

CRS Issue Brief

Israel's Request for U.S. Loan Guarantees

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LEGISLATION

Israel's Request for U.S. Loan Guarantees

SUMMARY

Between January 1990 and August 1993, Israel welcomed over 430,000 new immigrants, mostly from the Soviet Union and Ethiopia. Israel expects an additional 600,000 Soviet Jews to emigrate to Israel over the next 3 years. Israel anticipates spending between \$45 billion and \$50 billion over 5 years to provide housing, infrastructure, clothing, food, education, transportation, training, and other services associated with settling the new immigrants. On Sept. 6, 1991, Israel requested from the United States a total of \$10 billion in loan guarantees over 5 years to finance housing, infrastructure, and job creation for the immigrants. Israel will borrow \$10 billion from U.S. commercial banks, pension funds, corporations, and other sources, and the U.S. Government will guarantee repayment of the loans. Israel will seek another \$10 billion from other nations, \$5 billion in philanthropic donations, and will finance the other \$25 billion in its own national budget.

Consideration of the loan guarantees was delayed from September 1991, when Israel submitted its original request, and January 1992 to allow Secretary of State Baker time to arrange for the Madrid peace conference that began on Oct. 30, 1992, and again from January through September 1992 when Congress, Israel, and the Administration could not agree on conditions to be placed on the loan guarantees.

The Senate approved a non-binding resolution (S.Res. 277) on Apr. 1, 1992, expressing the "sense of the Senate that the

United States Government should support appropriate loan guarantees to Israel for refugee absorption."

After more than a year of negotiations with Israel and Congress over the terms and conditions of the Israeli request, President Bush formally asked Congress on Sept. 11, 1992 to approve up to \$10 billion in loan guarantees, in \$2 billion annual increments over FY1993-FY1997. Israel could not use the loans for activities outside its pre-1967 borders, and the President would retain the right to suspend or terminate the loans if the terms and conditions are violated. The President could also reduce the loans by an amount Israel spent the previous year on settlement construction and other activities deemed inconsistent with U.S.-Israeli agreements concerning implementation of the program. President Clinton informed Congress on Sept. 30, 1993, that he intended to reduce the amount available to Israel in FY1994 by \$437 million, equal to the amount Israel spent on settlements in the occupied territories in FY1993. Israel further agreed to pay all fees associated with the loan guarantees and the President did not ask Congress to appropriate funds. The Senate Appropriations Committee attached the loan guarantee proposal to the Foreign Operations Appropriations bill, H.R. 5368, which was subsequently enacted as P.L. 102-391, on Oct. 6, 1992.

MOST RECENT DEVELOPMENTS

An Israeli newspaper reported on Nov. 24, 1993, that the Finance Ministry would commit \$800 million of the FY1994 \$2 billion in loan guarantees to the Israeli Electric Company for facilities development. A rumor circulating in Israel suggested that some future loan guarantee funds would be used to finance military redeployments called for in the Palestinian-Israeli peace negotiations. In February 1994, some Members of Congress asked if loan guarantees could be used to finance moving Israeli Jewish settlers from the occupied territories back to Israel, but Administration officials said the answer would depend upon Executive-Legislative branch consultations on the issue. (See also the "op-ed" piece in the Washington Post, May 29, 1994, p. C4.)

President Clinton informed Congress at the end of September 1993 that the \$2 billion in loan guarantees for Israel scheduled to be available in FY1994 would be reduced by \$437 million, the amount the Administration calculated the Israelis spent on settlements in the occupied territories in FY1993. Israel will be able to draw on \$1.563 billion in loan guarantees in FY1994. (See Section 226(d) of the Foreign Assistance Act of 1961, as amended by Section 601, Title VI, of P.L. 102-391, 106 Stat. 1633, Oct. 6, 1992.)

Late April 1994 news reports from Israel said that Israel had disbursed only \$800 million of the \$3 billion drawn from the \$10 billion in loan guarantees. The remaining \$2.2 billion was on deposit in foreign banks.

BACKGROUND AND ANALYSIS

Israel's Loan Guarantee Request

Israel submitted a formal request to Secretary of State James Baker on Sept. 6, 1991, for a total of \$10 billion in five annual installments of \$2 billion each for fiscal years 1992 through 1996. Israel needs funds to settle the 750,000 to one million Soviet Jews expected to migrate to Israel over the next few years. According to the Israeli request, the loan guarantees will be used to finance programs in the three areas -- housing, infrastructure, and employment -- that represent a significant portion of the costs of absorbing the growing immigration population. The loans would be used to cover part of the expense of constructing about 260,000 new housing units estimated to cost \$12 billion to \$15 billion and to finance infrastructure projects such as new main highways, a light rail line, and water and sewerage systems for 20 new towns or cities. The government expects to spend \$3 billion to \$4 billion annually in the 5 years between 1992 and 1997 to improve the Israeli physical base for the economy. Finally, between \$600 million and \$700 million in American-backed loans would be made available each year to Israeli businesses to import the additional capital goods necessary to stimulate the expansion of operations and more jobs for arriving immigrants.

Bush Administration September 1992 Proposal

After more than a year of negotiations with Israel and Congress over the terms and conditions of the Israeli request, President Bush formally asked Congress on Sept.

