United States General Accounting Office

GAO

Report to the Chairman, Subcommittee on Europe and the Middle East, Committee on Foreign Affairs, House of Representatives

SECURITY ASSISTANCE

Foreign Military Sales Debt Refinancing

GAO

United States
General Accounting Office
Washington, D.C. 20548

National Security and
International Affairs Division

B-217660

August 16, 1989

The Honorable Lee H. Hamilton
Chairman, Subcommittee on Europe
and the Middle East
Committee on Foreign Affairs
House of Representatives

Dear Mr. Chairman:

In response to your request, we assessed the implications and associated costs of the Foreign Military Sales (FMS) debt reform legislation included in the fiscal year 1988 Continuing Appropriations (P.L. 100-202). The FMS debt reform legislation allows countries to prepay FMS loans by refinancing them in the private sector at lower interest rates, thus reducing the countries' debt burdens.

Results in Brief

We estimated that, as of September 1988, $14.8 billion in outstanding FMS loans and overdue payments was eligible for refinancing. As of May 18, 1989, Israel, Jordan, Pakistan, Spain, Tunisia, and Turkey had refinanced almost $7.5 billion of this amount. Using Defense Security Assistance Agency's (DSAA) projections that 13 countries will prepay $9.7 billion during fiscal years 1988-90, we estimated that the present value cost to the U.S. government will be $1.8 billion. This cost, however, will be incurred over a long term. The U.S. government benefits from the receipts in the year of the prepayment, but the receipts are offset by the forgone future principal and interest payments.

Some countries with eligible FMS loans may decide not to participate in the refinancing program because of (1) the program's 90-day arrearage restriction, (2) the collateral required by the private sector for refinancing, and (3) the expense and unattractiveness of refinancing small FMS loans. As an alternative to private sector refinancing, some debt relief could be achieved by the use of appropriated funds to directly reduce interest rates on FMS loans. Congress appropriated up to $270 million for this purpose, subject to presidential request. According to DSAA officials, the administration has not requested the funds because the money would likely come from discretionary security assistance funds.

Background

In December 1986, the administration proposed a debt relief package to aid countries that were having difficulties repaying their debt due in part to the high interest rate on FMS loans. The program allowed for countries to prepay the face value of the loans or to delay interest payments and make a balloon payment at maturity. Three countries—South Korea, Oman, and Thailand—were to participate. However, in July 1987, the Comptroller General issued a decision stating that the proposal should not be implemented without specific legislative authority.

On December 22, 1987, debt reform legislation was approved, allowing countries to prepay FMS loans. The legislation identifies three criteria under which FMS loans may be refinanced. They must mature after September 30, 1989, have interest rates of 10 percent or higher, and have been outstanding as of December 22, 1987. Additionally, the legislation requires that countries remain current within 90 days on payments for all refinanced loans and for FMS loans outstanding as of December 22, 1987, to be eligible for additional FMS and Military Assistance Program (MAP) funds.

The Secretary of the Treasury issued regulations for the program on July 6, 1988. The regulations divide the responsibility for reviewing and approving applications to refinance loans among DSAA and the Departments of the Treasury and State. DSAA has assumed the lead responsibility for coordinating refinancings with the countries and the financial institutions to include identifying the eligible FMS loans and conducting preliminary reviews of countries' applications. The regulations permit all FMS loans—direct, guaranteed, and rescheduled[1] —to be refinanced if they meet the three eligibility criteria. More than 90 percent of all loans eligible to be refinanced are guaranteed loans financed by the Federal Financing Bank (FFB).

The loans are being refinanced in the public securities market, where U.S. financial institutions underwrite bonds issued, on behalf of the countries, to raise funds necessary to make the loans to the countries. The U.S. government guarantees 90 percent of the private loan used to refinance the debt or any portion or derivative of the private loan. The 90-percent guaranteed portion of the private loan cannot be separated from the 10-percent unguaranteed portion (non-separability) at any time. This precludes the creation of two separate securities, one fully guaranteed by the U.S. government and one backed by the credit of the

[1]Direct loans are appropriated and therefore in the budget; guaranteed loans are financed through Treasury borrowing and are guaranteed by DSAA; and rescheduled loans are refinanced through the Paris Club, a multilateral environment in which debtor and creditor nations negotiate rescheduling of official debt (i.e., country to country).

issuing country. According to financial institution representatives, however, the U.S. securities market will not accept the risk of the 10-percent portion of the loan secured by a foreign country. As a result, financial institutions are requiring countries to collateralize the 10-percent unguaranteed portion of the loan to eliminate that risk.

