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Statement of

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before the

Subcommittee on Foreign Operations

of the

Senate Committee on Appropriations

on

GAO Reviews of

Foreign Economic Assistance Programs

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Mr. Chairman and Members of the Subcommittee:

We appreciate the opportunity to provide an overview of our recently completed and on-going work on U.S. economic assistance programs.

Our work has emphasized concerns with specific aspects of the overall program and/or selected regions or countries. As in the past, we continue to address those areas of congressional interest in which we believe management and administrative improvements can be made and implementation of our recommendations can result in program improvements, reduce costs, and provide better opportunities for congressional oversight.

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THE ECONOMIC SUPPORT FUND

A major trend in the U.S. economic assistance program in recent years has been the increased use of the Economic Support Fund (ESF). While the funding levels for other forms of bilateral aid have declined or remained stable since fiscal year 1981, the ESF program has increased by over 55 percent, to a proposed level of $3.4 billion for fiscal year 1985. The number of countries receiving bilateral ESF assistance has increased at an even greater rate, from 20 in fiscal year 1981 to a proposed 37 in fiscal year 1985. Approximately half of the Fund is allocated to Israel and Egypt. Although the Fund is used to promote economic or political stability in countries where the United States has special security or foreign policy interests, Congress has required that ESF assistance be directed, to the maximum extent possible, toward basic human needs and developmental goals. ESF assistance is used for balance-of-payments support and commodity import programs and to finance infrastructure and other capital projects.

During the past year we issued three reports on ESF activities and one on AID management of commodity import programs and provided Congress with information on ESF cash transfers in Central America. In April 1983, we reported on the political and economic factors influencing ESF funding levels and the structuring of individual country programs. We reported that ESF programs are developed on a country-specific basis, that they are not governed by any over-all formula for determining their composition and that, because few restrictions govern the

Fund's uses or the eligibility of a country to receive aid, ESF levels may be set higher than economic needs alone may warrant in order to communicate political messages. We also reported that, unlike Development Assistance funding, which uses per capita income as a primary criteria for determining whether the assistance will be provided as a grant or a loan, decisions on ESF assistance involve security concerns as well as per capita income.

One of the key foreign policy objectives supported by the ESF program is to ensure continued U.S. access to military facilities in foreign countries. For example, the Philippines received $200 million in ESF assistance between fiscal years 1980 and 1984 and was the subject of our January 1984 report. We examined the progress and constraints encountered in implementing the ESF program over the past 5 years and the implications of current program experience for future ESF assistance. We reported on the need for the United States and Philippine governments to clarify such long-standing issues as the types of ESF assistance to be provided, the purposes and uses of the assistance, and the degree of administrative control to be maintained by AID.

ESF, as a highly flexible form of assistance, is often used to help recipients meet short-term economic needs, such as balance-of-payment and budget deficits. This type of aid is used to assist recipients in importing all types of goods and services. Cash transfers are associated with a recipient country pledging to allocate foreign exchange to imports of eligible

U.S. goods and services in an amount at least equivalent to the cash transfer.

In April 1983, we reported on the $188 million in balance-of-payments assistance provided to Jamaica between 1981 and 1982. The majority of this assistance was in the form of cash transfers and was intended to stimulate economic growth by providing the foreign exchange necessary to purchase needed U.S. imports. We concluded that AID's procedures for monitoring Jamaican use of the foreign exchange assistance were limited. We believed that AID could encourage Jamaica to increase imports from the United States and recommended that AID implement a system for monitoring imports. We also suggested a monitoring process that could be implemented by AID.

The Jamaican report also discussed the use of local currencies for development purposes. We reported that, although AID requires Jamaica to provide local currency equivalent to the value of U.S. balance-of-payments assistance for agreed upon development projects and purposes, AID played a relatively passive role in the selection of these projects. Furthermore, AID relied on the government of Jamaica to select up to 90 percent of the local currency projects and performed no on-site monitoring of the projects to assure that funds were provided for agreed upon purposes or to determine whether projects were progressing adequately. We recommended that AID consider a more active role in identifying and monitoring projects.