11, 1992 to approve up to \$10 billion in loan guarantees. Under the proposal, Israel will borrow \$10 billion from U.S. commercial sources, such as banks or insurance companies, and the U.S. Government will underwrite the loans, guaranteeing their payment should Israel default to the original lenders. The loan guarantees are in addition to, and separate from, U.S. foreign assistance to Israel, which is about \$3 billion per year. Agreement on the loan guarantee package had been worked out during meetings in mid-August between the President and Israeli Prime Minister Rabin. Uncertainty over the size and who would pay the fees associated with the loan guarantees, however, delayed a submission to Congress for another month. Initially, Israel reportedly agreed to pay fees totalling 3.5% of the loan amount. Office of Management and Budget (OMB) officials said in August, however, that fees might reach 7% to 9%, meaning that Congress would have to appropriate some money to back the loans. Some Members opposed the loan guarantee package if it required the expenditure of Federal funds and pressed the Administration to alter the arrangement. President Bush's proposal required Israel to pay for the entire fee amount, although OMB had not issued an estimate as to what that amount would be. Press reports indicated it might be about 4%, or \$80 million, for the initial \$2 billion of loans.

Congress Acts on Loan Guarantee Proposal

On Sept. 18, 1992, the Foreign Operations Subcommittee of the Senate Appropriations Committee added a Title VI to the foreign operations appropriations bill, H.R. 5368, that authorized the loan guarantees for Israel. The Committee passed the bill and reported it to the floor on September 23. The Senate voted 87 to 12 to pass H.R. 5368 with the loan guarantees for Israel on October 1, and requested a conference with the House. By a vote of 312 to 105, the House approved the conference report on October 5, and the Senate passed the conference report by voice vote the same day. On Oct. 6, 1992, the President signed the bill into law, P.L. 102-391. Key elements of P.L. 102-391 included the following (provisions not included in the President's proposal that were added by Congress are noted in brackets).

- **Size of the loan guarantees:** up to \$2 billion for each of FY1993 through 1997, with a total amount of up to \$10 billion [any amount not used in a fiscal year will remain available until Sept. 30, 1998]. [The United States guarantees 100% of the loans Israel will receive under the program. Repayment is to be over 30 years, with semi-annual payments of interest only for the first 10 years.]
- **Conditions on use of the loan guarantees:** loan guarantees may only be used for activities located in the pre-June 1967 Israeli borders.
- **Reductions of the loans due to continuing Israeli settlement activities:** the President may reduce the annual size of the loan guarantees by an amount equal to the estimated value of Israeli activities undertaken the previous year that the President determines are inconsistent with agreements between the United States and Israeli Governments on the use of the loans. (The President notified Congress on September 30, 1993 that the \$2 billion in loan guarantees for Israel scheduled to be available in FY 1994 would be reduced by \$437 million, the amount the Administration calculated the Israelis spent on settlements in the occupied territories in FY 1993. Israel will be able to draw on \$1.563 billion in loan guarantees in FY 1994.)

- **Suspension or termination of the loans:** the President may suspend or terminate the loans if he determines that the terms and conditions of the loans have been violated. The President is to report suspensions or terminations to the Speaker of the House and the President Pro Tempore of the Senate.
- **Congressional review of the suspension or termination of the loans:** within 30 days of being notified of the suspension or termination, Congress can enact a joint resolution continuing the loan guarantees despite the President's action. Presumably, the President would veto the joint resolution, requiring a two-thirds congressional majority to reinstate the loans.
- **Fees for the loan guarantees:** all fees associated with the loan guarantees will be paid by the Israeli Government [including an administration fee for the Agency for International Development, and origination fees to be paid as each increment is issued]; Congress was not asked to appropriate any funds. Israel may pay the fees using part of the annual \$1.2 billion economic aid it receives from the United States. The size of the fee will be determined annually by the OMB and will equal the estimated subsidy cost of the guaranteed loans (see below under "Budget Implications" for a discussion of subsidy costs). OMB set the subsidy rate at 4.6% for the first tranche, which means that Israel placed \$92 million in the Treasury account in addition to the administrative and origination fees.
- **Economic conditions:** a non-binding "sense of the Congress" states that the United States and Israel should continue to consult about economic and financial steps that Israel should undertake, specifically to address the areas of budget policies, privatization, trade liberalization, financial and capital markets, labor markets, competition policy, and deregulation.

Current Status of the Loan Guarantees

Israel and the United States sign agreements specifying conditions attached to the loan guarantees, types of projects to be financed with the guaranteed funds, and payments of fees and subsidies. Israel, the lenders, and the U.S. Government also sign agreements covering payment amounts and timetables, projects to be financed, conditions attached to the loans, definitions of default, and a myriad of other technical issues attached to the loans. On Dec. 23, 1992, AID released the first tranche of \$2 billion for FY1993. Israel arranged for the first installment of \$1 billion in March 1993, and for the second installment of \$1 billion in September 1993. The second annual tranche of \$1.563 billion (\$2 billion minus the \$437 million President Clinton deducted for Israeli settlement expansion) for FY1994 was available in October 1993, but has not been released by AID as of Mar. 3, 1994. Israel is still arranging the lender/underwriter syndicate.