The proceeds of the bond issuance are used to prepay the original FMS loans. Specifically, in the case of guaranteed loans, the proceeds are used to prepay FFB. FFB borrows funds from Treasury under a master note agreement. The agreement states that each advance of funds (loans) by Treasury to FFB must match the terms, except the interest rate, of corresponding loans made by FFB to the countries. Accordingly, the loans from Treasury must have the same principal amounts, maturity dates, principal and interest payment schedules, and provisions as the corresponding loans made by FFB.

FFB charges a borrower the interest rate it incurs on the Treasury loan, plus a fee of 1/8 of 1 percent to cover administrative costs and to establish a reasonable reserve for contingencies. The administrative fees are accumulated in the FFB's reserve fund and turned over to the Treasury General Fund at the end of each quarter.

FFB's general policy is to accept prepayment of loans at a "current Treasury market value." A loan's "current Treasury market value," computed as defined by FFB, is the present value,[2] based on comparable Treasury interest rates, of the loan's principal and interest payments that FFB forfeits by accepting prepayment. When a loan is prepaid at its current Treasury market value, FFB experiences neither economic gain nor a loss on the prepayment.

The debt reform legislation directs FFB to accept prepayment of the FMS loans at book value. FFB, however, remains obligated to the Treasury for the difference between the present value of the prepaid loans and the prepayment amounts FFB received. There are two primary alternatives under which FFB can repay this difference to the Treasury. One alternative is to use FFB's reserve fund, but at the current rate of 1/8 of 1 percent, it would take FFB several years to repay the Treasury. The second alternative is to obtain appropriations from Congress to repay the Treasury. These alternatives are discussed more fully in our report, Federal

[2]Present value is the value today of principal and interest amounts to be paid or received later, discounted at some interest rate.

Financing Bank: The Government Incurred a Cost of $2 Billion on Loan Prepayments (GAO/AFMD-89-59, to be issued).

FMS Loans Eligible for Refinancing

As of August 2, 1988, $26.4 billion in FMS loans was outstanding, including $18.9 billion in guaranteed loans, $5.4 billion in direct loans, and $2.1 billion in previously rescheduled loans.

We estimate that about $14 billion of the total $26.4 billion in outstanding FMS loans is eligible to be refinanced. Six countries—Israel, Egypt, Turkey, Pakistan, Greece, and Spain—borrowed $12.6 billion, or 90 percent, of the $14 billion eligible to be refinanced. Israel and Egypt alone account for $9.9 billion, or 71 percent, of the $14 billion.

All arrearages, regardless of interest rates, are eligible to be refinanced. As of September 30, 1988, $768 million in overdue payments (principal and interest) was eligible to be refinanced. Appendixes II and III summarize outstanding FMS loans, eligible principal, and arrearages by country.

As of May 18, 1989, six countries had refinanced almost $7.6 billion: Israel, $4.8 billion; Jordan, $222 million; Pakistan, $629 million; Spain, $315 million; Tunisia, $196 million; and Turkey, $1.5 billion. Jordan, Turkey, and Spain refinanced $100 million, $478 million, and $17,000 in arrearages, respectively.

Program Costs

A loan is a financial asset that is designed to provide interest and principal payments to the lender over a period of years. The value of these payments at any point in time can be determined by discounting the future payment stream by an appropriate interest rate to determine its present value. For the federal government, the appropriate interest rate to use in determining the current Treasury market value of a loan is the current market yield on outstanding Treasury obligations that will mature in the comparable length of time. The Treasury borrowing rate should be used because the government is a net borrower of funds, and this is the rate at which Treasury would borrow money if the prepayment had not taken place. The loan's value should also be adjusted to reflect expected defaults. If the net proceeds of a prepayment are equal to the loan's present value, the government experiences no financial loss by allowing prepayments.