The concerns associated with monitoring ESF cash transfers are not unique to the Jamaican program. Our review of economic assistance to Central America has shown that AID's financial controls cease once funds are deposited in a recipient's central bank and commingled with other sources of funds. Since cash transfers are not directly linked to the procurement of specific U.S. goods and services, the recipient is able to import any type of commodity from any country. GAO has not taken a position that controls are inadequate; it has merely raised policy questions on which Congress and the administration need to reach an understanding; i.e., how much control is practical and what should be the expectations attributed to cash transfers.

AID IN COMPARISON WITH OTHER DONORS

Over the past 20 years, one of the clearest trends in international development assistance is the increasing number of major donors to the developing world. Although the United States remains a leading donor country, its share of the world's total development assistance has steadily declined, from about 60 percent of the total aid provided in the 1960s to about 22 percent today. This decrease is partially due to the growth of donor programs in other countries and the emergence of such new donors as members of the Organization of Petroleum Exporting Countries (OPEC) and multilateral agencies.

In response to this growth of other donor programs, we compared the approach used by the United States with those of five major Western nations--Canada, France, Sweden, the United Kingdom, and West Germany. The resulting report was issued last year and provided an analysis of three management issues confronting all donor assistance organizations: (1) the donor's provision of different types of aid, (2) the donor's organizational structure, and (3) the donor's administrative procedures and financial controls. We reported that AID differs from the primary aid agencies of the other donors studied in a number of ways. Specifically, AID has the most extensive program in terms of dollars allocated, number of personnel, and extent of overseas field offices. AID is generally more accountable to legislative controls, more sensitive to domestic public opinion, and focuses its assistance on the rural areas where the largest number of poor reside.

Although this report contained no recommendations, it discussed the implications of applying the foreign aid management approaches used by the other donors to the AID program, particularly the dilemmas and trade-offs that would accompany such an action. The report has been used extensively by AID, others in the development community, and the recently concluded Commission on Security and Economic Assistance.

AID ADMINISTRATION AND MANAGEMENT

Commodity Import Programs

AID spends half a billion dollars a year for Commodity Import Programs (CIPs), which provide developing countries with dollar exchange to import various commodities to help meet resource shortfalls. Additionally, it provides local currency from the sale of these commodities. In response to the growing congressional interest in the size and management of these programs, we recently evaluated the extent of AID's program and financial controls over CIPs. We reported that AID had not always adequately planned procurements and delivery of the commodities. Adequate internal controls to assure compliance with existing eligibility and price regulations and requirements were not always used. AID's monitoring of the implementation of CIPs and of local currency generation was not adequate. Accordingly, we recommended that the Administrator of AID:

--Establish procedures requiring more specific pre-implementation CIP planning.

--Initiate action to improve controls, including increasing audit coverage.

--Issue specific guidance on monitoring CIP implementation at the AID mission level.

--Issue guidelines on accounting for the generation of local currency proceeds resulting from the sale of AID-financed commodities and on monitoring the use of such proceeds.

--Require that CIP assistance be systematically evaluated and develop specific guidance for those performing such evaluations.

AID agreed with our recommendations and has either initiated corrective action or informed us of plans to issue appropriate guidance to officials involved in these activities.

Recurring costs of project operation and maintenance

Proper operation and maintenance is critical to the long-term success of donor-assisted development projects. Low recipient and donor priority and inadequate financial support for the recurrent costs associated with proper operation and maintenance have adversely affected many well-intentioned development efforts. Since 1975, we have issued nine reports which have discussed the lack of host-country ability and/or willingness to maintain AID-funded projects after external assistance ends and thus becoming dependent on AID for project success. The topics of these reports varied widely and included housing, health care, water supply projects, training, and disaster assistance. Our reports during the past year on donor-assisted irrigation systems and AID's rural potable water and sanitation program again highlight the severity of the problem.

The United States, directly through AID and indirectly through the World Bank and Asian Development Bank, has invested billions of dollars in irrigation systems in Asia. These systems represent one of AID's largest investments in the region, as the Agency plans to spend as much as $750 million in Asian irrigation development in the next 5 years. Poor operation and maintenance practices, however, are seriously limiting the efficiency of those systems already in place. Furthermore, the rapid deterioration of irrigation systems represents a special dilemma for donors who must justify additional investments in new systems during the next decade. There is clearly a question of the absorptive capacity of the developing countries in the irrigation sector, in terms of recurrent budget capability and institutional expertise. Inherent in these issues is the extent to which the United States should continue to finance new irrigation activities in the face of inadequate operation and maintenance and whether it should resolve to provide such assistance only if recipient countries show the willingness, commitment, and capability to effectively operate and maintain such systems.