Uses of Loan Guarantees: Because of the declining number of East European and Ethiopian Jews migrating to Israel and the possibility that Israel overestimated immigrant financial needs, Israelis, Members of Congress, and others have suggested several alternative uses for the loan guarantees. Among the alternative uses are; first, funding the Israeli military withdrawal from Gaza and Jericho as called for in the PLO-Israeli Declaration of Principles signed on Sept. 13, 1993 (Israeli General Ehud

Barak was quoted as saying the military withdrawal from Gaza and Jericho would cost between \$175 million and \$245 million); second, paying compensation to Israeli settlers who leave their homes in the occupied territories and return to Israel; third, building housing or funding infrastructure projects for settlers returning to Israel from the occupied territories; fourth, meeting Israel's \$75 million pledge to the \$2 billion fund to finance development of the Palestinian entity; and fifth, meeting some of Israel's regular budget expenditures. It is not known if any of these or other alternative uses for the loan guarantees would be legal under U.S. law -- Section 226(c) of the Foreign Assistance Act of 1961 forbids using the funds in the occupied territories, which might preclude paying compensation to settlers returning to Israel. Would Israeli citizens moving from the occupied territories back to Israel fit the description of "immigrants"? One alternative use of loan guarantees, supporting industries or enterprises not directly connected with Soviet or Ethiopian immigrants but which strengthen Israel's infrastructure, was approved by the Administration. Assistant Secretary of State Robert Pelletreau told the House Foreign Affairs Committee on Mar. 1, 1994, that Israel was using loan guarantees for an \$800 million electric power facility improvement program. Pelletreau said other uses of the loan guarantees would be the subject of Executive-Legislative consultations. Obviously, Congress can amend the law to allow alternative uses of the loan guarantees.

Background of Earlier Administration Positions and Congressional Action

Initial Israeli Request -- September 1991

In March 1991 the United States gave Israel \$650 million in Economic Support Fund grants to help Israel repair the damages from the Iraqi missile attacks during the Persian Gulf war. At that time, the Bush Administration and Israel agreed to postpone until September Israel's anticipated request for U.S. loan guarantees to assist in the absorption of Soviet Jewish immigrants. Secretary Baker said on September 4 that the United States needed time to study the proposed loan guarantees, and that he did not want the discussions to undercut the peace conference tentatively scheduled for October. On September 6, President Bush told the press that he had asked Israel and Congress to delay consideration of the Israeli request for 120 days so as not to harm the peace process. In exchange for the delay, according to press accounts, the President was willing to promise that there would be no other delays after January, that the Administration would provide quick action on the request in January, that the United States would compensate Israel for any costs brought about by the delay, that the subsidy rate for the loan guarantees would be low, and that he would solicit funding for Israel from other countries. Despite the President's and Secretary of State's appeals, Israel submitted the request anyway on September 6.

On Sept. 11, 1991, President Bush said he was not committed to supporting the \$10 billion guarantee; the statement was in response to reports that Israeli officials said that the United States was morally obligated to provide the guarantees, that President Bush promised to provide the funds, and that Israel wanted the funds immediately in September 1991. On September 12, the President repeated that he wanted action on the Israeli loan guarantees postponed until 1992, and added that he would veto loan guarantee legislation in the current session of Congress.

Some observers believed the Bush Administration was using the loan guarantees as leverage to get favorable replies from Israel on several peace conference issues, such as selecting a Palestinian Arab delegation, or securing an Israeli pledge to stop constructing settlements in the occupied territories. Other observers agreed with the President that the request should be delayed while the peace conference negotiations were underway. There was also speculation that Administration and Congressional leaders could negotiate a compromise on the timing of the loan guarantees to avoid the confrontation over whether or not to wait until January as the President requested. (The peace conference began in Madrid on Oct. 30, 1991.)

On Sept. 10, 1991, Senators Kasten and Inouye inserted in the Congressional Record proposed language to provide for U.S. loan guarantees for Israel. On Oct. 2, the Senators introduced Amendment 1247 to H.R. 2621, the foreign assistance appropriations bill then in the Foreign Operations Subcommittee of the Senate Appropriations Committee, to add a Section 226 to the Foreign Assistance Act of 1961. The proposed language stated that \$2 billion in loan guarantees would be available on September 30 of each fiscal year 1992 through 1996, that the loans would be for 30 years with an interest-only grace period of 10 years, that the loans could be used only inside Israel's pre-1967 boundaries, and that the operating expenses for the total \$10 billion would be \$100 million, or 1% of the total. The proposal stated that Israel would pay the \$100 million fee, on a pro rata basis as each increment of the loans were made. There would be no subsidy, thereby canceling the need for any appropriation.

Senator Leahy, Chairman of the Foreign Operations Subcommittee, had stated in early September that he supported the President's request to delay consideration of the Israel loan guarantee until January 1992. Representative Obey, Chairman of the House Foreign Operations Subcommittee, agreed. Senator Leahy further said that he favored adding conditions to the legislation that would freeze Israeli settlements in the occupied territories, encourage Israel to implement economic reforms, provide for independent monitoring of the loan guarantee program in Israel, and ensure that none of the guaranteed funds were used in the occupied territories. By Oct. 1, congressional leaders announced that they would agree to delay consideration of the Israeli request for loan guarantees until January 1992.