For example, if a loan with an interest rate of 10 percent and no chance of default were considered for prepayment and the Treasury borrowing rate were also 10 percent, then the current Treasury market value of the loan would be its face value. If the Treasury rate were 8 percent on the same loan, the current Treasury market value of the loan would be greater than the face value. Conversely, if the Treasury rate were 12 percent at the proposed prepayment date, the current Treasury market value would be less than its face value.

The costs to the government associated with the FMS debt reform legislation will be incurred over time. The prepayment program generates budgetary receipts in the prepayment year, reducing the Treasury's need to borrow money. The receipts, however, will be offset by the forgone principal and interest payments in the future, and as a result, the Treasury will increase its borrowing in later years because of the lost offset income.

DSAA identified 13 countries most likely to refinance their eligible FMS loans. These countries have 81 loans that are eligible for refinancing with a total face value of $13.4 billion,[3] or 96 percent of the total $14 billion in eligible principal for refinancing. For fiscal year 1989, the current Treasury market value of principal and interest payments for all eligible loans of the 13 countries is $15.9 billion. Thus, if the 13 countries prepaid all their eligible loans in fiscal year 1989, the present value cost to the U.S. government would be $2.5 billion. This figure is obtained by subtracting the loans' total eligible face value amounts for the 13 countries, $13.4 billion, from the current Treasury market value of the future principal and interest payments, $15.9 billion. (See table 1 for the cost by country.)

[3]In these calculations, we did not include five loans for which DSAA did not identify a consolidated interest rate. One loan for each of the following five countries was not included: Greece, Jordan, Morocco, Portugal, and Thailand. The total value of the excluded loans is about $153 million, or 1.1 percent of the total value of the loans for the 13 countries (about $13.4 billion).

Table 1: Potential Cost to the U.S. Government Resulting From Prepaid Loans

Dollars in thousands

Country	Potential cost
Egypt	$839,614
Greece	35,503
Honduras	1,602
Israel	1,205,708
Jordan	6,588
Korea	38,051
Morocco	11,359
Pakistan	51,170
Portugal	2,841
Spain	20,503
Thailand	6,728
Tunisia	17,468
Turkey	256,173
Total	**$2,493,308**

DSAA, however, does not expect the 13 countries to prepay all their eligible FMS loans but estimates that they will prepay $9.7 billion, or 72.4 percent, of the $13.4 billion. DSAA does not anticipate that all the prepayments will be made in fiscal year 1989 but rather that prepayments will be spread over fiscal years 1988, 1989, and 1990.[4] For fiscal year 1989, the current Treasury market value of the $9.7 billion in expected loan prepayments (unpaid principal balance) is $9.3 billion; the market value of the government's receipts (that is, principal and interest payments over the life of the loans) for the loans that are expected to be prepaid is $11.1 billion. Thus, the present value cost to the government would be $1.8 billion ($11.1 billion minus $9.3 billion).[5]

A large share of the total amount of eligible loans is attributable to Israel. The total face value of Israel's eligible loans is $5.4 billion. The difference between the face value of prepayments of all of Israel's loans in fiscal year 1989 and the market value in 1989 of Israel's original payments ($6.6 billion) is $1.2 billion, which would be the present value cost to the government over the long term.

[4]Israel, the only country to prepay in fiscal year 1988, prepaid some of its eligible FMS loans on September 29, 1988. In our analysis, however, we treated this prepayment as if it had been prepaid in fiscal year 1989.

[5]We did not estimate default rates over the life of the loans. Any adjustments based upon possible defaults, however, would have to consider that the U.S. government guarantees 90 percent of the private loans used to refinance the debt (see page 2).

Issues Affecting Participation

All countries are eligible to refinance their FMS loans that meet the legislative criteria. So far, Israel, Jordan, Pakistan, Spain, Tunisia, and Turkey have refinanced some or all of their eligible loans. Other countries, including Greece, Egypt, and Morocco, have expressed interest and may refinance in the near future. Although all countries are eligible to participate in the program, some may decide not to because (1) the legislation requires countries to remain current within 90 days on refinanced loans and FMS loans outstanding as of December 22, 1987, (2) they cannot afford the collateral, and (3) their eligible FMS debt is too small to be considered attractive to either the countries or the financial institutions because of associated transaction costs.

