# REPORT TO

# THE CONGRESS OF THE UNITED STATES

## NEED FOR IMPROVED PLANNING AND SURVEILLANCE OF ECONOMIC DEVELOPMENT PROJECTS IN INDIA

AGENCY FOR INTERNATIONAL DEVELOPMENT
DEPARTMENT OF STATE

UNITED STATES GENERAL ACCOUNTING OFFICE

BY

THE COMPTROLLER GENERAL OF THE UNITED STATES

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To the President of the Senate and the
Speaker of the House of Representatives

The General Accounting Office has completed a review of six capital investment projects designed to support the economic development of India through United States assistance equivalent to about $200 million in dollars and rupees.

The Agency for International Development is responsible for ensuring that projects are soundly conceived and effectively implemented, through adequate participation and review of the planning, construction, and early operational stages. This report presents an analysis of the Agency's handling of these elements in relation to these six projects which have been in the planning, construction, or early operational stages for several years. In our review we have endeavored to analyze and present these case situations with the thought that they will be of continuing value in the consideration of current and prospective capital projects. Brief comments from the report are:

-- Cost estimates and certain technical aspects were not resolved when the Agency approved the project for financing.

-- Arrangements had not been made for successful project implementation and, as a result, the project had undergone delays and difficulties.

-- We found that there was a need for defining the work required for completing the project and responsibilities for its completion, including costs applicable thereto, to minimize the delays and costs.

-- An important part of the project was not being effectively utilized over an extended period because of a mechanical breakdown of which the Agency was not aware.

-- The Agency's participation in the planning of the project and its monitoring of various implementation stages was incomplete and, as a result, the project's prospects for successful completion were not reasonably assured.

We recognize the magnitude of the problems inherent in forecasting, planning, and administering capital development projects under the prevailing conditions. Progress has been reported, notably in the training of personnel and in the increased technical participation by the Agency in the process of developing and executing capital projects in India. As brought out in our report, however, some major impediments continue.

For example, a continuing problem area concerns impediments faced in importing equipment essential to completion of projects. This has resulted in extended delays and in frustrations in the implementation of approved projects. Some corrective actions reportedly have been taken. We believe that more corrective actions are essential. We are therefore recommending that the Administrator, Agency for International Development, seek specific understanding with the Government of India in relation to future loan agreements regarding necessary importation of equipment and parts. In the past the general agreements have, in some cases, been ineffectual in the face of restrictive import controls which impede work on the projects by stalling procurement of essential equipment.

With respect to the administration of loans to the Industrial Finance Corporation of India, we are recommending that the Administator, Agency for International Development, take action necessary for (1) implementing the controls provided in the agreement for rupee loans to the Corporation, (2) periodically reviewing projects involving significant loans to its subborrowers, to determine whether the loan funds are being effectively utilized, and (3) establishing procedures for ensuring more effective monitoring of subborrowers procurement activities by the Corporation.

The Agency's comments on our draft report, included as an appendix to the report, indicate an awareness of the need for further improvement in the administration of capital assistance activities in India. The Agency reported that it was attempting to improve procedures and staffing and that the Government of India had taken steps to facilitate sound economic development.

The Agency believes that the steps that have been initiated either by the Agency or by the Government of India will result in significant improvements. We believe that time will be needed before these steps can be evaluated.

These matters are being reported to the Congress because of its widespread interest in assistance to India and in improvements in the effectiveness of United States foreign assistance and because these matters demonstrate areas where needed improvements are being undertaken.

Copies of this report are being sent to the Director, Bureau of the Budget; the Secretary of State; and the Administrator, Agency for International Development.

Elmer B. Staats

Comptroller General
of the United States

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# DEPARTMENT OF STATE

## INTRODUCTION

The General Accounting Office has reviewed six economic de- :lopment projects financed by United States assistance equivalent more than $200 million in dollars and rupees for India, mostly ı loans administered by the Agency for International Development ıID), and has considered AID's plans and arrangements for the im- ırtation of equipment and materials essential to completion of ·ojects. This examination, a part of our continuing audit of the ·reign aid program, was made pursuant to the Budget and Accounting ·t, 1921 (31 U.S.C. 53), and the Accounting and Auditing Act of '50 (31 U.S.C. 67). The scope of our audit is set forth on page ' of this report.

The individual projects described in our report were selected ·r review, on the basis of a preliminary survey that we made of :D-assisted development projects in India, as being representative major projects, the successful accomplishment of which could ntribute significantly to the economic development of India and .rther United States objectives in that country.

Our field work related primarily to the administration of as- stance for economic development and covered projects that were ll under way or very nearly completed. This gave perspective to ə total range of AID's administration, from the earliest stages project planning through the final phases of project implemen- .tion evident at the time of our review. We were concerned ·incipally with whether the projects were materially contributing ward the accomplishment of United States economic assistance ob- :tives in India and were being completed and utilized in a rea- nably effective, efficient, and economical manner.

The officials primarily responsible for administration of th economic assistance program in India are shown in appendix I.

On November 14, 1966, we submitted our findings and proposa to AID for comment. AID's comments, which are set forth in lette dated March 8, 1967, are presented as appendix II and, where appr priate, are discussed in the body of the report.

## BACKGROUND

The basic authority to finance capital activities is found in ıe Foreign Assistance Act of 1961, as amended. The statute pro- .des that capital activities may be financed by development loans : grants for the purpose of promoting economic development of less ɜveloped friendly countries and areas.

The basic authority requires that AID, in determining whether ɔ provide financing for a proposed capital activity, take into ac- ɔunt various economic and technical factors to ensure that the :tivity is soundly conceived and effectively implemented. Al- ough not required to do so by the basic authority, AID applies ıe same standards of economic and technical feasibility to a proj- :t financed with United States owned or controlled foreign cur- ɜncy.

The United States economic assistance program for India has ɜen basically designed to assist India in carrying out its series 5-year plans for economic development. The first such plan was ıaugurated in 1951. The third plan, completed in March 1966, rep- .sented the first phase of long-term development extending over ıe period 1961-76. The fourth plan, which will last until 1971, ıs being considered by the Government of India (GOI) at the time our review.

The methods of rendering assistance to India have been ad- .sted as India's needs and United States legislative and adminis- ative requirements changed. The latest administrative change ok place on November 3, 1961, when technical assistance activi- ɜs, until then administered by the International Cooperation Ad- nistration, were merged with Development Loan Fund operations to AID. AID programs in India are administered by the AID over- ɜs Mission in India (hereinafter referred to as the Mission).

India's development objectives include production of more od, building of a broad industrial base, creation of new employ- nt opportunities, education of the Indian people, improvement in ɜlth conditions, and development of sound social institutions for ɔmoting the general welfare. The basic purpose of United States sistance is to help India become economically self-sufficient on these fronts. To this end, United States project assistance vers almost all economic sectors. In addition, United States nonproject loans have provided foreign exchange for importing nec essary goods by enterprises throughout India.

An important part of the assistance furnished has been in support of specific economic development projects, most of which involve substantial construction. The foreign exchange requirements of such projects were financed by dollar loans and grants. Local currency costs were financed with rupees generated principally by the sale of surplus agricultural commodities under Publi· Law 480. Cumulative obligations for project assistance as of June 30, 1966, totaled about $1.3 billion in dollar loans and grants and the equivalent of about $3 billion in rupee loans and grants.

The following schedule shows the total dollar and rupee assistance furnished through the time of our review for the six eco· nomic development projects discussed in this report.

| | Dollars | Rupees (dollar equivalent) | Tot. |
|---|---|---|---|
| | | (millions) | |
| Delhi Cloth and General Mills Co., Ltd. | $ 9.8 | $ - | $ 9 |
| New Delhi thermal power extension project | 16.0 | - | 16 |
| Trombay fertilizer plant | 37.8 | 28.0 | 65 |
| Modern storage of food grains project | 1.5 | 25.0 | 26 |
| Napco Bevel Gear of India, Limited | 2.3 | 1.6 | 3. |
| Industrial Finance Corporation of India | 40.0 | 42.0 | 82 |
| | $107.4 | $96.6 | $204. |

## FINDINGS AND RECOMMENDATIONS

### NEED FOR IMPROVED PLANNING AND SURVEILLANCE OF ECONOMIC DEVELOPMENT PROJECTS IN INDIA

We found that (1) inadequacies in planning, constructing, and surveillance of economic development projects had contributed to delays and limited accomplishments of the intended objectives and (2) AID had not formulated necessary plans and arrangements for the importation of equipment essential to completion of projects.

We noted delays and difficulties in connection with several AID-financed projects indicating that the Mission's project implementation and surveillance should be improved. Substantially changed conditions relating to a rayon yarn and tire cord facility raised doubts as to the technical and economic feasibility of constructing a proposed cotton linters pulp plant estimated to cost in excess of $2.2 million, as a result of which AID reevaluated the feasibility of the project and advised us that it would not be constructed.

For three development projects--New Delhi thermal power extension project, Trombay fertilizer plant, and the modern food grains storage project--we noted that improvements in project implementation were possible through increased Mission activity and surveillance. We noted also that project objectives of a gear plant were not being met but that action was being taken by AID to determine whether the situation could be corrected. For substantial dollar and rupee loans being provided to the Industrial Finance Corporation of India for new development or expansion, there is an opportunity for improving financial management and AID needs to be more reasonably assured that projects are sound as to technical and economic feasibility.