Consideration by Congress in Early 1992

In January 1992, Secretary of State James Baker testified before Congress that the Administration would place conditions on loan guarantees for Israel, stipulating that Israel limit the expansion of Jewish settlements in the occupied territories. The following month, House and Senate Foreign Operations Appropriations Subcommittees held hearings on the Israeli loan guarantee request, during which Administration and congressional positions on the issue clarified. Although a number of committee members opposed placing any conditions on the loan guarantees, Secretary of State Baker and Senate subcommittee chairman Leahy both set out proposals upon which most attention focused. Secretary Baker stated that the Administration had offered the Israeli government two options: first, the United States would extend the full \$2 billion for each of the next five years if Israel agreed to an immediate halt of settlement activities in the occupied areas; alternatively, if Israel chose to complete settlement construction already underway -- but agreed to halt plans for any new construction -- the United States would provide loan guarantees of "some lesser amount," reduced by however much Israel spent on completing the work already in progress. On March 18,

the Administration released more specific details on its position: the United States would agree to \$10 billion in loan guarantees on the condition that Israel would halt new construction activity, except what was under way on Jan. 1, 1992; U.S. and Israel would agree in advance what construction could continue and all building on pre-Jan. 1, 1992 activity would end within 12 to 18 months; the United States immediately would provide \$300 million in loan guarantees, with the balance disbursed over the next six years. The President, however, would retain total discretion to suspend the guarantees if Israel violated the terms of the program.

Building on his earlier proposals, Senator Leahy joined with Senator Kasten in mid-March to present the Administration with their compromise plan. Under the Leahy-Kasten recommendation, Israel would receive within 30 days the first disbursement of the loan guarantees. This first tranche, representing six months or \$1 billion of the five-year program, would not be conditioned on an Israeli freeze of settlements activities, but would be reduced by \$200-\$250 million, the estimated amount that Israel would spend in 1992 on projects in the occupied areas. Consequently, Israel might expect to receive about \$700-\$750 million almost immediately. For the balance of the \$9 billion, the proposal would give the President wide discretion and authority when and under what conditions to disburse the loan guarantees. The plan further would exempt certain settlement construction from being linked to the loan guarantees -- for example, security related construction and infrastructure that would benefit both Israelis and Arabs. President Bush, however, rejected the Leahy-Kasten plan because he opposed the disbursement of any loan guarantees not linked with Israeli settlement activity.

With an apparent Executive-legislative impasse and an almost certain Presidential veto, Congress decided to postpone further debate on approving the loan guarantees indefinitely. Although lawmakers took no final action on the issue, the Senate approved a non-binding resolution (S.Res. 277) on April 1 expressing the "sense of the Senate that the United States Government should support appropriate loan guarantees to Israel for refugee absorption."

Israeli Election, June 1992

In the June 23, 1992 Israeli elections, the Labor party won 44 seats in the 120 seat Knesset and the right to form a coalition government to replace the 32-seat Likud party. On July 13, Prime Minister Yitzhak Rabin won a Knesset vote of confidence for his government, and stated his intention to halt new settlement activity, thereby meeting at least part of the Bush Administration conditions for the loan guarantees. At its first meeting on July 19, the new cabinet announced that Israel would stop signing contracts for about 3,000 planned new housing units in the occupied territories. Secretary of State Baker arrived in Israel on July 20, and, after conferring with the new Government, hinted that the Administration would favor loan guarantees for Israel. In what appeared to be further steps aimed at convincing both the Bush Administration and the Arabs of Israel's good intentions, the Rabin government announced 2 days later that another 3,000 housing units under contract but not yet started would be frozen, and that some infrastructure projects in the occupied territories, such as highways, would be canceled. Another 14,000 housing units already under construction in the occupied territories were not affected by the Rabin announcements. The Rabin Government also announced that some infrastructure projects would be delayed or halted.

Soviet Jewish Immigration to Israel

The United States, through its policies and actions has encouraged the Soviet Union to allow its Jewish citizens to migrate freely. (For example, the Jackson-Vanik amendment to the 1974 Trade Act, Section 402, P.L. 93-618, denied trade agreements to countries with non-market economies that restricted free emigration.)

In the past, the Soviet Union restricted Jewish religious practices and limited Jews opportunities granted to other Soviet citizens. The Soviet Union did not recognize the right of its citizens to migrate, except for a few Soviet citizens who left the country under family reunification plans. Thus, many Jews who wished to leave were unable to do so. As part of the reform movement beginning in 1985, the Soviet Union relaxed its emigration ban and allowed some Jews to leave. Jewish emigration reached 1,000 per month in September 1989, 3,500 in December 1989, and 10 times that number one year later in December 1990. A new emigration law, passed in May 1991, permitted Soviet citizens to have passports, and would have allowed freer emigration. Since the breakup of the Soviet Union, the Republics have followed the Soviet lead to allow free emigration. (See also CRS Issue Brief 90083, *Soviet Jewish Emigration*.)

Current and Future Immigration

In the 10 years between 1980 and 1989, a total of 87,707 immigrants arrived in Israel, 27,715 of whom were from the Soviet Union and about 14,000 were from Ethiopia. With an average of almost 9,000 immigrants per year, Israel could feed, house, process, educate, and train the new immigrants without straining the government machinery or Israeli society. In 1990, 194,941 immigrants arrived in Israel, 181,759 of whom were from the Soviet Union. In 1991, 143,851 Soviet Jewish immigrants arrived in Israel, and in late May 1991, 14,078 Ethiopian Jews left their civil war-torn country to migrate to Israel. Russian immigrants to Israel averaged about 5,000 per month for 1992. Processing, placing, and integrating the nearly 400,000 immigrants over the past 2 years has strained the Israeli government and society. (Figures from the Israel Central Bureau of Statistics, the National Conference on Soviet Jewry, and the American Association on Ethiopian Jews.)