The 90-Day Restriction

The debt reform's 90-day arrearage criteria is more restrictive than other legislative requirements. Under the debt reform legislation, countries that are in default for more than 90 days (1) on any refinanced loan or (2) on any FMS loans outstanding on December 22, 1987, are not eligible for additional FMS credits and Military Assistance Program funds.

Since mid-1977, a legislative restriction, or sanction, known as the Brooke amendment has been included in the annual appropriations act. The Brooke amendment terminates future foreign assistance to any country that is in default in excess of one calendar year in payment of principal or interest. If countries do not refinance under the new legislation, they can remain in arrears longer without being subject to Brooke amendment sanctions.

According to DSAA data, 12 countries have been sanctioned under the Brooke amendment over the past few years. These countries are Benin, Bolivia, Costa Rica, Ethiopia, Gabon, Liberia, Madagascar, Nicaragua, Panama, Peru, Somalia, and Sudan. Ethiopia and Nicaragua have been under Brooke amendment sanction since 1980. Six of the 12 countries (Bolivia, Liberia, Peru, Panama, Somalia, and Sudan) have outstanding FMS loans eligible for refinancing; Sudan's is the largest loan—about $145 million.

Some countries rely on the additional cash-flow period of one year permitted by the Brooke amendment to pay FMS debt. As of September 30, 1988, 17 of the 32 countries with eligible FMS loans were in arrears for more than 90 days (see table 2). According to private and government sector representatives, some countries will have difficulties staying current within 90 days and will not refinance because they do not want to jeopardize future FMS credits. Without refinancing, they can continue to pay within the 1-year limit.

Table 2: FMS Loan Payments in Arrears for More Than 90 Days (As of Sept. 30, 1988)

Country	Payment in arrears
Botswana	$230
Bolivia	671,454
Dominican Republic	2,237,325
El Salvador	18,902,829
Honduras	7,523,707
Jamaica	107,032
Jordan[a]	58,082,573
Liberia	4,560,650
Morocco	5,136,472
Niger	335,103
Peru	5,478,623
Panama	3,954,791
Portugal	308
Somalia	2,395,273
Sudan	16,875,262
Turkey[a]	329,722,494
Zaire	6,007,777

[a]Both Jordan and Turkey refinanced in December 1988 and now must remain current within 90 days on their refinanced loans and other loans outstanding as of December 22, 1987.

Collateral

The Treasury's regulations preclude private lenders from using only the guaranteed portion of the private loan to secure bonds. Financial institutions underwrite bonds issued to raise funds for the countries' loans. According to financial institution representatives, although the United States guarantees 90 percent of the loan, the public securities market will not accept the remaining 10-percent risk because of the "weakest link" theory. The premise of the theory is that the entire loan assumes the risk of the weakest link, in this case, the 10-percent risk. As a result, financial institutions are requiring countries to provide collateral for the 10-percent unguaranteed portion of the loan. According to financial institution representatives and Treasury Department desk officers, some countries may have difficulty raising the 10-percent collateral. To raise the collateral, the countries can either pledge reserves or borrow from a third party. This would reduce potential savings to the countries.

To address the collateral requirement, some financial representatives have suggested allowing countries to use FMS credits to purchase collateral. The debt reform legislation revises the definition of defense services to allow countries to use FMS credits to refinance FMS debt outstanding on December 22, 1987, but according to DSAA officials, the countries may not use FMS credits to purchase collateral.

Government and private sector representatives said that loans could be refinanced without collateral if the countries paid higher interest rates. According to a Treasury official, refinancings without collateral will cost the countries an additional 1-1/2 percentage points.

Country Debt Too Small

Some financial institution representatives said that the associated transaction costs, which include financial institution and attorney fees, may deter some countries with small loans, such as Honduras, from refinancing their loans. The costs may be substantial enough to erode any potential savings to countries with small, eligible FMS loans.

Additionally, because of fixed transaction costs associated with refinancings, small loans are also less attractive to the financial institutions. However, the financial institution representatives' definitions of small loans varied. For example, some said loans of less than $100 million were small; others said less than $25-30 million were small. Sixteen countries, or about 50 percent of the total number, have eligible loans below $30 million, and 20 countries, or 62 percent, have eligible loans below $100 million. (See app. III.) Therefore, about half or more of the countries may choose not to refinance because of the amount or size of their eligible loans.