Although AID provides the necessary foreign exchange for the importation into India of equipment in support of major development projects, there are problems in the implementation of such projects due to the Indian Government's extension to the AID-provided foreign exchange of its traditional practices of conserving its foreign exchange and of restricting imports, as a consequence of which importation of equipment essential to successful and timely project completion is delayed.

We believe that, on balance, the inadequate planning and pr· ect implementation difficulties we noted during our review demon strate that the effectiveness of AID's capital assistance activi ties for India can be substantially improved. AID's preliminary and intensive reviews of applications for capital activity finan ing could be performed more completely and, equally important, i plementation plans should more comprehensively delineate the responsibilities of all parties concerned with successfully execut the projects. We believe also that such improved planning must l accompanied by more intensive monitoring of projects, including contracting, construction, and procurement activities.

AID directives and orders specify, in detail, the policies procedures for capital assistance. We believe, therefore, that proved operations can be brought about only through more conscie tious efforts of all responsible officials on each capital assistance activity undertaken. With a more conscientious effort alc these lines to ensure that capital activities are soundly concei and efficiently implemented, project delays and difficulties suc as those we noted during our review in India should diminish.

AID's comments on our draft report indicated an awareness o the need for improvement in the field of capital assistance acti ties in India, and such improvements are being attempted. AID stated that, while earlier loan agreements, including the ones we reviewed, call for a minimum amount of participation by the Missi itself and by United States engineers, it contemplated a much mor substantive role for United States engineers, both Government and private, in the formulation and the execution of Indian capital projects.

AID stated also that a large increase in the staff assigned the loan program in India reflected AID's awareness of the need f playing a much greater role in the process of developing and executing capital projects in India and for building an organizatior capable of playing that role.

Our specific findings are discussed in detail in the followi sections of this report.

:consideration given to
:chnical and economic feasibility of
:rtain proposed construction

Our review showed (1) that $1.7 million of a $9.8 million cap-
:al development loan was intended for construction of a cotton
.nters pulp plant which information available at the time of our
.view indicated was not economically feasible but was still under
›nsideration and (2) that, because of GOI import controls (see
•. 32 to 36), the productivity of a rayon plant in which $7.6 mil-
.on of the loan had been invested was seriously impaired and the
.ant's proposed expansion was prejudiced.

By a loan agreement dated June 28, 1962, AID agreed to lend up
$9.8 million to an Indian firm, the Delhi Cloth and General
lls Co., Ltd., to finance the reasonable foreign exchange costs
equipment and services required for constructing a rayon plant
· produce filament yarn and tire cord and, 1 or 2 years after com-
etion of the rayon plant, a related plant to produce cotton lint-
·s pulp to be used as the basic raw material in the rayon plant.
.ans called for the use of imported United States wood pulp as the
.sic raw material in the rayon plant prior to completion of the
·tton linters pulp plant. Upon completion of the cotton linters
.lp plant, pulp produced from indigenous cotton linters was to be
ed as the raw material.

The estimated foreign exchange cost of the project was
.1 million for the rayon plant and $2.2 million for the cotton
nters pulp plant. At the borrower's request, the loan under con-
deration was increased from $9.3 million to $9.8 million to pro-
de $500,000 for contingencies. AID considered the proposed proj-
t to be an important contribution to the economic development of
dia because expanding highway construction and vehicle production
.s increasing the requirement for tires. It was expected that
mpletion of the project would result in annual foreign exchange
vings to India of $3 million on tire cord imports and eventually
other $8 million on wood pulp imports.

In approving the project for financing in March 1962, AID con-
uded that all conditions required under section 611 of the For-
gn Assistance Act of 1961 had been met and that the proposed
oject was sound as to technical and economic feasibility. During
.r review of this project in November 1964, however, we had noted

a number of important matters which cast doubt on the feasibility of constructing the proposed cotton linters pulp plant.

India's yearly requirement for cotton linters was estimated be 4,000 tons, but only 3,000 tons of cotton linters were being produced annually in India and that quantity had to be shared by three plants then in existence whose requirements could not be me from indigenous sources. Also, there was some reluctance on the part of United States companies to provide the technical assistar needed for construction of the cotton linters pulp plant, which stemmed from the likelihood of the plant's becoming a competitor the procurement of the raw material that was not only in short su ply but also rather high in price.

In addition, the equipment supplier would guarantee neither the quality of the rayon nor the production capacity of the rayon plant unless the plant continued to use the particular type of wo pulp that was available only from the United States, which was us in the early operation.

We inquired in November 1964 as to the feasibility of constructing the cotton linters pulp plant. In response to this inquiry, the Mission Director, in February 1965, reaffirmed AID's d cision to finance the plant and advised us (1) that, once a syste of cotton linters collection was organized, the proposed plant would have an adequate supply for its own needs and (2) that the technical assistance needed for the construction of a cotton lint ers pulp plant had been found.

Notwithstanding AID's conclusion when the loan was made in 1962, reaffirmed by the Mission Director in February 1965, that t cotton linters pulp plant was considered to be feasible, our subsequent review in India in March and April 1966 showed that then, more than ever, there were reasons for questioning the feasibilit of constructing the proposed plant.

As the result of improved technology after the cotton linter pulp plant was planned, the tire cord that the rayon plant produc from wood pulp has an average tensile strength of 37 pounds, well above the tensile strength of 32 to 33 pounds--acceptable in India--of tire cord produced from cotton linters pulp.

The tire cord that the rayon plant produces from wood pulp i superior to, and has better marketing prospects--especially for export--than, the tire cord that it would be able to produce from cotton linters pulp. Since it is required by GOI to export some of its product, the rayon plant's competitive position would be jeopardized by a lesser quality product.

Moreover, rayon plants usually do not have their own pulping operations, regardless of the raw material used, since the relatively small quantity of pulp required makes such operations uneconomical.

While only $1.7 million of the loan was intended for construction of the cotton linters pulp plant, a Mission official stated that a plant larger than had been originally planned would be required, which would cost at least $3 million. It seemed reasonable to expect that AID would be asked to provide the additional financing, or possibly the total amount, since the borrower proposed to utilize the $1.7 million for expanding the rayon plant rather than for constructing the cotton linters pulp plant as originally had been planned.

In March 1966 the Mission indicated that the borrower's proposal to utilize the balance of the loan proceeds--$1.7 million--for expansion of the rayon plant would likely be acceptable. We noted that the rayon plant had been operating at less than 50-percent capacity because wood pulp imports had been drastically reduced due to India's shortage of foreign exchange. The records we examined indicated, however, that (1) the existing rayon plant had a history of curtailed production, (2) the construction of a cotton linters pulp plant appeared to be infeasible, and (3) adequate supplies of imported wood pulp appeared to be doubtful.

During our field work in India, we advised the Mission Director that the feasibility of constructing the cotton linters pulp plant or expanding the rayon plant appeared to be questionable because of the facts discussed above. The Mission advised us, by letter dated August 15, 1966, that the availability of cotton linters was being reexamined and that, when the loan had been approved in March 1962, the Mission had relied on the statement in the borrower's application that a sufficient supply of cotton linters could be obtained.

The Mission advised us also that a reappraisal was under way, which would embrace technical feasibility, economic costs, and alternative processes and that no final decision would be made or the use of the $1.7 million until the reappraisal was completed.

Unless the remaining project construction meets sound techni cal and economic standards, its contribution to India's developi economy seems questionable. We believe that conditions surroundi the project since its inception, considering also that cost esti- mates and certain technical aspects were not resolved when AID ap proved the project for financing, are sufficient to warrant thorough reconsideration as to the feasibility of the expansion of the rayon plant and the construction of the cotton linters pulp plant.

In commenting on our draft report, the Assistant Administrat for Administration informed us that GOI, by letter of November 27 1966, to the Mission, had approved the Delhi Cloth and General Mills Co., Ltd., plan to drop the proposed cotton linters pulp plant. He stated that GOI had approved also the use of the $1.7 million allocated for the cotton linters pulp plant for fi- nancing the foreign exchange costs of expansion of the rayon plar In addition, he stated also that the Mission had been instructed initiate a thorough study of the existing rayon plant and its pro posed expansion and that the final decision with respect to the u of the $1.7 million would be based on the results of that study.

## mprovements being sought to expedite completion f the New Delhi thermal power extension project

We noted, in connection with an AID loan for a thermal power xtension project in New Delhi, that arrangements had not been made or successful project implementation and that, as a result, the roject had undergone delays and difficulties.

By a loan agreement dated March 8, 1963, AID agreed to provide p to $16 million to GOI to finance the reasonable foreign exchange osts of importing and installing three 60-megawatt thermal elec- ric generating units and related equipment at the Delhi thermal ower station. The three units were to be installed in an exten- ion of a 36.6-megawatt station which had been constructed with nited States assistance under an earlier grant of $4 million to OI.

When considering the $16 million loan for the extension proj- ct, AID was aware that the first-stage construction of the power tation was not being implemented in accordance with the original imetable and that there would be extensive delays before it could ommence generation of electricity. Problems identified included elays in selection of consulting engineers, relocation and modifi- ation of the facility, delays in tendering and awarding contracts, nd inadequate coordination of numerous small contractors. Accord- ngly, AID, in considering the loan for the extension project, spe- ifically stated its intention of avoiding similar problems.