There are about 2 million Jews in the Soviet Union. Israeli officials estimated in 1990 that between 750,000 and one million of the Soviet Jews would migrate to Israel by 1995. Following the August 19, 1991 changes in the Soviet government, Israeli leaders encouraged the estimated 60,000 Jews holding exit permits to leave the Soviet Union immediately. Many observers believed that most Soviet Jews, fearing a more oppressive regime, would emigrate as soon as possible. But with the reversal of the coup on Aug. 21, 1991, Soviet Jewish emigration became more problematic. Some believe that Soviet Jews will be less likely to leave the Soviet Union or the republics now that the democratic forces have prevailed. Others believe that the attempted coup serves as a warning that a less liberal regime could emerge, at some time in the future, and that Jews should migrate to Israel now, while they have the opportunity. Many eyes will be watching the Soviet Jewish community over the next few months to see which way it will react. A poll published in the Nov. 8, 1991, *Jerusalem Post* stated that 52% of recent Soviet immigrants in Israel were advising their family and friends in the Soviet Union to postpone their emigration and remain where they were. Since June 1991, Soviet Jewish immigration to Israel has fallen off. Just over 5,300 Jews left the Soviet Union each month for Israel in 1992.

It is estimated that between 2,000 and 2,500 Jews remain in the northern provinces of Ethiopia. Israeli authorities assume that all Ethiopian Jews will migrate to Israel in the near future. The population of Israel (pre-1967 boundaries) at the end of 1992 was 5.3 million, of which 4.3 million were Jews.

Immigration Problems in Israel

The current wave of more than 430,000 Ethiopian and Soviet immigrants has created or aggravated a series of problems for the Israeli government, for the Jewish Agency and other philanthropic organizations that support immigrants, and for the Israeli people.

Immigration Costs

The privately funded, independent Jewish Agency and the government of Israel, led by the Ministry of Absorption, provide food, shelter, clothing, job training, health services, education, language training, and cash for immigrants in need. The 1992 Israeli budget, passed in early January 1992, includes \$6.5 billion for immigrant absorption out of the total of \$45 billion. The \$40 billion budget proposed for 1993 includes about \$3 billion for refugee absorption. The Jewish Agency has budgeted \$4.25 billion over the next 4 years for immigrants in Israel. According to Israeli sources, the government of Israel and the Jewish Agency provide a subsidy of about \$10,000 per year for each Soviet family of 3. Of that amount, about \$2,600 is a loan. Immigrants are entitled to another \$1,000 loan, repayable over 10 years.

Israeli officials anticipate a total cost of absorbing one million Soviet Jews at between \$45 billion and \$50 billion (one Israeli official said \$60 billion, other Israeli estimates range up to \$70 billion). Of that amount, according to press reports, Israel asked the United States to provide \$10 billion in housing loan guarantees, European national and commercial sources to provide another \$10 billion in loans, guarantees, and grants, philanthropic sources to provide \$1 billion per year, and the remainder -- \$20 to \$25 billion -- to be financed internally in Israel.

Jobs

Israel will have to find jobs for the new immigrants. Israel's unemployment rate hovered around 5% in the 1970s and early 1980s, but jumped to 11.5% in 1992. According to Israeli sources, 67% of men and 47% of women immigrants from the Soviet Union will enter the Israeli job market; and the vast majority were professionals in Russia who will be seeking comparable professional jobs in Israel, the most competitive segment of Israel's job market. Israeli officials state that one use for the loan guarantees will be job creation. Unemployment among recently arrived Soviet Jews in Israel is variously estimated at between 40% and 70%. Some Soviet Jews are taking semi-skilled, unskilled, and menial jobs usually held by Israeli Arabs or Arabs from the occupied territories. The government of Israel estimated the cost of job training or retraining at about \$8,000 for each Soviet immigrant unable to find a job in his or her field, and some estimate that Israel will need 600,000 new jobs over 5 years to accommodate the immigrants.

Infrastructure

Israel will need roads, water, electrical power, sewerage treatment, schools, public transportation, and other infrastructure to meet the needs of the expected one-fifth increase in the population over the next 5 years. Israelis point out that such infrastructure, built with the loan guarantee funds, will benefit all Israeli citizens, not just the recent immigrants.

Housing in Israel

New Housing Starts. Israel's 1.4 million housing units have been fully occupied since December 1990 (about 140,000 of those units are Arab owned and occupied). Prior to the late-1989 surge in Soviet migration, Israel needed about 20,000 new housing starts each year to meet the demands of its growing population. By the end of 1990, Israel needed between 70,000 and 100,000 new housing starts in 1991 to meet the current demand, but, according to Israeli press sources, less than one-tenth of the new housing construction approved by the government in March 1990 had been started by the end of the year. There appeared to be several reasons for the delays: planning was difficult because the numbers arriving from the Soviet Union kept increasing; government bureaucracy was slow to approve necessary licenses and permits; banks were reluctant to approve mortgages for immigrants; construction companies would not start building without government guarantees to purchase the unsold homes; and new construction was delayed while officials debated agency responsibility and policies, such as whether or not to buy prefabricated housing. The former Housing Minister, Ariel Sharon, implemented a plan to purchase some 9,000 prefabricated houses and 33,000 mobile homes (10 by 48 foot, 2 family mobile home units) to meet immediate needs while the Israeli construction industry prepared to meet the new demands. (See CRS Report 91-693 RCO, *Israeli Housing: Needs and Resources*, by Morton J. Schussheim, Sept. 23, 1991.) Former Finance Minister Modai stated on June 13, 1991, that Israel needed about 250,000 new houses or apartments over the next 5 years just to meet the Soviet immigrant needs alone. And, former Housing Minister Sharon has been quoted in the Israeli press as saying Israel needs 500,000 new housing units over the next 5 years.

