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U.S. Foreign Assistance: USAID Loan Guarantees

The U.S. Agency for International Development (USAID), the leading humanitarian and development agency in the U.S. government, provides assistance through multiple mechanisms. Until the early 1980s, a significant portion of its assistance was provided in the form of concessional loans for development purposes, often for purposes of building economic infrastructure, in much the same way as the World Bank provides loans to developing countries today. Since then, it has provided almost all assistance on a grant (i.e., gift) basis. But the agency maintains two programs that issue loan guarantees: the Development Credit Authority (DCA) and sovereign loan guarantees. Both have grown in prominence in recent years.

Development Credit Authority

Although the DCA program was formally launched in 1999, it has its roots in several predecessor loan guarantee programs with discrete development purposes, including the Housing Loan Guaranty Program, originating in the 1960s, and the 1990s Micro and Small Enterprise Development Program. Like those programs, the DCA stimulates private sector lending for development purposes by employing the promise of U.S. government repayment typically of up to half of each loan in case of default. By lessening the liability to the lending bank, these partial loan guarantees encourage banks to make loans for purposes and for clients that they may have previously avoided as commercially unviable or too risky.

DCA loan guarantees may be used to support any development purpose in any part of the world. In FY2016, nearly half of DCA guarantees issued by value (47%) promoted activity in energy; 26% focused on agriculture; 9% were multi-sector; 3%, environment; 4%, women; 3%, trade; 3%, health; and 2% supported infrastructure. DCA programs have always been prevalent in sub-Saharan Africa. In FY2016, 51% of the value of DCA guarantee assistance went to sub-Saharan Africa; 25% to Asia; 15% to Latin America and the Caribbean; 3% in Europe and Eurasia; and 6% was globally oriented. Often USAID technical assistance is provided at the mission level to reinforce the development purpose of the loans.

Examples of DCA Loan Guarantees

USAID guarantees vary in form. They may support a loan or a bond; they may support a loan directly from a specific bank to a specific single borrower or a loan to a borrower from a yet unidentified bank. The vast majority of DCA guarantees are loan portfolio guarantees in which bank loans are provided to a range of borrowers in one or multiple countries to be used for certain purposes. The duration of guarantees is defined in each agreement—most range from 5 to 20 years. Current appropriations legislation limits the amount of DCA-guaranteed loans provided to any one country in any one fiscal year to $300 million. It further restricts total U.S. participation in any year to no more than $1.75 billion in lending no matter the portion being guaranteed.

Examples of 2016 DCA guarantees include the following:

Burkina Faso. A guarantee will make $16 million available for lending to micro, small, and medium enterprises (MSMEs) along the non-cotton agricultural value chain: producers, agro-processing businesses, and businesses selling agricultural products.

Kenya. $17 million in loans are expected to be provided to individuals, MSMEs, service providers and others in the agriculture, renewable energy, and water and sanitation sectors, all currently lacking adequate sources of financing.

East and South Africa Regions. A guarantee will make $50 million available to support lending in the power sector for renewable energy generation and natural gas-fired generation, transmission, and distribution.

Haiti. A guarantee will make $6 million available to support building of low- to moderate-income housing.

India. A guarantee will mobilize $9 million to support a healthcare provider's early stage development of a primary care model.

Table 1. DCA Appropriations
(in $ millions)

	FY15	FY16	FY17	FY18 req.
Program Transfer Ceiling	40	40	50	60
DCA Administration	8.1	8.1	10.0	9.1
Annual Portfolio Limit	1,500	1,500	1,750	2,000

Source: Foreign Operations Budget Justification Documents.

U.S. Funding for DCA Loan Guarantees

Each year, in the annual State, Foreign Operations, and Related Programs (SFOPS) appropriations, Congress specifies an amount up to which USAID may transfer funds from other accounts to support DCA loan guarantee programs. It also directly appropriates funding to support the administrative costs of the office that both runs the DCA program and administers sovereign loan guarantees.

The level of program funding required is not the same as the level of actual lending that takes place as a result of the guarantees. First, as noted, the United States is usually only

guaranteeing half of the proposed loan amount. Second, under existing budget practices, the only program funding put forward is the so-called subsidy cost, the amount calculated that might be required in case of loan default.

