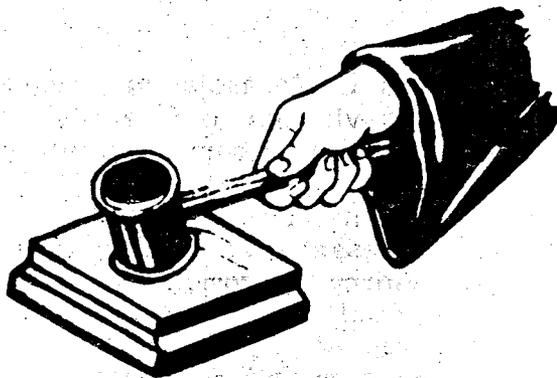


LEGAL NOTES



Loan Guaranties Under the Arms Export Control Act

By

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Among the many issues that arise concerning the financing of foreign military procurements, one aspect that deserves attention is the recent change in the Arms Export Control Act in the authorization of loan guaranties. That Act (generally referred to as the "AECA") provides two methods of financing: direct credits extended under section 23 (including so-called "forgiven" credits), and loan guaranties under section 24. The latter are issued by the Director, Defense Security Assistance Agency, to lenders doing business in the United States, committing the United States Government to pay the lender in the event of default on loans made to friendly foreign countries and international organizations to finance their procurement of defense items. Since FY 1974, guaranties have been issued only to the Federal Financing Bank, an instrumentality of the United States Government under the general supervision and direction of the Secretary of the Treasury (12 USC 2283). The Bank (the "FFB") operates "off-budget," that is, FFB loans and receipts are excluded from the budget totals and are exempt from any general limitation on expenditures and net lending (budget outlays) of the United States [12 USC 2290(c)].

From the inception of the guaranty program in 1964, until last year's legislative amendments, a percentage of the face amount of each guaranty was required to be obligated and placed in a single reserve account for the payment of guaranty claims. The percentage was reduced from 25% to 10% as of July 1, 1974, for guaranties issued thereafter. When reserve funds are expended in satisfaction of a guaranty claim, e.g., when payments under the loan are rescheduled, the guarantor (DSAA) is subrogated to the rights of the lender to collect the corresponding missed payments with the borrower. Until

last year's amendments, funds received from subrogated loan payments made by the borrower were required by section 37(b) AECA to be transferred to the miscellaneous receipts of the Treasury.

With the enactment on December 16, 1980, of section 104 of the International Security and Development Cooperation Act of 1980, several changes in the loan guaranty program were effected. No appropriations are required for the program because the requirement for the obligation of a percentage of the face amount of the guaranties issued after December 15, 1980, was repealed by section 104. However, funds received thereafter from the subrogated loan payments by borrowers are returned to the guaranty reserve account pursuant to section 37(c) AECA, rather than transferred to the miscellaneous receipts of the Treasury. The dramatic effect of these two changes may be seen in the following statistics.

	<u>FY 1980</u>	<u>FY 1981</u>
	(in \$ millions)	
Opening Balance of the Guaranty Reserve	\$1,160.4	\$1,170.4
Payments of Guaranty Claims	135.0	164.0
Obligation of Appropriated Funds	145.0	N/A
Income from Subrogated Loans	N/A	54.0*
Closing Balance of the Guaranty Reserve	1,170.4	1,060.4
Total Guaranteed Loans Outstanding (including undisbursed amounts) at close of the fiscal year	11,318.0	13,232.7
Percentage of Guaranteed Loans Outstanding protected by Guaranty Reserve Balance	10.34%	8.00%

*An additional \$2.7 million was received by DSAA between October 1, 1980, and December 16, 1980, from subrogated loan payments and was transferred to miscellaneous receipts.

The President's FY 1982 Budget estimates that \$170 million will be paid on guaranty claims during FY 1982, and that \$70 million will be received during FY 1982 from subrogated loan payments. On September 25, 1981, the President requested legislative authority to issue up to \$3,063.5 million in guaranteed loans during FY 1982. Clearly, the percentage of guaranteed loans outstanding protected by the guaranty reserve balance will continue to decline.

Section 104 of the International Security and Development Cooperation Act of 1980 also requires the annual Congressional Presentation Document to set forth the total amount of funds in the guaranty reserve as of the close of the preceding fiscal year, "together with an assessment of the adequacy of such total amount of funds as a reserve for the payment of claims under guaranties issued pursuant

to section 24 in view of the current debt servicing capacity of borrowing countries, as reported to the Congress pursuant to section 634(a)(5) of the Foreign Assistance Act of 1961" (emphasis added). Furthermore, the President is required to report promptly to the Congress whenever the payment of a claim under a loan guaranty reduces the reserve to an amount less than \$750 million, together with his recommendations for the authorization of appropriations of "additional funds for such reserve."

Even though the issuance of loan guaranties no longer involves the use of appropriated funds, the Congress took care to ensure that loan guaranties could not be issued despite various statutory prohibitions and limitations on the use of funds appropriated under the Arms Export Control Act. Guaranties as well as direct credits extended under section 23 of the Act continue to be subject to such prohibitions and limitations. Section 24(c) of the AECA was amended last year to provide that "for the purposes of any provision in this Act or any other Act relating to a prohibition or limitation on the availability of funds under this Act, whenever a guaranty is issued under this section, the principal amount of the loan so guaranteed shall be deemed to be funds made available for use under this Act." Thus, loan guaranties will remain subject to such provisions as those relating to off-shore procurement in section 42(c) AECA, those relating to residential waiver authority under section 614(a) of the Foreign Assistance Act of 1961 (FAA), those relating to nuclear enrichment transfers, nuclear reprocessing transfers, and nuclear detonations under sections 699 and 670 FAA, and the various foreign aid appropriation act general provisions (e.g., reprogramming procedures, the 15% limitation on obligations of funds in the last month of fiscal availability, and the prohibition on assistance to countries in default on loan repayments).