Housing Costs. By June 1990, housing prices were increasing at a rate of over 30% per year, about twice the consumer price index growth rate of 14% per year. Landlords, anticipating higher profits, raised rents because Soviet Jews were willing and able to pay higher rents with their government/Jewish Agency subsidies. Soaring rents dislocated poorer Israelis, driving many to seek less expensive housing and forcing a few into temporary tent encampments. The Bank of Israel reported in October 1990 that as many as 150,000 families were homeless in Israel (the figure is in dispute). New housing construction costs about \$65 per square foot for the average 1,000 square foot unit. The price on the open market for the average housing unit is about \$100 per square foot (with builders' profit, infrastructure, and other added costs), but the subsidized cost to immigrants is about \$55 per square foot. As mentioned above, Housing Minister Sharon signed agreements with private contractors to purchase unsold housing units. By mid 1992, the Government of Israel expected to pay over \$2 billion for unsold housing, most of it the south where few people want to live.

Land Use. In the past, Israel assigned higher priority for agricultural and industrial land use than for housing, which resulted in dense concentrations of houses

and apartments on less valuable land. Land use policies are the subject of some debate in Israel, with new emerging policies apparently leaning toward allocating bigger and better tracts of land for housing to meet the new demands. The state of Israel controls 92% of the land, most of which was purchased by the Jewish National Fund, which holds the land in perpetuity for the Jewish people. The state leases land to Jews for 49 years, renewable for another 49 years.

Land use practices in Israel may pose a dilemma for the United States. On the one hand, some could argue that providing U.S. guarantees for Jewish immigrants to build housing on land restricted only for Jews may support ethnic or religious discrimination against Israel's Arab citizens. On the other hand, others may argue that the central problem is the nature and scope of Israel's emergency of providing for 1 million needy Soviet Jews, and that the emergency demands immediate attention that currently overrides other considerations. Israeli government sources claim that the only constriction on Israeli Arabs leasing or renting homes is the preference offered to military veterans for government loans; Arabs do not serve in the military.

U.S. Loan Guarantee Programs

The U.S. Government maintains a wide range of domestic and international loan guarantee programs. The Office of Management and Budget (OMB) estimates that the United States will offer commitments for nearly \$200 billion in loan guarantees in FY1994. Foreign loan guarantee programs are currently operated by the Commodity Credit Corporation, the Export-Import Bank, the Overseas Private Investment Corporation, and the Agency for International Development (AID). AID programs back both housing and micro and small enterprise loans.

Congressional Role in U.S. Loan Guarantee Programs

Until FY1992, Congress approved the total principal amount of the housing loan guarantee program in authorization acts and set annual ceilings on new loan commitments in appropriation bills. Neither of these actions, however, required Congress to authorize or appropriate new funds (budget authority), unless the program had suffered losses due to claims from lending institutions associated with previously approved loan guarantees. For example, Section 222 of the Foreign Assistance Act of 1961 authorizes AID's Housing Guaranty Program to maintain up to \$2.558 billion in outstanding principal at any one time, while the FY1994 foreign aid appropriation places a limit on new loan commitments for this year at \$110 million. Because loan guarantees were not counted as budget authority before FY1992, nothing was "scored" against AID appropriations. (In a separate action, however, the FY1991 appropriations provided \$48 million for the Housing office's reserve fund to service claims on previous loans.) Likewise, the 1990 supplemental of \$400 million for Israeli housing guarantees had no budgetary impact at the time and required no appropriation of funds.

Budget Implications

Pursuant to the Budget Enforcement Act of 1990, Congress and the Administration agreed to apply new accounting methods and procedures to U.S. Government guarantee and other credit programs. The Budget Enforcement Act added

a new Title V to the Congressional Budget Act of 1974, referred to as the Federal Credit Reform Act of 1990. The new methods and procedures under the Act applied for the first time in FY1992. Under the Act, OMB coordinates agency estimates of the cost of U.S. guaranteed loans, taking into account such factors as cost of money at the time the loan is issued, the interest rate charged by the lender, and the risk that the United States may be required to make payments in the future if a lender is not paid under the terms of the loan. In short, the new arrangement, or subsidy, represents what the U.S. Government could reasonably expect to lose over the entire life on a credit transaction calculated on a net present value basis. Congress must now appropriate the estimated subsidy. For FY1995, for example, OMB estimates that AID's requested housing program of \$82 million has a subsidy rate of 14.6%, thereby requiring Congress to appropriate \$12 million in support of the \$82 million in new principal guaranteed by the program.

Consequently, under the new credit reform rules, most had expected the anticipated Israeli request for \$2 billion in loan guarantees in FY1992 and \$10 billion over 5 years to have some budgetary pact. However, because Israel agreed to pay the subsidy costs, the Administration did not ask Congress to appropriate funds to back the loan guarantees.

Assessing the Risk of Default

Even though Israel agreed to pay all fees associated with the loans, and Congress enacted such a requirement into law, OMB established an official subsidy rate of 4.6% for the loan guarantees. The subsidy, expressed as a percentage of the total loan amount, is placed in the AID-Treasury jointly managed account to be held in case Israel defaults on its loans to the commercial lenders. The subsidy calculation is based on Israel's economic performance, its previous debt repayment record, the projected impact of the new immigration on the Israeli economy, on Israel's capacity to acquire and manage the new debt, and on other factors. According to some economists, it is more difficult to calculate the risk factor for Israel than for some other countries because of Israel's high security expenses, the size of the immigration problem, and the Israeli economy's close link to U.S. foreign assistance.