The risk of default depends on a range of factors, which may vary by country and sector. USAID calculates the risk of default and the appropriate subsidy for each guarantee in consultation with the Office of Management and Budget (OMB). The subsidy amount for a particular loan guarantee is placed in a Treasury-held account that also holds all other DCA subsidies, and, in case of default, those collective funds are used to back up all the loans as needed. Only 2.4% of the DCA portfolio experienced default between 1999 and 2015.

With the risk of default low and shared with the lending bank, each U.S. dollar leverages a much larger amount of potential lending. So, for instance, $60 million in potential loans to a parastatal electric utility in Zambia requires a $5.5 million subsidy, leveraging nearly $11 for every aid dollar. In FY2016, $28 million in total subsidies were expected to generate up to $891 million in loans, a 32 to 1 ratio.

Sovereign Loan Guarantees

Under a sovereign loan guarantee, the United States government takes on the entire risk associated with a private bank loan to a sovereign country or support for issuance of foreign government bonds. Guarantees allow a country to have access to financing from international capital markets at a rate significantly lower than would be the case without U.S. backing. Often the guarantee is made in association with reforms specified in the loan agreement made between the United States and the recipient country.

Table 2. Sovereign Loan Guarantees Since 2000

Ukraine	FY2014	$1 billion
	FY2015	$1 billion
	FY2016	$1 billion
Tunisia	FY2012	$485 million
	FY2014	$500 million
	FY2016	$500 million
Jordan	FY2013	$1.25 billion
	FY2014	$1 billion
	FY2015	$1.5 billion
Iraq	FY2017	$1 billion
Egypt	FY2005	$1.25 billion
Israel	FY2003	$4.1 billion (drawn on to date from $8 billion authorized)

Source: USAID.

The United States has provided sovereign loan guarantees to six different countries since 2000: Israel, Egypt, Tunisia, Jordan, Iraq, and Ukraine. Although Section 122 of the Foreign Assistance Act of 1961 (P.L. 87-195) provides basic authority to the President to provide loans, including the DCA and sovereign loan guarantees, in practice, sovereign guarantees have been specifically authorized by Congress. For example, the FY2017 SFOPS appropriations (§7034 (o)(1) of P.L. 115-31) authorizes loans to Egypt, Tunisia, Jordan, Ukraine, and Iraq.

Once Congress has approved the use of a sovereign guarantee, an interagency committee meets to structure the guarantee and agree on terms and conditions. That group is typically coordinated by the State Department, with active participation of USAID, Treasury, and OMB.

The purposes and associated conditionality of sovereign loan guarantees have varied. Guaranties for Israel in 2003 were intended to aid that country's then-ailing economy. Conditions included, among other things, that the funds be used to refinance its debt, that they not be used for military purposes or to support activities in the occupied territories, and that total guarantees available could be reduced by the amount Israel independently spends on settlements in the occupied territories (in 2003 and 2005, $1 billion of the original $9 billion authorization was deducted as a result). Although loan guarantees are available for a defined period, in the case of Israel, their availability ($3.8 billion remaining) has been extended twice, currently to September 2019.

Loan guarantees have been provided to Tunisia and Jordan in the wake of the "Arab Spring" to foster economic and political reform and, in the latter case, to address economic dislocations stemming from the Syria refugee crisis. The Iraq guarantee is meant to address the economic impact of low oil prices and the war with the Islamic State. Conditions for all these countries have included adherence to economic reforms.

The sovereign loan guarantees provided to Ukraine are intended to assist the country reach economic and political stability in the face of challenges from Russia and Russian-supported separatists as well as to send a signal of U.S. political support. Conditions include adoption of economic and governance reforms. Ukraine has also been required to provide certification that proceeds from guarantees will contribute to social spending to help protect the most vulnerable citizens from the impact of economic adjustments.

As is the case with the DCA, to support the loan or bonds in case of default—an event made unlikely due to the highly negative consequences that would result to the borrowing country—the United States sets aside a subsidy cost in the U.S. Treasury using funds appropriated in the SFOPS legislation, usually from the Economic Support Fund (ESF) account. The subsidy level is determined on the basis of a country rating of the estimated risk involved provided by OMB, contract terms, and other loan characteristics. The 2015 $1.5 billion guarantee for Jordan required a $185.6 million subsidy; the 2015 $1 billion guarantee for Ukraine required $447 million. No defaults of guaranteed sovereign loans have occurred to date.

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