An AID engineer visited the site of the first-stage construc- ion in India before the extension loan agreement was signed. He eported that he had ascertained nothing in his discussions con- erning the proposed extension project that had assured him it ould be handled any better than the first-stage construction then n progress. He recommended that the following seven controls, imed at more effective project implementation, be made a part of he agreement in order to ensure that the proposed project would be onstructed more efficiently than the first stage.

1. A single officer should be designated who would represent the various Indian agencies and be responsible for all de- cisions on contract and procurement awards.

2. Contracts should include severe penalty clauses, applicable to both local and foreign contractors, for failure to meet schedules.

3. A procedure for expediting approvals and authorizations should be established.

4. An engineering services contract should be entered into that will be comprehensive in scope and give weight to th recommendations of the project engineer.

5. A formal explanation for any part of the project's fallin more than 30 days behind schedule, at any time between au thorization of the loan and final acceptance of the proj- ect, which shall include the effect of the delay on the project and the remedial measures being taken.

6. Preference should be given to awarding a few prime con- tracts, rather than numerous lesser contracts, so that re sponsibilities will be concentrated.

7. Contact should be maintained with all equipment suppliers and contractors, both foreign and local, to ensure that work is progressing at a rate that will meet delivery schedules.

As a result of the AID engineer's recommendations, AID's Was ington office suggested to the Mission that a special condition precedent to loan disbursements be included in the loan agreement requiring evidence that satisfactory arrangements had been made f effectively carrying out the project and for effectively utilizin the eligible items. Such a special condition precedent was not i cluded in the loan agreement, however, as it was opposed by the Mission primarily on the grounds that it would be difficult to ne gotiate and that alternative measures in the form of implementati actions and day-to-day surveillance would more practically serve the same purpose.

Despite the fact that AID had knowledge of the existing proj ect problems and had stated its specific intention of avoiding si ilar problems, we found that overall project progress under the e tension loan had experienced essentially the same types of proble that had been encountered in the earlier construction. From our observation, the most important factors contributing to the prob- lems were:

1. The predictable lack of harmonious relationship between the Indian project authorities and the engineering consultants.

2. The Mission's limiting its project activity primarily to review of problems after they occurred rather than performing systematic routine checking and monitoring of the project activities for timely and efficient project implementation.

The extension project as originally planned was intended for completion in December 1965. The contract for consulting engineering services approved by AID specified completion dates for the three generating units of August, October, and December 1965, respectively. We noted, however, that a quarterly progress report for the period ended December 31, 1965, had shown the project to be only 30 percent completed and that the Indian project authorities had estimated that the first generating unit would not be operating before March or April 1967. A Mission official had described this rate of progress as certainly not commendable and had cited several reasons for the delays as follows:

1. Much of the work performed by the consulting engineers was lost due to changes in the project concept by the Indian project authorities.

2. It was decided at a late date to construct a barrage (earthen dam) across a nearby river, rather than construct cooling towers as originally planned, to obtain a reliable water source for direct cooling.

3. The lack of an early agreement between the various GOI agencies concerned with the movement of energy from area to area.

4. Cumbersome procurement practices.

We found that the above-cited reasons for project delays had caused disagreements between the Indian project authorities and the firm of consulting engineers employed on the project, resulting in claims for additional compensation.

The consulting engineers for the project had commenced engineering design work before they entered into the contract with GOI on July 8, 1963. By the time that the contract was submitted to the Mission for approval in January 1964, the consultants had per formed extensive work and had incurred foreign exchange expenses totaling $125,000. The consultants stated that they would not cc tinue work until they were reimbursed for these expenses, and AII agreed that it could reimburse the consultants for these prior ex penses after it approved the contract.

The contract, as finally approved by AID in September 1964, provided for a fee of $430,000 to be paid from the AID loan. In May 1965, however, the consulting engineers submitted a letter to the Indian project authorities requesting payment of an additiona $184,000 for design and engineering work which they considered to be outside the scope of their contract and advised AID that there would be charges amounting to about $150,000 to cover increased a ministrative overhead and increased costs for the period the proj ect would extend beyond the December 1965 completion date specifi in their contract.

At the time of our review in India, the consulting engineers claim for services beyond the scope of their contract had been countered by Indian criticism of the engineering work they had per formed and backcharges for poor design and for work errors.

Although all parties had stated a willingness to compromise i order to reach a negotiated settlement, the consultants had indicated that they might stop work on the part of the project considered to be beyond the scope of their contract and the Mission had expressed the view that it was highly improbable that a compro mise could be reached in the near future. The Mission had also stated that it was pessimistic about the prospect of effective mediation by AID.

We noted another conflict on the project which had prompted the Mission to consider whether the borrower should be found in de fault due to the lack of diligence and efficiency in carrying out the agreement and, if so, whether AID's right to terminate the loa agreement should be invoked.

The consulting engineers reported that a civilian contractor on the project had been authorized to proceed with the constructic of a concrete intake tunnel over their objections and notified AII that they denied all responsibility. Mission engineers inspected the tunnel and found that about 50 percent of the concrete that ha been poured showed some very bad workmanship and concluded that

hat portion of the tunnel would have to be reconstructed. They tated that it might be necessary for AID to have its own inspector f it wished to ensure that the project would be carried out with iligence and efficiency in the future.

Mission officials agreed that the project had proved extremely roublesome and that the relationship among the project authori-ies, consulting engineers, and contractors left much to be desired nd had caused substantial delays in project procurement. The Mis-ion officials stated, however, that a recent progress report had ndicated that the project could be completed for $1.4 million less han the amount of the authorized loan and that the Mission there-ore had no indication that any costs for the project would be ex-essive.

The Mission also attributed the delayed project completion to he fact that the original completion date of December 1965 had not nticipated the substantial delay that occurred prior to the com-encement of procurement and construction or the 5-month lag that ccurred during the early stages of construction.

We suggested to Mission officials that the Mission might pro-ide more effective project management and thereby eliminate the roblems encountered in the implementation of this project. The ission officials did not concur in the suggestion and stated that, otwithstanding all the problems, the project was finally progress-ng satisfactorily.

In commenting on our draft report, the Assistant Administrator or Administration advised us that the project was receiving con-inuous attention in an effort to do whatever could be done to ex-edite completion of the project. He said that AID would follow evelopments closely and, whenever such course of action promised esults, would intercede with the Indian authorities responsible or the execution of the project.

Need for defining work required for completing fertilizer plant at Trombay

Our review showed that there was a need for defining the wor required for completing the fertilizer plant at Trombay, near Bombay, India, and responsibilities for its completion, includin costs applicable thereto, to minimize delays and costs and to realize the economic benefits expected to accrue from the project completion as soon as possible.

Prior to the establishment of AID, the Development Loan Fund entered into a loan agreement with Hindustan Chemicals and Fertilizers, Limited, predecessor of Fertilizer Corporation of India (FCI), for up to $30 million to finance the reasonable foreign ex change costs of constructing a fertilizer plant at Trombay.

AID provided the rupee equivalent of more than $28 million from Public Law 480 sales proceeds, on a loan basis, to meet the local currency costs of the project. Subsequently AID financed a increase in the costs of the planned project and certain addition to the plant with an additional loan of $7.8 million. Thus the United States financed the entire cost of the project.

Construction of the fertilizer plant at Trombay was original planned by GOI as early as 1955. By January 1959 GOI had considered alternative methods of production, and in July 1959 it ap plied for United States financial assistance, resulting in the first dollar loan agreement dated December 29, 1960. The first contract was awarded in mid-1961, and the foundations and other local contract work commenced in April 1962.

The project is expected to produce 99,000 metric tons of ure and 330,000 metric tons of nitrophosphate fertilizer a year. The project also involves construction of ammonia and nitric acid plants to produce 33,000 metric tons a year. Originally it had been estimated that the fertilizer plant would be tested in late 1963 and be in full production by early 1964. Such production is expected to realize foreign exchange savings to India of more tha $30 million a year, on the basis of the estimated landed costs of imported urea and nitrophosphate fertilizer equivalent to the capacity of production at the Trombay plant.

Similar foreign exchange savings for argon and methanol capacity of the project are estimated at almost $10 million a year. Most important, however, the fertilizer plant will produce enough fertilizer to increase Indian food grains production by more than 1 million tons a year.

The Mission became aware, in the early stages of construction, that the project would likely incur increased costs and undergo serious delays. During an inspection trip to the project site in July 1962, Mission officials were advised by FCI that it might have trouble staying within the $30 million foreign exchange loan, despite the fact that assurances had been made that costs were reasonably firm and the fact that contingency funds had been provided.

According to a Mission report on that inspection, delays had been caused largely by a drainage problem that was more extensive than originally anticipated and by GOI's reluctance to import essential commodities. (See p. 34.) Also, a United States contractor for a major portion of the project had complained to Mission officials that his company did not have authority to make project implementation decisions.

Mission records indicate that AID officials, despite this evidence of conditions that would seriously hamper the project, did not visit the construction site again until August 1963, after the Indian project authorities had applied for an additional loan to cover $1.8 million for increased costs and $6 million for additional plant facilities, including the methanol plant. The additional dollar loan agreement was signed on June 19, 1964.