Israeli officials and Israeli supporters believe that there is little risk in guaranteeing Israel's loans. Israel, they argue, has never defaulted on a loan, has never been late with loan payments, has good credit ratings among international commercial lenders, has experience handling large numbers of immigrants, and has an expanding economy. They point out that Bank of America rates Israel as a "non-problem" country, and that Salomon Brothers wrote a favorable report on Israel's credit standing. The immigrants arriving from the Soviet Union are well educated and highly motivated, and will become productive members of the Israeli society very quickly, they point out. The Israelis also say that in recent years Israel has undertaken a series of economic reforms that lowered inflation, stabilized the currency, increased exports, and restored a steady economic growth rate. Israel improved its debt situation over the past few years and now has a debt picture better than or similar to many industrialized nations. A GAO report further concluded that, although the size of loans makes the risk greater for the United States, "Israel will likely be able to fully service its external debt and to continue its past record of payment under most foreseeable circumstances." The GAO believes, as do a number of economists, that the level of risk depends to some extent on Israel's

implementation of its absorption plans and willingness to pursue economic reforms suggested by the United States and Israeli experts.

Others are not as optimistic about Israel. The Israeli economy is tied to U.S. foreign assistance and to philanthropic donations to meet Israel's \$3 billion per year balance of payments deficit. Israel consistently runs a budget deficit, and a trade deficit. Unemployment rose from 6% to 10% over the past 2 years, and appears destined to climb further with the wave of immigrants in search of jobs. Housing and infrastructure construction needed to accommodate the immigrants are falling further behind each month. Economists point out that Israel must be judged not on its past performance but on its capacity to meet the future debt service. Standard and Poor rated Israel as a "BBB-" credit risk for long-term government debt not backed by the U.S. Government, their lowest rating for investment grade bonds. According to the June 25, 1991, *Christian Science Monitor*, Institutional Investor ranked Israel in the upper tier of Third-World countries, just behind Algeria, Venezuela, and Colombia. According to both Israeli and U.S. Government sources, the Export-Import Bank of the United States rated Israel a "C" on an A through F scale. The Export-Import Bank rating could not be verified because Ex-Im Bank keeps rating matters confidential. (See CRS Report 91-690 E, *The Israeli Economy and its External Economic Relations: An Overview*, by Patricia A. Wertman, Sept. 6, 1991.)

U.S. Aid to Israel

Between 1949 and 1994, the United States has provided Israel with over \$60 billion in foreign assistance. Of that amount, \$36.6 billion has been military loans and grants and the remainder economic assistance. From 1985 through 1994, U.S. assistance through regular aid programs to Israel has been \$3 billion per year (with supplemental grant aid in 1986 and 1991). As of Sept. 30, 1993, Israel owed the U.S. Government \$3.7 billion for previous loans. Also, the U.S. Government is the guarantor of another \$5.9 billion in U.S. commercial loans to Israel, loans that for the most part stemmed from refinancing under the debt reform provisions of P.L. 100-202 of 1987. (See CRS Issue Brief 85066, *Israel: U.S. Foreign Assistance Facts*.)

The loan guarantees requested by Israel differ from the bulk of U.S. aid currently extended to Israel -- assistance that now is provided mainly in the form of economic cash transfers (\$1.2 billion) and military grants (\$1.8 billion). Under a guaranteed loan package, Israel borrows funds from U.S. private lenders and the U.S. government backs, or guarantees, Israeli payment of the loans. In the event Israel did not make its scheduled payments, the United States would be responsible to pay the lender.

Israeli Loan Repayments to the United States

Since 1949, Israel has borrowed about \$14.1 billion from the United States, most of it (\$13.2 billion) associated with U.S. economic and military aid programs. Economic and food assistance loans (about \$2 billion) are made on a concessional basis, usually at about 3% interest rate. Military loans for Israel carry near-market rate terms, varying according to the interest rates at the time the loan was made. The range has been between about 7% and 13%. Economic and military aid loans require repayment over 30 years, with a 10-year grace period during which only interest payments are required. Israel also has borrowed about \$900 million from the Export-Import Bank and other U.S. credit programs, loans issued at near-market rate terms. (The United

States also has guaranteed loans that private commercial lenders made to Israel; the United States is liable for these loans only if Israel does not meet the repayment terms to the private lender. The figures above do not include guaranteed loan amounts.)

Overall, Israel has maintained a very good debt service record in repaying loan obligations to the United States. Israel has never defaulted or received debt forgiveness from the U.S. Government. (In 1974, President Nixon proposed that part of the military loans to Israel have the repayment waived. Thereafter, Congress waived the requirement for Israel, along with Egypt and a few other countries, to repay a portion of new military loans. The practical effect of this was to convert part of the loan to a grant prior to the issuance of the loan, a process quite different from the normal procedure for forgiving a country's debt at a later time when repayment problems had developed. Between 1974 and 1990, the United States waived repayment of about \$17 billion in military loans to Israel.)