Interest Reduction—Another Option for Foreign Borrowers

Congress appropriated up to $270 million to reduce interest rates to 10 percent on eligible FMS loans for countries that do not refinance. The funds are to be deposited in an account to be used to reduce the interest rates to 10 percent for the remaining life of the loans. This program may be an option for countries with small loans eligible for refinancing or for those that cannot afford the collateral. It eliminates the financial institutions from the transaction, thus reducing the transaction costs and the need for collateral for the participating countries. Although funds have been appropriated for this program, the administration has not requested them because of its concern that the funds likely would have to come from limited discretionary security assistance funds. This would restrict its ability to provide other security assistance.

Agency Comments

We received comments on a draft of this report from the Departments of Defense, State, and the Treasury. The Departments of Defense and the Treasury provided technical and editorial comments that have been incorporated into the report. The Department of State said that the report would be more useful if it considered the impact of various interest rates on the decisions of debtor countries to refinance. For example, fewer loans might be refinanced because of rising interest rates, which would then reduce the cost to the United States. We agree that changes in interest rates can affect decisions to refinance, but our objective was to estimate the cost on the basis of the best information available rather than to develop a series of estimates based on circumstances that could occur.

Our review was performed in accordance with generally accepted government auditing standards. Appendix I describes our objectives, scope and methodology.

Unless you publicly announce its contents earlier, we plan no further distribution of this report until 14 days from its issue date. At that time, we will send copies to the Chairman, House Committee on Foreign Affairs; the Secretaries of State, Defense, and the Treasury; the Director, Office of Management and Budget; and other interested parties on request.

Please contact me at (202) 275-4128 if you or your staff have any questions concerning this report. Other major contributors to this report are listed in appendix V.

Sincerely yours,

Joseph E. Kelley

Joseph E. Kelley
Director, Security and International
Relations Issues

Contents

Abbreviations

DSAA	Defense Security Assistance Agency
FFB	Federal Financing Bank
FMS	Foreign Military Sales
GAO	General Accounting Office

Objectives, Scope, and Methodolgy

Our objectives were to (1) estimate the cost to the U.S. government of refinancing FMS loans and (2) assess the implications of the program.

We conducted our review from June to September 1988 in accordance with generally accepted government auditing standards. We met with officials from DSAA, the Departments of State and the Treasury, and the Office of Management and Budget in Washington, D.C. We also interviewed representatives of nine financial institutions in New York.

To estimate the cost of the prepayments of eligible FMS loans, we relied on DSAA estimates of

- the amounts eligible for prepayment, the interest rate on loans eligible for prepayment, principal payments, and the maturity of the loans and
- countries that are most likely to refinance their loans and the amounts and timing of refinancings.

In determining the cost of the refinancings, we calculated the semiannual payment of principal and interest for each loan. We then discounted these future receipts in order to calculate their present value, that is, the value to the government of the future payments, using a discount rate equal to the cost of government borrowing applicable to the time period over which the loans would run. For the period examined, we used discount rates ranging from 8.2 to 9.0 percent, depending on the maturity of the loan. These present values were then added together. From this total, we subtracted the total eligible loan amount. This difference represents the cost to the government if all eligible loans from the 13 countries were prepaid in fiscal year 1989.

DSAA, however, does not expect that all loans will be prepaid. We estimated that if prepayments were made they would not all occur in fiscal year 1989 but would likely be spread over fiscal years 1988, 1989, and 1990.[1] The present value of the expected loan prepayments was subtracted from the present value of the principal and interest payments for loans that were expected to be prepaid to obtain the cost to the U.S. government.

[1] Israel, the only country to prepay in fiscal year 1988, prepaid some of its eligible FMS loans on September 29, 1988. In our analysis, we included this as fiscal year 1989.