During an inspection trip in January 1965, a Mission engineer found that, even then, the Indian project authorities and United States contract advisors on the project were not in agreement on the construction schedule and completion date. He confirmed an advisor's estimate that the plant, even if it operated satisfactorily upon completion, would not be in full production until the end of 1965.

In addition to citing poor planning for the project, the Mission engineer concluded that the long delays in constructing the plant could be attributed to the division of authority among the borrower, Indian project authorities, local contractors, and suppliers of equipment who had only advisory responsibility in regard to construction of the plant for housing the equipment which they supplied.

Our review at the project site in March 1966 and our discussions with project officials and United States contractors indicated that the divided authority was still standing in the way of early project completion. Production runs on a test basis had be started in November 1965, and, through March 28, 1966, the plant produced less than 8,000 metric tons of urea and less than 16,00C metric tons of nitrophosphate fertilizer. These test runs showec that the nitrophosphate fertilizer plant could not produce at the desired capacity, and the plant was undergoing design changes at the time of our review.

There was also a dispute between the Indian project authorities and a United States contractor having major design responsibility as to what constituted a successful test run of production While at the site we received estimates of several months to possibly 1 year more for the plant's reaching full production. We c served that the test runs were utilizing the plant at about one third capacity.

We also learned during our visit to the project site that th GOI had approved, in principle, expansion of the Trombay fertiliz plant by about 170 percent, with such expansion expected to be co pleted within 3 years from the date when definite financing arrangements were made for the necessary foreign exchange.

Although the Mission had not yet been involved in the planne expansion, FCI officials thought that application would eventuall be made to AID for financing. We believe that, if such is the case, the difficulties encountered in the present construction, a well as the fact that private United States companies have expressed interest in participating in India's fertilizer development, should be fully considered before committing the United States to additional funding of fertilizer production facilities the public sector.

We suggested that the Mission might improve the lagging project implementation and prevent additional delays and increased costs by defining the work remaining to be done and the responsibilities for its completion. Mission officials stated that, in their opinion, such action was neither appropriate nor necessary, because these things were defined in the contracts which had been extended to April 30, 1966, and which would be further extended b Indian project authorities as necessary. The Mission opposed our suggestion on the basis that AID was never intended to provide management services for projects but that the borrowers, with expert help from consultants, were to play an active role in project management.

We did not agree with the Mission's reasons for opposing our suggestion, chiefly because the arrangements on which these reasons were based had not prevented major difficulties' being encountered in the bulk of construction already completed and, in our opinion, were not likely to prevent problems in bringing the plant into full production. At the time of our review in March 1966, it appeared that planned project completion was lagging and that Indian project authorities and contractors were not completely in agreement as to specific completion plans.

In view of the importance of this project to agricultural production in India and in view of the foreign exchange savings expected to result from its completion, we believe that the Mission should define the work remaining to be done and the responsibilities for its completion, including costs applicable thereto. With regard to the possibility of substantial plant expansion, we believe that the interest expressed by private United States companies in participating in India's fertilizer production should be explored.

In commenting on our draft report, the Assistant Administrator for Administration stated that this project had had AID's close attention for a considerable period of time. He stated also that meetings with the contractors had been held in Washington, site visits had been made, and efforts to resolve existing disagreements between the project authorities and the contractors had continued. As to the possibility of plant expansion, he described the extensive efforts being taken toward private sector investment in fertilizer production and stated that AID had no plan for financial participation in an expansion of the Trombay fertilizer plant.

Need for improved surveillance of modern storage of food grains project

We found, in regard to the AID-financed project for modern storage of food grains, that (1) AID was not aware that an important part of the project was not being effectively utilized becau of a mechanical breakdown in one of the three units of the marine leg for bulk unloading of grain ships at the Calcutta port, which had occurred about 9 months before our visit to the port and (2) there was need for the Mission to take a more active part in implementing the grain warehouse construction phase of the projec

The United States began a program, in 1954, of assisting GOI in exploring the advantages of new types of construction for the storage of food grains. In our prior report on India (B-114845, September 14, 1959), we pointed out that the project had experienced considerable difficulties and delays and that the Mission h considered the possible cancellation of the entire project and a request for refund from GOI for all dollar funds expended. AID a vised us, however, that, inasmuch as the project was then being satisfactorily implemented, cancellation of the project would be inappropriate at that time.

The primary project goal was to demonstrate modern methods o grain storage by assisting GOI in the construction and initial op eration of two 10,000-ton silos, complete with grain elevators, a 50 prefabricated 1,000-ton warehouses. One silo was to be erecte at or near a major port area and the other at a suitable interior center. The prefabricated warehouses were to be erected at locations where transit storage was urgently needed.

For the project, the United States provided the services of two United States technicians, training in the United States for eight GOI officials, and commodities worth approximately $1.5 million. Also, grants of United States-owned rupees generated by th sale of surplus agricultural commodities under Public Law 480 totaling the equivalent of more than $25 million are being provided for additional storage capacity.

The silo at the Calcutta port was completed in September 196 The Mission, through its grain storage advisor, found that the silo, since it was 350 feet from the waterfront, could be used on by installing a conveyor belt and mechanical unloading equipment for transferring the bulk grain from the holds of the ships to th silo. The bulk unloading equipment was to consist of three units of 75-ton-an-hour capacity each, for lifting the grain from the holds and spouting it onto the conveyor belt for transport to the silo and to bagging facilities. The silo and marine leg cost more than $580,000.

Although the bulk unloading equipment had arrived in Calcutta in April 1963 and its erection had been delayed because of GOI's reluctance to permit import of certain essential commodities (see p. 33), the Mission took no action until a Port Facilities and Cargo Handling Improvement Team visited the Calcutta port in the fall of 1964. The team noted that grain was still being moved by hand labor and, in October 1964, recommended that the silo and associated bulk unloading equipment be placed in operation as soon as possible.

The Mission's grain storage advisor departed India in April 1962. In January 1965 he was recalled to India on a temporary assignment, to make a review of the progress of the project and the rate of utilization of resources provided by the United States. Thus, insofar as is shown by the Mission's records, the Mission had no direct participation in the project and no real knowledge of the progress of and problems in the technical and administrative direction of the project by GOI for the period from April 1962, when the grain storage advisor left India, until January 1965, when he returned, despite the large amount of dollar and rupee funds provided.

In March 1965 the first trial run was made on the bulk unloading equipment using only one of the three 75-ton units. During our visit to the site in April 1966, we were advised by a mechanical engineer that trial runs had continued until August 1965 when full-time operations were started.

We observed that only two of the three 75-ton units were in operation. The mechanical engineer told us in April 1966 that the other unit had broken down about the time trial runs had ended and that it had not been repaired during the 9-month intervening period because the necessary repair parts were not available in India. We found no evidence that the Mission had been aware of the breakdown and resultant nonutilization of this equipment.

During his temporary stay in India, the grain storage advisor visited 14 of the 29 grain warehouses being financed by AID. He reported that they were lacking in roof ventilation and rodent-proofing and that the cost data for each location were so inconsi tent that he could not arrive at a unit cost figure.

We believe that a basic cause for the long history of difficulties and delays in the grain storage project has been the lack of effective and direct participation in the planning and impleme tation of the project by the Mission. The extent of Mission acti ity in the project since April 1962, except for the grain storage advisor on temporary duty for several months in 1965, has consist of no more than reviews of quarterly reports by GOI on warehouse construction, which reports the Mission has characterized as meager.

In view of the nonutilization of AID-financed equipment, evi dence of construction deficiencies and generally ineffective util zation of the storage facilities reported by the grain storage ad visor, and the massive rupee funding now being provided for additional warehouse construction, it seems evident that the Mission should perform a detailed review of the project for determining ways and means of improving equipment and facility utilization an for making informed decisions on the need for and location of add tional grain warehouses.

In commenting on our draft report, AID stated that the Missi had been asked to make a review of the project and had been instructed to take appropriate steps to correct any misutilization nonutilization of United States-financed equipment.

Action being taken to determine whether gear plant can be successfully completed

We noted that AID's planning of a project for the establishment of a precision gear plant in India, financed in part with a series of AID loans, and its monitoring of the various implementation stages were inadequate and that, as a result, the project's prospects for successful completion and contribution to India's economic development were not reasonably assured.

By a loan agreement dated July 27, 1962, AID made a loan of $2.3 million to a privately owned Indian corporation, Napco Bevel Gear of India, Limited (NBGI), to assist in financing the foreign exchange costs involved in the purchase and transfer to India of the precision gear manufacturing equipment of the Detroit, Michigan, plant of the Detroit Bevel Gear Division of Napco Industries, Incorporated, a United States firm located in Minneapolis, Minnesota.

Napco Industries in addition to being paid the proceeds of the AID loan, was issued 37.5 percent of the initial issue of capital shares of NBGI, worth about $1 million, to cover the remainder of the sale price of the equipment and for technical supervision and other costs relative to moving the equipment to India. The estimated local currency costs of the project, totaling the equivalent of $1.7 million, were to be met through the remaining issue of capital shares, about one half to the Indian businessmen participating in the project and about one half to the Indian public.