Although Israel has not had any of its U.S. debt forgiven, two legislative initiatives have helped Israel to service its U.S. debt and improve the terms of the loans. The first, originally enacted in 1984 and commonly referred to as the "Cranston amendment," states that it is the "policy and intention" of the United States that annual economic aid levels for Israel should not be less than annual debt service payments owed by Israel to the U.S. Government. (Currently, Section 517 of the Foreign Operations Appropriations, FY1994) Israel uses most of its economic aid grants (\$1.2 billion in FY1994) to repay its U.S. loan obligations. Apparently, the Cranston amendment would not apply to the \$10 billion in guaranteed loans because the lender will not be the U.S. Government. The second initiative, enacted in 1988, permitted any eligible foreign country holding U.S. military aid loans with interest rates above 10% to pre-pay the U.S. Government without penalty, and to refinance these loans in private markets on more favorable terms; the United States also would guarantee 90% of these loans. Under this provision, Israel pre-paid and refinanced about \$5.5 billion of its military aid debt, gaining new loans at about 8.5% interest, and saving about \$150 million annually on debt service payments.

Previous Housing Loan Guarantees to Israel

Between 1972 and 1980, Israel received \$200 million in housing loan guarantees. In 1990, Israel received another \$400 million (H.R. 4404, P.L. 101-302, May 25, 1990). According to Sections 221, 222, and 223 of the Foreign Assistance Act of 1961, as amended (P.L. 87-195, 75 Stat.424, Sept. 4, 1961), U.S. housing loan guarantees are intended for developing countries, are limited to \$25 million per country, should target 90% of the guarantees to families below the median income, and should include two fees, usually a one-time fee of 1% of the total, to be paid to the United States for administrative expenses, and a fee of 0.5% of the remaining principal paid annually to the United States to cover technical assistance and other recurring costs. For the \$400 million loan guarantee for Israel in 1990, Congress waived the \$25 million limit per country, lowered the administrative fees, and waived the stipulation that the housing should be targeted to low income families.

The \$400 million in loan guarantees was not released until March 1991, contributing to speculation in Israel that Secretary of State Baker was using release of the funds to trade for Israeli concessions in the peace process. Suspicions about Secretary Baker's motives aside, there is some doubt that Israel could have used the

loan guarantees because the Government could not agree on a housing plan for the Soviet immigrants and the Israeli construction industry did not appear prepared to begin the new construction. Israel sold bonds through U.S. underwriters to raise the \$400 million.

Israeli Use of U.S. Aid in the Occupied Territories

In accordance with U.S.-Israel aid agreements, Israel cannot use any U.S. foreign assistance in the occupied territories: the Gaza Strip; the Golan Heights; or the West Bank, which includes the east Jerusalem area annexed by Israel in 1967. From 1967 to 1981, it was U.S. policy that Israeli settlements in the occupied territories were illegal under international law (paragraph 6, Article 49, Fourth Geneva Convention, which states that an occupying power may not transfer its civilian population to occupied territories). Some Israelis and their supporters maintain that Israeli settlements are legal. It has been U.S. policy since 1967 that Israeli settlements are an obstacle to peace, a point repeated by successive Administrations. U.S. Administrations have argued that the Arabs have little reason to negotiate with Israel if they believe Israel intends to retain the occupied territories, as the presence of permanent Israeli settlements indicates. Israel's supporters point out that Israel surrendered settlements in the Sinai in the peace treaty with Egypt, a precedent that should demonstrate that settlements are not an obstacle to peace.

On Oct. 1, 1990, Israeli Foreign Minister Levy stated in a letter to Secretary of State Baker that Israel would not use any of the \$400 million housing loan guarantees in the occupied territories, would not encourage new immigrants to settle in the occupied territories, and promised to provide information on the Israeli Government's financial support for Jewish settlements in the occupied territories. (Levy's letter said use of the funds would be limited to "geographic areas which were subject to the government of Israel's administration prior to June 5, 1967," which would exclude east Jerusalem.) Baker approved the release of the guarantees on Feb. 20, 1991, (AID began processing loans at the end of March 1991), but it was not clear if Israel had provided the promised information about settlement funding.

The Israeli request presented to the Secretary of State on Sept. 6, 1991, said: ". . . the utilization of funds shall be restricted to the geographic areas which were subject to the Government of Israel's administration prior to June 5, 1967." In an interview with NBC on Aug. 12, 1992, Prime Minister Yitzhak Rabin repeated that Israel would not use any U.S. aid or guaranteed loans in the occupied territories. President Bush's Sept. 11, 1992 proposal to Congress stated that the funds would not be used in the occupied territories. H.R. 5368, as passed by the Senate and the House-Senate conference, includes language stating that all of the funds under the loan guarantee program must be used inside Israel's June 5, 1967 boundaries.

LEGISLATION**P.L. 102-391, H.R. 5368**

Title VI of the Foreign Operations Appropriations Act FY1993, authorizes \$10 billion in loan guarantees for Israel; \$2 billion per year for 5 years, repayable in 30 years with interest only for the first 10 years. Israel is to pay all administrative and subsidy fees. Funds guaranteed under the program may not be used in the occupied territories. The President may reduce the annual increment by an amount equal to the amount Israel spends in the occupied territories if the President determines that Israel has acted in a manner inconsistent with U.S. objectives. The President may suspend or terminate the program if Israel breaches the U.S.-Israel agreement. The President must report to Congress by September 30 each year on the status of the program. H.R. 5368 passed the House on June 25, 1992 (297-124), and passed the Senate on Oct. 1, 1992 (87-12). The House passed the Conference report on October 5 (312-105), and the Senate passed the conference report on Oct. 5 by voice vote. The President signed the bill into law (P.L. 102-391) on Oct. 6, 1992.

S.Res. 277 (Lautenberg)

Expresses the sense of the Senate that the United States Government should support appropriate loan guarantees to Israel for refugee absorption. Passed Senate Apr. 1, 1992 (99-1).