Outstanding FMS Debt (As of August 2, 1988)

Dollars in thousands

	Type of loan			
Country	Guaranteed	Direct	Rescheduled	Total
Botswana	$5,923.6	$5,000.0	$0.0	$10,923.6
Bolivia	6,000.0	0.0	28.6	6,028.6
Sri Lanka	1,800.0	0.0	0.0	1,800.0
Cameroon	3,500.0	5,000.0	0.0	8,500.0
Colombia	13,421.0	0.0	0.0	13,421.0
Zaire	14,865.0	11,000.0	124,203.5	150,068.5
Dominican Republic	10,750.0	3,000.0	2,236.7	15,986.7
Ecuador	10,819.0	7,828.0	18,597.3	37,244.3
Egypt	4,550,000.0	0.0	1,431,158.9	5,981,158.9
El Salvador	79,425.0	10,000.0	0.0	89,425.0
Ethiopia	0.0	0.0	0.0	0.0
Gabon	1,425.5	0.0	1,181.1	2,606.6
Greece	1,321,179.0	1,273,650.0	0.0	2,594,829.0
Haiti	520.0	0.0	0.0	520.0
Honduras	28,204.7	0.0	0.0	28,204.7
Indonesia	72,671.0	50,022.9	0.0	122,693.9
Israel	8,557,794.7	387,248.9	0.0	8,945,043.6
Jamaica	1,791.4	0.0	1,484.6	3,276.0
Jordan	171,206.6	171,345.0	0.0	342,551.6
Kenya	46,697.0	3,000.0	0.0	49,697.0
Korea	0.0	392,690.0	0.0	392,690.0
Lebanon	83,184.0	0.0	0.0	83,184.0
Liberia	11,261.9	0.0	7,026.4	18,288.3
Malaysia	23,982.8	5,484.0	0.0	29,466.8
Morocco	145,725.1	41,750.4	146,266.3	333,741.8
Oman	40,000.0	49,140.0	0.0	89,140.0
Niger	1,998.2	0.0	2,863.1	4,861.3
Nicaragua	0.0	0.0	0.0	0.0
Peru	14,455.2	8,000.0	6,611.2	29,066.4
Philippines	125,187.1	29,335.0	70,758.8	225,280.9
Pakistan	423,691.5	1,051,524.0	0.0	1,475,215.5
Panama	7,908.0	3,828.0	560.5	12,296.5
Portugal	136,500.0	98,065.0	0.0	234,565.0
Senegal	1,264.0	0.0	7,190.0	8,454.0
Somalia	50,672.0	0.0	40,126.6	90,798.6
Spain	737,017.0	487,800.0	0.0	1,224,817.0
Sudan	105,590.0	0.0	42,764.4	148,354.4

(continued)

Country	Type of loan			Total
	Guaranteed	Direct	Rescheduled	
Thailand	170,000.0	175,531.0	0.0	345,531.0
Tunisia	229,687.0	75,839.0	0.0	305,526.0
Turkey	1,669,834.0	1,072,394.0	193,737.0	2,935,965.0
Total	**$18,875,951.3**	**$5,418,475.2**	**$2,096,795.0**	**$26,391,221.5**

FMS Debt Eligible for Refinancing (As of Sept. 30, 1988)

Dollars in thousands

Country	Eligible principal	Amount in arrears[a]	Total eligible FMS debt
Botswana	$1,073.0	$127.6	$1,200.6
Bolivia	5,228.6	671.5	5,900.1
Sri Lanka	0.0	2.5	2.5
Cameroon	0.0	922.8	922.8
Colombia	0.0	241.7	241.7
Zaire	7,378.4	11,480.5	18,858.9
Dominican Republic	7,996.9	3,431.0	11,427.9
Ecuador	14,463.8	592.7	15,056.5
Egypt	4,513,415.0	181,744.2	4,695,159.2
El Salvador	67,700.0	18,902.8	86,602.8
Ethiopia	0.0	5,561.1	5,561.1
Gabon	0.0	4,284.8	4,284.8
Greece	342,751.3	0.0	342,751.3
Haiti	438.4	62.5	500.9
Honduras	21,964.1	8,989.8	30,953.9
Indonesia	24,497.1	0.0	24,497.1
Israel	5,412,436.5	0.0	5,412,436.5
Jamaica	1,722.6	343.5	2,066.1
Jordan	120,349.1	80,339.4	200,688.5
Kenya	21,987.4	2,166.1	24,153.5
Korea	230,000.0	0.0	230,000.0
Lebanon	4,547.0	0.0	4,547.0
Liberia	14,376.0	5,668.8	20,044.8
Malaysia	3,077.2	0.0	3,077.2
Morocco	175,499.8	30,275.1	205,774.9
Oman	0.0	0.0	0.0
Niger	2,130.1	335.1	2,465.2
Nicaragua	0.0	389.4	389.4
Peru	10,100.1	6,223.6	16,323.7
Philippines	63,460.2	0.6	63,460.8
Pakistan	618,164.6	0.0	618,164.6
Panama	6,231.5	4,502.1	10,733.6
Portugal	31,888.4	0.3	31,888.7
Senegal	0.0	317.0	317.0
Somalia	61,582.1	2,395.3	63,977.4
Spain	315,478.0	0.0	315,478.0
Sudan	145,184.4	22,223.6	167,408.0
Thailand	160,760.1	0.0	160,760.1