AID made the loan in 1962, on the basis of statements in NBGI's application setting forth the conclusions formulated by Napco Industries and NBGI that the project was feasible; that the plant could be moved, installed, and undergoing test runs within a period of 13 months; and that the various gears planned for production would have a ready market within India and abroad. AID officials knew at that time, however, that the equipment would require reconditioning prior to its transfer to India and that a qualified inspector would be needed to check all items for completeness and quality before shipment was made from the United States.

Moreover, in September 1962, or about 1 year before AID actually disbursed any of the loan funds, AID received specific allegations from one of the prospective Indian stockholders that the equipment was substantially worn out and was overpriced. Despite these circumstances which, in our opinion, should have raised serious doubt as to the feasibility of the proposed project, AID continued with the financing of the project as originally planned.

The Mission's records show that the project was hardly launched before it ran into difficulties. First, the United States technicians recruited by Napco Industries for the project were principally operating persons who had never worked at the Detroit plant. The original plan had been to send the general manager of the Detroit plant to India. Since the technicians were not familiar with the equipment, it took a longer time than it normally would have taken to assemble the plant. Secondly, an underestimate in the rupee requirements for the project, plus the inability to collect on the stock subscribed by the Indian public, led to a financial crisis which placed NBGI on the verge of bankruptcy. Finally, and probably the most desperate problem, various pieces of equipment arrived haphazardly, unreconditioned, and with broken or missing parts.

Because of these problems, NBGI applied for and, on July 31, 1963, received an additional loan from AID of 4 million rupees (the equivalent of $840,000). The relief provided by this loan was only temporary, and on August 27, 1964, AID made a further loan to NBGI of 4 million rupees. In late 1964--after AID had made the second rupee loan to NBGI--Mission officials visited the project site and, for the first time, became aware of the critical status of the project.

Mission representatives made routine site inspections in September and November 1964. Their reports on these inspections described the status of equipment installation, discussed the anticipated lines of production, and concluded that substantial production could not begin before mid-1965. A Mission engineer visited the project in January 1965 and confirmed that the equipment received in India had not been reconditioned and that much of it could not be reconditioned and was little more than junk.

The Mission engineer also reported that the tools received in India were used for making gears for United States motor vehicles constructed on the United States system of measurement but were to be used for making gears for Indian motor vehicles constructed on the British metric system. He stated also that:

"Neither AID nor Napco, India [NBGI] had anyone inspect the equipment before it was crated and shipped, or was there any rational scheduling of the shipments to enable the plant to go into production as quickly as possible."

NBGI's tool engineer estimated that $1 million worth of tools .re obsolete or worn out and that many others were of no use since ey pertained to "job applications the company never will under- .ke."

At the time of our visit to India, the project was still hav- ıg serious financial and production difficulties. Production had :portedly been substantially limited to Mercedes crown wheel and .nion gears for which there was no ready market, and in February '66 the plant was not in production at all. We noted that gears the type being produced by NBGI were also being imported from e United States under AID's nonproject financing, which probably ntributed to NBGI's sales problems. The plant's raw material ıpply had been shut off because of delinquent bank loans, and GI was negotiating high-interest loans for meeting operating :penses.

Because of these difficulties, the Mission questioned whether e project had any hope for success under new management or with lditional funds or whether the plant should be closed, with the ›nsequence that AID's loans would be considered to be in default.

The Mission was reviewing the qualifications of several man- ;ement consulting firms with a view toward having an outside firm ›nduct a study at NBGI to determine whether the project was cap- ›le of being successfully implemented. This proposed study would : for the purpose of reviewing project implementation, studying 3GI's problems, examining sales potential, and evaluating the ·oject's prospects in order that meaningful recommendations for ·oject success may be made.

We believe that the difficulties encountered on this project ıderscore the importance of the need for effective planning for ıd surveillance of capital assistance activities. The facts dis- ıssed above indicate that many problems could have been foreseen ıd overcome or substantially reduced. For example, the suitabil- :y of the equipment for production in India and the marketability of the products should have been items for determination with regard to the feasibility of the project. Information concerning the condition of the equipment before it was shipped and upon its arrival in India indicates that AID could have been more effective on this project.

The Mission now recognizes the project difficulties and has stated that it is taking action to reevaluate the plant's potential for successful completion.

In commenting on our draft report, the Assistant Administrator for Administration stated that AID had recently made a thorough investigation of the affairs and prospects of the company, the conduction and adequacy of its equipment, the capability of its management, and the market for the company's product. He stated also that the study had been completed by a team of engineers from Washington assisted by Indian accounting and engineering firms and that AID was evaluating the study to decide on a course of action.

Opportunity for improving financial management of loans to Industrial Finance Corporation of India

We believe that there is an opportunity for improving the financial management of substantial rupee and dollar loans being provided by AID through the Industrial Finance Corporation (IFC) as the prime borrower, to industrial concerns in the private sector of India for the purpose of new industrial development or expansion.

IFC was established in 1948 under an act of the Indian Parliament, with the object of making medium- and long-term credit more readily available to industrial concerns in the private sector of India. The Industrial Development Bank of India, a wholly owned subsidiary of the Reserve Bank of India, holds 50 percent of the paid-up capital. The remaining 50 percent is held by scheduled banks, cooperative banks, insurance companies, and investment trusts.

The main eligible source of funds for IFC, other than its own capital, retained earnings, repayment of loans, and sale of investments are borrowings from the market by issue of bonds, loans from GOI and the Industrial Development Bank of India, and foreign credits from the United States, Germany, and France. The only dollar credits available to IFC are from AID loans.

United States assistance to IFC began in May 1959, and, since that time, 200 million rupees, equivalent to about $42 million, of funds generated under Public Law 480 have been loaned to GOI for IFC. Additionally, since December 1960 AID has made three dollar loans to IFC, totaling $40 million, to be utilized to provide the foreign exchange component of IFC loans for the establishment of new industrial concerns and for the development and expansion of existing concerns.

Rupee loans

Under the agreement for providing rupee funds, GOI, until March 31, 1964, advanced rupees to IFC as operationally required and AID, upon receipt of reimbursement claims, reimbursed GOI on a loan basis. Since April 1, 1964, AID has advanced rupees to GOI. The original agreement dated May 21, 1959, made 100 million rupees available, and a supplement to the agreement, dated January 10, 1964, made an additional 100 million rupees available. This assistance toward the local costs of projects is equivalent to about $42 million.

The agreement making rupee funds available requires that a separate set of accounts be maintained for all transactions financed, or to be financed, with the funds and that documents such as contracts and purchase orders, detailed invoices and evidence of payment, and bills of lading or other documents evidencing delivery be retained for inspection and review by AID.

Despite the elements of financial management control which are contractually available to AID, rupee loan funds advanced through GOI to IFC are commingled with its other capital, revenue, and borrowings. AID is therefore not able to determine the specific projects or portions thereof for which the loan funds are used. Neither can AID determine what portion of the funds are used for general operating expenses of IFC. Therefore, AID cannot determine whether the funds are well spent.

We found this apparent lack of concern over rupee loan funds resulted from the Mission policy of providing financial support to IFC without implementing the available financial controls. The Mission internal audit staff, in mid-1963 during its only review of the agreement to provide rupee funds to IFC, found that there was no adequate basis for ascertaining the actual specific uses made of the funds. The staff's recommendations, which were included in a draft report to Mission officials, were that rupee funds be restricted to extending IFC loans and that IFC be required to maintain separate records showing the specific uses which were made of rupee funds provided.

The Mission's response to the internal audit staff's recommendations was that AID management noted that GOI intended, in any event, to advance additional funds to IFC for its general operating purposes, and, for the Mission to be identified with those advances and with IFC, the Mission decided to allow normal GOI rules for accounts and audit to apply. The Mission further indicated that nothing more than a general agreement was required for the rupees to IFC because rupees from the Public Law 480 account were merely a "fiscal convenience."

Because of the policy expressed in the Mission's response, the internal auditors's report was not issued in final form and the financial management controls by which AID could be ensured that the funds were utilized to promote India's economic development were not implemented.

In response to our inquiry into the lack of financial management control over the use of rupee funds provided to IFC, Mission officials advised us that a determination had been made that IFC activities promoted economic development, that continued contacts with IFC officials and IFC borrowers had confirmed the Mission's original determination, and that the rupee funds in support of IFC operations in general promote economic development and were therefore in accord with United States objectives.

In commenting on our draft report, the Assistant Administrator for Administration stated that the method of making rupee loans and the procedures for monitoring the loans had been under review for some time. He stated also that loans direct to IFC, rather than through GOI, as intermediary, was one approach that was under active consideration. He stated also that direct loans to IFC would, of course, require a review of AID's monitoring procedures.

Dollar loans

The first dollar loan to IFC was for $10 million in December 1960, which was followed in June 1962 and April 1965 by additional loans of $20 million and $10 million, respectively. At May 31, 1966, substantially all the first $10 million loan had been disbursed and about 30 percent of the $20 million loan had been disbursed but disbursements under the second $10 million loan had not commenced.

AID dollar loans to IFC are to be utilized in extending 5- to 25-year credits, commonly called IFC subloans, to industrial concerns in the private sector of India in industrial categories contributing to the economic development of India. Subloans provide the required foreign exchange component of projects for the import from the United States of goods and services required to complete the projects.

Under the terms of the loan agreements, it is incumbent upon IFC to make subloans with due diligence and efficiency, in conformity with sound banking and financial practices and under the supervision of qualified and experienced management. IFC, in addition to being required to comply with these and other specific covenants and warranties imposed by the loan agreements, is required also to ensure that no disbursement of United States dollars under a subloan is made until the subborrower has completed satisfactory technical and financial planning for the project, has prepared reasonably firm cost estimates of the project, and has arranged for any additional resources which may be required for the project.

IFC is also prohibited by the loan agreements from making any subloan or series of subloans financed, in whole or in part, by an AID loan for any single project which exceeds $3 million. IFC must submit a detailed description of the proposed project and obtain prior AID approval for any subloan or series of subloans for any single project which exceeds $500,000. Prior to mid-1963 only a subloan or series of subloans to the same borrower in excess of $100,000 were restricted to procurement in the United States; since that time, however, procurement of all eligible items has been restricted to United States sources, except in specific cases approved by AID.

Our review showed that AID's monitoring of these development loans could be strengthened.

We noted that neither AID nor IFC, in its regular operations, monitors subborrowers' procurement activities regarding equipment specifications and bid solicitation and awards, despite the fact that the basic loan agreements require that eligible items be procured at reasonable prices which normally are to be based upon solicitation of a reasonable selection of suppliers and that normally these prices approximate the lowest competitive prices for the eligible items procured--quality, time, cost of delivery, and other factors considered.

Both AID and IFC were made aware, through the efforts of Mission internal auditors, that there was some question regarding the reasonableness of prices paid by borrowers for imported equipment. As a result, IFC was to extend and strengthen its inspections of projects in the area of procurement. We noted, however, that IFC's inspection reports had not covered such areas as the number of bidders solicited, the number of bids received, and analyses of the bids nor had the reports contained any assurances that the lowest responsible bidders had been selected. IFC officials informed us that such information pertaining to procurement was available at each subborrower's place of business.

In view of the fact that substantially all the dollar loans are for financing the import of equipment and since it is incumbent upon AID and IFC to be reasonably assured that such equipment is obtained from the lowest responsible bidder, it appears that some monitoring of overall procurement activities of each subborrower is warranted.

Mission officials stated that prior review or approval of procurement activities would be undesirable as it would add another level of institutional approval before any procurement could be made and would entail additional and unwarranted delay. They agreed, however, that inspections by IFC might be expanded to provide useful information as to the number of bidders, the analysis of the bids, and the contract awards.

In commenting on our draft report, the Assistant Administrator for Administration reiterated AID's reluctance to impose upon private companies benefiting from AID loans to IFC any more restrictions than are clearly necessary to ensure the use of such loans for the intended purpose and in a responsible manner. He agreed, however, that purchasing records should be maintained by IFC's borrowers and should be available for review by IFC and AID. He stated that this additional requirement would be a safeguard against frivolous purchasing decisions and would supplement existing post audit review.

In our opinion, the circumstances involved in economic assistance through IFC indicate that AID's financial management can be improved. We believe that the measures for improving administration of loans to IFC as outlined above, especially in view of the total loans to date, would be the minimum control adequate for ensuring that the funds are used in an economical and efficient manner.

Recommendation

Accordingly, we recommend that the Administrator, AID, direc the Mission to (1) implement the controls provided in the agreeme for rupee loans to IFC, (2) periodically review projects involvin significant loans to subborrowers, to determine whether the loan funds are being effectively utilized, and (3) establish procedure for ensuring more effective monitoring of subborrowers procuremen activities by IFC.

Need for more complete agreements regarding import of equipment essential to completion of projects

We noted that, although AID provided the necessary foreign e: change for the import of equipment in support of major developmen projects, there were continuous problems in the implementation of such projects because AID failed to make necessary plans and arrangements for the import of equipment essential to completion of the projects. In the absence of such plans and arrangements, the traditional practices of GOI of conserving its foreign exchange ar of restricting imports have been extended to AID-financed project: as a consequence of which importation of equipment essential to successful and timely project completion is delayed.

Because of the need to conserve its limited foreign exchange holdings, GOI employs a system of foreign exchange allocation and import controls which is increasingly complex, according to AID, and which is generally regarded by AID and others involved, such as contractors and consulting engineers, as being cumbersome, too pervasive, and inefficient in many respects.

Although the basic elements of the system have remained esse tially unchanged over the past few years, the system has become more burdensome due to the increasing emphasis on efforts to ascer tain whether required equipment is obtainable from indigenous sources. Although such controls have been aimed at supporting India's economic development program through maximum use of indigenous materials and minimum import of nonessential items, the controls have worked to delay the import of parts and equipment essen tial to the timely completion of projects financed by AID.

Project delays resulting from GOI's restricting imports were noted by AID's internal auditors during their review in India in 1964. The auditors found that a marine leg for transferring grain from ship to silos, one of the key factors to the successful completion of a modern storage of the food grains project, had not been put into operation at the time of their review. (See p. 21).

The auditors reported that the entire project had been delayed by GOI's unsuccessful attempt to supply indigenous parts and by its delay in issuing the necessary import license. The auditors noted that similar delays had been encountered on a thermal power project financed by AID also because of GOI's desire to use indigenous materials and despite the fact that AID financing was specifically for the import of required commodities.

As a possible solution of the problem, AID's internal auditors recommended that the Mission establish procedures for ensuring that the project or loan operations would be all-inclusive package deals from the United States where studies indicate that project progress would be unduly delayed if such arrangements were not made. The Mission's response to the auditors' recommendation was essentially negative on the basis that existing procedures adequately safeguarded United States interests by minimizing dollar costs and project delays.

During our review in India, we found that, although procedures for solving the problem had been developed (see p. 34), there was no evidence that they had been implemented. We noted that, in a summary dated January 28, 1966, the Mission had cited the same problem in connection with delays encountered on an important hydroelectric project in southern India. For constructing a dam having a volume of about 1 million cubic yards of concrete, a modern batching plant of high-output capability and related rock-crushing plants were required. The Mission summary attributed the project delays, in part, to delays in receipt of this equipment. A pertinent part of the Mission summary is quoted, as follows:

> "According to project source information, about six months was lost in the process of satisfying the Directorate of Technical Development that the type of batching plant desired was not manufactured in India. A similar

delay was experienced in the case of the sand plants needed to crush rock to the proper quality of sand for both the Kakki and Pamba Dams."

We noted also that a similar situation had existed in the con struction of a fertilizer plant at Trombay. (See p. 17.) A contractor had prepared a list of imported equipment necessary for a nitrophosphate installation. The Ministry of Commerce and Industry, GOI, desired to go over the list item by item and component b component, to be absolutely sure as to what could or could not be purchased in India.

According to AID's records, the contractor had stated that such scrutiny would take months and would delay the project. The contractor also estimated that such detailed scrutiny could not possibly save more than $20,000 in foreign exchange, whereas each month's delay represented $2 million in lost production and, there fore, use of foreign exchange for fertilizer imports. He stated also that he had investigated two suggestions presented to him about indigenous procurement and, in each case, had found the equi ment to be suitable but the delivery time to be too long (at least 3 years away).

The importance of this problem to successful and timely project completion was recognized in 1963 in connection with an AID loan of up to $80 million for financing construction of a nuclear power station. For that loan, AID required that GOI make adequate provisions, satisfactory to AID, for meeting all essential require ments of the project that were not the direct responsibility of th prime contractor. These requirements included arrangements for im port license and customs clearance procedures that were satisfactory, reasonable, and workable from the point of view of both prim contractor and GOI.

These arrangements, which required approval by AID before the loan funds were made available, were brought about by congressiona concern into the proposed international agreements for the nuclear power project, but were not adopted as a general policy with respect to all AID-assisted capital projects.

With respect to this problem and its effect on AID-financed projects, we were informed by Mission officials that they were about to try, simultaneously, two different approaches to the prob lem.

First, the Mission was experimenting with a critical-path nalysis for projects, whereby a schedule would be worked out indiating when each piece of equipment must be ordered to allow the roject to be completed on time. On the basis of such a schedule, ission officials would work out with GOI project authorities the etails of the customs clearances which would be necessary.

Second, the Mission would make an overall study of GOI foreign xchange and import controls and would recommend ways in which such ontrols might be simplified, particularly with reference to AID rocurement. Mission officials stated, however, that they had some eservations about specifically identifying in the loan agreement he project items to be imported and those to be obtained in India. hey pointed out that a loan agreement was a general document and hat detailed itemization was left to letters of implementation and o other collateral documents.

We believe that the increasingly complex manner in which GOI s applying its foreign exchange allocation and licensing system ontributes to delays in many AID-assisted capital development ojects. We further believe that this condition will persist unil India's economic growth rate accelerates and its balance-ofade position improves.

The Assistant Administrator for Administration acknowledged hat the rigidities of the Indian import system have been a major oncern to the United States Government and to other aid donors, ncluding the World Bank, for some time. He stated that last year OI had announced an economic reform program which included a dealuation of the Indian rupee and the start of a program to reduce nport, investment, and other administrative controls interfering ith the market mechanism. He stated also these new policies contituted a major new departure which would permit, if the program as continued and expanded, a better allocation of all resources nd greater reliance on economic factors in making investment and ther business decisions.

The Assistant Administrator for Administration stated that imorts required to permit production at full capacity in all activies receiving AID support were being freely licensed. He stated urther that AID expected that the better preparation of future ojects would permit more rapid decision on the choice between imorted and domestic supplies. Imported supplies will continue to equire a license.