(continued)

Country	Eligible principal	Amount in arrears[a]	Total eligible FMS debt
Tunisia	196,243.0	0.0	196,243.0
Turkey	1,399,224.3	375,779.5	1,775,003.8
Total	**$14,001,349.0**	**$767,974.9**	**$14,781,723.9**

[a]Arrears include principal and interest

Agency Comments

DEPARTMENT OF THE TREASURY
WASHINGTON

May 23, 1989

Dear Mr. Conahan:

In response to your April 21, 1989 request for the Treasury Department's review and comment on your draft report, "Foreign Military Sales Debt Refinancing" (GAO/Code 463765), we would suggest the editorial changes in the enclosed mark-up.

We appreciate the opportunity to review the draft report.

Sincerely,

William J. Bremner
Deputy Assistant Secretary
(Federal Finance)

Mr. Frank C. Conahan
Assistant Comptroller General
U.S. General Accounting Office
Washington, D.C. 20548

Enclosure

DEFENSE SECURITY ASSISTANCE AGENCY

WASHINGTON, DC 20301-2800

22 MAY 1989

In reply refer to:
I-02789/89

Mr. Frank C. Conahan
Assistant Comptroller General
U.S. General Accounting Office
Washington, D.C. 20548

Dear Mr. Conahan:

This is the Department of Defense (DoD) response to the General Accounting Office (GAO) draft report, "SECURITY ASSISTANCE: Foreign Military Sale Department Refinancing," dated April 20, 1989 (GAO Code 463765/OSD Case 7967).

The DoD concurs with the draft report. A few technical corrections and updates were provided separately to members of your staff and they have been incorporated in the draft. The Department appreciates the opportunity to comment on the draft report.

Glenn A. Rudd

GLENN A. RUDD
ACTING DIRECTOR

United States Department of State

Comptroller

Washington, D.C. 20520

May 23, 1989

Dear Mr. Conahan:

I am replying to your letter of April 21, 1989 to the Secretary which forwarded copies of the draft report entitled "Foreign Military Sales Debt Refinancing" (Code 463765) for review and comment.

The enclosed comments were coordinated within the Department and prepared by the Bureau of Economic and Business Affairs.

We appreciate the opportunity to review and comment on the draft report.

Sincerely,

Roger B. Feldman

Roger B. Feldman

Enclosure:
As stated.

Mr. Frank C. Conahan
Assistant Comptroller General,
National Security and
International Affairs Division,
U.S. General Accounting Office,
Washington, D.C. 20548

GAO DRAFT REPORT COMMENTS: FOREIGN MILITARY SALES DEBT REFINANCING (CODE 463765)

The State Department offers the following comments on the GAO draft report on Foreign Military Sales (FMS) debt refinancing.

See p. 10

We agree with the report's conclusions that refinancing eligible FMS debt with a private loan under a 90 percent U.S. Government guarantee carries a potential cost to the USG. The scope of the report could usefully be broadened, however, to consider the impact of various market interest rate scenarios on decisions by debtor countries to refinance under this program. We understand that at least one FMS debtor--Morocco--has elected not to refinance its outstanding FMS loans because increased interest rates have made this option relatively unattractive. We assume that other eligible debtors will make similar choices as long as current market conditions persist. The effect clearly would be to reduce the cost of the program to the United States as estimated by GAO.

Alan Larson

Alan Larson
Acting Assistant Secretary
Bureau of Economic and Business Affairs

Major Contributors to This Report

National Security and International Affairs Division, Washington, D.C.

Stewart L. Tomlinson, Assistant Director, Security and International Relations Issues
Deborah A. Davis, Evaluator-in-Charge
Charles Perdue, Economist

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