Although some progress is being made, as indicated above, the measures seem to have been directed at the overall business and investment climate and not to planning which should be an integral part of each proposed capital development project to prevent delayed decisions on the choice between imported and domestic equipment, which still remains with GOI.

We believe that the corrective measures to be taken by the Mission, as described above, are important steps toward improving project execution and, if properly implemented, should result in alleviating many predictable project delays. Because of the recognized importance of the problem and the evident remoteness of the accomplishment of planned corrective measures, however, we believe that it is essential that AID promptly secure assurance that GOI has made, is making, and will continue to make adequate provisions for meeting all essential requirements of future capital development projects, including the importation of materials and equipment for such projects. Such assurance would be consistent with AID's stated intention to provide for better preparation of future projects.

Recommendation

Accordingly, we recommend that the Administrator, AID, require the Mission to reach a specific understanding with GOI in connection with all future loan agreements regarding the importation of all necessary equipment and parts to prevent project delays.

## SCOPE OF REVIEW

Our review consisted principally of a review of the financial and related management practices followed by AID in administering six economic development projects involving major construction facilities and related activities within the overall economic assistance program, with particular emphasis on whether such practices were consistent with basic agreements and with stated United States objectives and whether the projects were planned and implemented in an efficient, effective, and economical manner. The review was substantially completed in March 1967.

We reviewed program documents, reports, correspondence, and other pertinent records at AID headquarters in Washington, D.C., and at AID's overseas Mission in India and discussed relevant matters with responsible Mission officials. In addition, we visited the individual project sites as deemed appropriate and discussed pertinent matters with project officials and consultants.

# APPENDIXES

# OFFICIALS PRIMARILY RESPONSIBLE FOR ADMINISTRATION OF THE ECONOMIC ASSISTANCE PROGRAM FOR INDIA

| | Appointed or commissioned (note a) |
|---|---|
| DEPARTMENT OF STATE: | |
| Secretary of State: | |
| Christian A. Herter | Apr. 1959 |
| Dean Rusk | Jan. 1961 |
| Under Secretary of State (note b): | |
| C. Douglas Dillon | Feb. 1959 |
| George W. Ball | Feb. 1961 |
| Nicholas deB. Katzenbach | Oct. 1966 |
| Ambassador to India: | |
| Elsworth Bunker | Nov. 1956 |
| John Kenneth Galbraith | Mar. 1961 |
| Chester E. Bowles | June 1963 |
| AGENCY FOR INTERNATIONAL DEVELOPMENT (formerly International Cooperation Administration): | |
| Administrator: | |
| James W. Riddleberger | Mar. 1959 |
| Henry R. Labouisse | Feb. 1961 |
| Fowler Hamilton | Sept. 1961 |
| David Bell | Dec. 1962 |
| William S. Gaud | Aug. 1966 |
| Assistant Administrator, Bureau for Near East and South Asia (note c): | |
| William S. Gaud | Nov. 1961 |
| William B. Macomber, Jr. | Feb. 1964 |
| Director, Mission to India: | |
| Howard Houston | Feb. 1957 |
| C. Tyler Wood | Nov. 1959 |
| John P. Lewis | Sept. 1964 |

OFFICIALS PRIMARILY RESPONSIBLE FOR ADMINISTRATION

OF THE ECONOMIC ASSISTANCE PROGRAM

FOR INDIA (continued)

[a]In the case of Ambassadors, date of presentation of credentials.

[b]On February 3, 1959, the Secretary of State assigned responsibility for the International Cooperation Administration to Under Secretary of State for Economic Affairs, Mr. C. Douglas Dillon. On June 12, 1959, this responsibility, together with the overall direction and coordination of the mutual security program, was reassigned to Mr. Dillon as Under Secretary of State. On February 2, 1961, Mr. George W. Ball was confirmed as Under Secretary of State for Economic Affairs and assumed responsibility for the mutual security program formerly carried out by Mr. Dillon. In November 1961, Mr. Ball was appointed Under Secretary of State.

[c]Bureau established in November 1961.

DEPARTMENT OF STATE
AGENCY FOR INTERNATIONAL DEVELOPMENT
WASHINGTON, D.C. 20523

MAR 8 1967

Mr. Oye V. Stovall
Director
International Operations Division
U. S. General Accounting Office
Washington, D. C. 20548

Dear Mr. Stovall:

This Agency has reviewed the General Accounting Office draft report entitled "Need for Improvements in Planning, Implementing, and Continued Surveillance of A.I.D.-Financed Capital Development Projects in India." Our detailed comments are included as attachments to this letter.

You will be interested to know that the cotton linters pulp plant proposal has been dropped with the approval of the Government of India. The GOI also has approved use of the $1.7 million, previously allocated to the linters plant, to finance the foreign exchange costs of expanding the rayon tire cord plant.

[See GAO note on p. 49]

The problems on import controls posed in the report remain, but the GOI has taken important steps toward freeing up the import system. On June 21, 1966, the GOI inaugurated an import liberalization program. The most important feature of this program is that industries in 59 priority categories will be issued licenses for the import of sufficient raw materials and spare parts to permit production at full capacity (this will include all activities receiving A.I.D. support).

GAO note: The page numbers cited by the Assistant Administrator for Administration in these comments refer to pages in the draft report submitted for review; the page numbers shown in brackets refer to the corresponding pages of this report.

Mr. Oye V. Stovall, Director

The above points and others were discussed at an informal meeting on December 22, 1966, between members of your staff and A.I.D. officials. I understand that as a result of the discussions some of the conclusions anc recommendations in the draft report will be further examined. We hope tha the comments included in the attachments to this letter will be useful anc can be reflected in the published report.

Sincerely yours,

William O. Hall

William O. Hall
Assistant Administrator for Administration

Attachments: a/s

ATTACHMENT A

## Loan Review and Administration

The following information is provided as background in connection with the discussion of specific capital projects.

### Background

At the time of independence, India already had a well developed and highly motivated Civil Service, as well as other institutions, which seemed eminently capable of assuming responsibility for administration of the country. India also was one of the first less developed countries to establish an economic Planning Commission and to undertake an organized program for economic and social improvement based on formal plans. Most prominent observers of the Indian scene in the late 50's were impressed by the efficiency industry and determination with which India tackled the task of economic development and it was generally thought that India's chief problem on the road towards more rapid economic growth was the foreign exchange constraint which limited the import of capital equipment and other goods needed to generate more rapid domestic production. Within the framework of the then existing policy it was expected that India would have the capacity for administering and executing capital projects with a relatively small amount of advice and assistance from external engineering firms.

The assumptions underlying this policy began to be questioned in the early 60's. One of the leading exponents of the view that Indian capacity to administer capital projects had been thought to be greater than proved to be the case, is the present AID Mission Director John P. Lewis, who set forth some of his views in his book on India "The Quiet Crisis in India" published in 1961.

While earlier loan agreements, including the ones reviewed by the GAO, call for a minimum amount of participation, or relatively a small amount of participation by the Mission itself and by American engineering firms, we now contemplate a much more substantive role for U. S. engineers, both government and private both in formulation and in the execution of Indian capital projects.

### Loan Proposals

The process of analysis of loan proposals both by agencies of the U. S. Government, now primarily by AID, and by other national and international lending agencies is a dynamic one in which the approach

ATTACHMENT A (Contd)

and the specific techniques are constantly being refined. Both academic research, particularly in the field of economic analysis, and practical experience gained by the lending institutions are playing their part in a continuing review by AID of its own practices and procedures.

Staff

Lending to the less developed countries to promote their economic development is a field for which a reservoir of trained manpower was non-existent 15 years ago and even today is very small. The specific contribution of economic, financial and political considerations going into the analysis of capital projects in the developing countries requires experience not readily found among the professionals trained for the needs of private investment, banking, academic or business economics or industrial management. Their experience, excellent in their own field as it may be, invariably has to be supplemented by on-the-job learning and training. Thus both the number of trained loan officers and the body of knowledge available to them have expanded considerably since the U. S. Government first organized a development lending operation. Both the people, and the organization and procedures, continue to develop as new experiences are gained and new methods developed.

The A.I.D. staff devoted to India projects has been substantially expanded. The Washington staff handling loans to India consists of two well trained loan officers with the required economic and financial background, working under the supervision of an Assistant Director and the Director of the Office of Capital Development and Finance (NESA/CDF) which is responsible for the administration of the loan program in the entire Near East-South Asia region. In addition, two officers handle the implementation of loans to India, working under the direct supervision of the Chief and Deputy Chief of the Loan Operations Division of NESA/CDF. In New Delhi, the loan program is administered by the Assistant Director, Capital Projects, who supervises a staff of five loan officers (Chief of the Loan Division and four loan officers) and of eight engineers (Chief Engineer and seven specialized engineers). In addition, one economist works practically full time on loan matters. This large increase in staff assigned to the loan program in India reflects the Agency's awareness of the need to play a much greater role in the process of developing and executing capital projects in India and to build an organization capable of playing that role.

ATTACHMENT A (Cont'd)

As noted earlier, our approach to handling India projects has undergone a major change in attitude and policy which is reflected not only in the expansion of personnel concerned with these problems but also by the adoption of new Implementation Procedures. The recently published "Capital Project Guidelines" embody most of the procedures now in effect. Beginning about 3 years ago, A.I.D. has required that the Indian government agencies responsible for a project obtain the services of U. S. consulting engineers, wherever such services are appropriate (as, e.g., in the construction of most power stations or industrial plants). Increasing emphasis is placed on site visits by Mission loan officers and engineers. Contracts for services and major equipment purchases are reviewed either by the Mission in New Delhi or by Washington staff. Quarterly progress reports (required under all loan agreements) are carefully analyzed both in the field and in Washington.

ATTACHMENT B

## Comments on Specific Projects

Industrial Finance Corporation (Page 13) [27]

Four criticisms were presented in the GAO report. (1) Monitoring of rupee loans; (2) alleged non-compliance with Section 611(a) of the FAA; (3) inadequate supervision of subloans made by IFC by A.I.D., particularly with regard to procurement practices by sub-borrowers; and (4) A.I.D.'s past practice of making separate, successive loans to IFC, separately administered, rather than establishing a line of credit against which amounts could be drawn by IFC as needed. The following comments are offered on each of these three points.

1. Monitoring of rupee loans

The method of making rupee loans, and the procedures for monitoring them, have been under review for sometime. Direct loans to IFC, rather than loans through the intermediary of the Indian Government, is one apprach that is under active consideration. /A precedent for this approach has been set in Pakistan by a first direct loan to the Pakistan Industrial Credit and Investment Corporation Ltd. (PICIC)./ Direct loans to IFC would, of course, require a review of A.I.D.'s monitoring procedures.

[See GAO note on p.49]

3. Inadequate supervision by A.I.D. of dollar sub-loans made by IFC. In its relationship with intermediate credit institutions and private borrowers, A.I.D. seeks to act, to the largest extent compatible with its obligation to prevent abuse and diversion of loan funds for purposes other than economic development, in a manner which promotes rather than hinders the operation of private companies by their management without undue interference by government agencies. The growth of private enterprise in developing countries is one of A.I.D.'s most important objectives and clearly in line with Congressior interest. We are, therefore, reluctant to impose upon private companie benefitting from A.I.D. loans to IFC any more restrictions than are clearly necessary to assure the use of such loans for the intended purpose and in a responsible manner. Deciding on the extent of supervision of sub-loans necessary to attain these objectives is, of course, to some extent a manner of judgment.

ATTACHMENT B (Cont'd.)

We believe that in the matter of procurement by IFC's private borrowers for which A.I.D. loan funds are used, normally the business judgment of such borrowers should be allowed to prevail. We, therefore, rely on the "reasonable cost" provisions in our loan agreements with IFC to prevent abuses of such freedom, rather than impose the rigidity of public bidding procedures on private companies (as we do in administering loans to public agencies of the borrower country). We also insure, by appropriate provisions in our loan agreements with IFC (as in all loan agreements), that all purchases are advertized in A.I.D.'s Small Business Bulletin. We agree with the GAO that purchasing records should be maintained by IFC's borrowers and should be available for review by IFC and A.I.D. We do not believe that enforcement of such a requirement would constitute undue interference with the business operations of IFC's borrowers. We do believe that it would be useful as a safeguard against frivolous purchasing decisions, supplementing the post-audit review of prices paid, which is already in effect.

4. Line of credit vs. separate loan

[See GAO note below]

Delhi Cloth and General Mills, Inc. ("DCM")

The Government of India (GOI) by letter of November 27, 1966, to the Mission, approved the Delhi Cloth and General Mills, Inc. plan to drop the cotton linters pulp plant proposal. The GOI also has approved use of the $1.7 million allocated for the linters plant to finance the foreign exchange costs of expansion of the rayon tire cord plant. Therefore, the cotton linters pulp plant proposal has been dropped, and the Mission has been instructed to initiate a thorough study of the existing rayon tire cord plant and the proposed addition. The final decision with respect to the use of the $1.7 million will be based on this study.

GAO note: Deleted comments relate to matters discussed in draft report but omitted from this report.

ATTACHMENT B (Cont'd.)

Delhi "C" Station (Page 24) [11]

This project has had continuous attention by engineers and loan officers in AID/W for many months. We have had a number of meetings with the consulting engineers and have discussed the project with the staff of the Mission in New Delhi, all in an effort to do whatever can be done at this stage to expedite completion of the plant. We agree that the relations between the project authority and the consulting engineers have been far from harmonious but it is obviously too late at this stage to change engineers or to modify the basic concepts underlying the present arrangements for the construction of a plant. This means that A.I.D. could not take over the project "management" in the strict sense of that term. It does not mean, however, that we will not follow developments closely and, wherever such course of action promises results, intercede with the Indian authorities responsible for the execution of the project. We might add that any amendment to the contract with the consulting engineers will require the approval of A.I.D., as did the original contract.

Trombay Fertilizer Plant (Page 32) [16]

This project has also had our close attention for a considerable period of time. Meetings with the contractors have been held in Washington, site visits have been made, and efforts have continued to resolve existing disagreements between the project authorities and the contractors. These measures constitute in effect a compliance with the recommendation included in the report to the effect that the "Administrator direct that the Mission initiate a review..." We will continue to do everything possible to assist the project authorities in bringing the plant into full production.

With regard to the second recommendation included in the report; i.e., that A.I.D. explore the possibilities of private investment in Indian fertilizer production before authorizing an expansion of the publicly owned Trombay plant, we would like to note that one fertilizer plant in India in which U. S. companies are investors is nearing completion, that a second plant in which a U. S. company owns a substantial interest has been formally agreed upon between the Indian Government, the U. S. investor, U. S. commercial banks providing loan funds and A.I.D. which will provide both specific and extended risk guaranties. A third private Indian-U. S. joint venture is at the moment developing the financial plan for a third plant. Both A.I.D. and the International Finance Corporation are planned to participate in the financing. A letter of intent for the construction of a fourth plant to be built by a U. S. company has been issued and that company is now in the process of making

ATTACHMENT B (Cont'd.)

its financing arrangements. A British company has the leadership in a fifth project. These results have been obtained by the joint efforts of the Indian Government, the World Bank group, and A.I.D. Both the World Bank and A.I.D. continue the search for possible private investors in Indian fertilizer production capacity. At this time, A.I.D. has no plans for financial participation in an expansion of the Trombay fertilizer plant.

NAPCO Bevel Gear (Page 43) [23]

Within the last few months A.I.D. has made an effort to ascertain the nature of the problems preventing the plant from getting into full production. A team sent from Washington to India, consisting of a former executive of a U. S. gear plant, a gear engineer, and an A.I.D. staff member, made a thorough investigation of the affairs and prospects of the company, the conduction and adequacy of its equipment, the capability of its management, and the market for the company's production. In this work they were assisted by Indian accounting and engineering firms which covered specific aspects of the study, such as the market and certain technical questions. The studies have been completed and A.I.D. is now evaluating them to decide on a course of action.

ATTACHMENT C

Import of Equipment Essential to Completion of Project (Page 48) [3

The draft Audit Report describes delays inthe completion of projects which are attributable to the non-availability or late availability of some imported materials. In many cases the items needed are not very costly but are essential to rapid progress.

The draft report recommends that A.I.D. make specific arrangements with the Indian government for the supply of needed imports related to our projects.

The rigidities of the Indian import system have been a major concern to the U. S. Government and to other aid donors including the World Bank for some time. We have felt that the Indian inclination to superimpose administrative controls onthe economic decision-making process has led to misallocation of resources of a serious nature. We have endeavored to deal with this problem on a general basis to obtain benefits for the economy as a whole, without losing sight of the needs of specific projects in which the United States has either a financial or other special interest.

Last year the Indian government announced a major economic reform program which included a devaluation of the Indian rupee and the start of a program to reduce import, investment, and other administrative controls interfering with the market mechanism. Imports required to permit production at full capacity in 59 priority industries (this would include all activities receiving A.I.D. support) are now freely licensed. The Indian government has also established new and simplifie procedures to assure the allocation of licenses required for the construction of new production facilities in the fertilizer industry, including financing of market seeding programs and other related activities. Initial experiences with these programs have been encourag

These new policies constitute a major new departure which will permit, if the program is continued and expanded, a better allocation of all resources and greater reliance on economic factors in making investment and other business decisions.

In the past projects have frequently been delayed because of efforts to exploit domestic production capacity as a source for specific parts or components. This is of course commendable and may result in foreign exchange savings. We expect that the better preparation of future projects will permit more rapid decision on the choice between imported and domestic supplies.

OPTIONAL FORM NO. 10
5010-104

UNITED STATES GOVERNMENT

# *Memorandum*

TO : GAO, Mr. Samuel Kleinbart
Room 710 SA-12

DATE: April 24, 1967

W. D. Austin

FROM : C/AUD, William D. Austin
Room 506 SA-12

SUBJECT: GAO Draft Report on "Need for Improvements in Planning, Implementing, and Continued Surveillance of A.I.D.-Financed Capital Development Projects in India."

Ie have been informed by India desk personnel that they have asked the Mission .n New Delhi to make a review of the Modern storage of foodgrains project. 'hey have instructed the Mission to take appropriate steps to see that any is-utilization or non-utilization of U.S.-financed equipment is corrected t once. You may treat this information as a supplement to the Agency's .rch 8, 1967 reply to the subject report.