During 1983 we assessed the operation and maintenance of U.S.-financed irrigation systems in Indonesia, Sri Lanka, and Thailand. In August 1983, we reported on these problems and pointed out that effective operation and maintenance requires a commitment by the recipient as well as the donor. We found several problems affecting the performance of irrigation systems in each country visited, which raised questions concerning the level of capability and commitment that actually exists.

We recommended that AID require a recurrent cost plan that identifies operation and maintenance requirements and funding sources for each project. This will necessitate a willingness on the part of AID, the recipient, and other aid donors to give sufficient attention to the long-term costs and benefits associated with efficiently operated and maintained irrigation systems. We also recommended that AID adopt stronger project design and construction criteria to reduce recurrent costs. AID substantially agreed with our findings and recommendations and is pursuing many of them through its policies and projects. AID has since proposed a project to begin in fiscal year 1985 that will address the operation and maintenance problems of small-scale irrigation systems in Indonesia. This project will reportedly take 8 years to implement and will benefit approximately 2.5 million farmers.

Unsafe water and inadequate sanitation spread fatal and debilitating diseases which affect millions of lives in the developing world. The United States has been concerned with this problem for over 40 years. Between fiscal years 1978 and 1982, AID provided over one billion dollars in assistance for expanding access to improved water and better sanitation. As we reported in February 1984, the Agency's rural water and sanitation program is experiencing difficulty in delivering a full range of intended facilities and services and implementing operation and maintenance activities.

Many factors affect the timely delivery of water and sanitation services. According to the World Bank, low host-country priority, inadequate financial support, and cumbersome logistics are among the problems contributing to the slow progress. We found these problems in three of the five countries we visited during our review; most prevalent were competing host-country priorities, which may result in inadequate institutions or personnel to implement the programs and install the facilities. As a result, not all the planned benefits reach the target populations. We did find, however, that AID projects in the five countries visited have been successful when there has been host-country commitment and participation. We made several recommendations to the Administrator of AID for improving implementation, ensuring that the projects receive proper upkeep, and identifying the improvements resulting from this type of assistance. AID has taken or planned actions which should implement our recommendations.

AID credit programs

During the past year, we reviewed AID's Productive Credit and Housing Guaranty programs, which provide credit guaranties to developing countries. The Productive Credit Guaranty program provides partial guaranties to private credit institutions that lend to small entrepreneurs engaged in credit and self-help development projects. In November 1983, we reported that the program has been at a virtual standstill since 1981 in several countries due to economic recessions in the recipient countries and problems with program management. The poor financial reporting by the recipient countries' central banks, and in some cases by the AID missions, had led to confusion over the extent of AID's financial liability under the program. We recommended several measures which we believe can be taken to determine AID's actual program liability and improve program management.

A report to be issued soon on AID's management of the Housing Guaranty program discusses AID's use of the program in an environment of high external debt, balance-of-payments difficulties, and other economic problems in recipient countries. Worldwide economic conditions have adversely affected program operations. Heavy debt levels and the international recession have undermined economic stability in many countries. Inflation and currency devaluations have undermined shelter finance systems and put many shelter solutions beyond the reach of target populations. Several countries have been consistently in arrears in their loan repayments. Host-countries' debt reschedulings of loans threatens the liquidity of the program's reserve fund. The U.S. government's contingent liability for Housing Guaranty loans exceeds $1 billion; the reserve fund to cover this liability is now down to approximately $20 million.

In our report we intend to recommend that AID take steps to stem further deterioration in the level of the reserve fund and to minimize the U.S. government's contingent liability exposure. We are also concerned that no Housing Guaranty loans be exempted from any counry's debt rescheduling if such reschedulings include other AID loans. We also believe that a thorough country risk analysis should be prepared for each proposed Housing Guaranty loan.

DEVELOPMENT EFFORTS IN AFRICA

As you know Mr. Chairman, Africa is currently experiencing one of the most severe droughts in that continent's history. In response, the United States has initiated a two-part program to assist famine-threatened areas. In the short run, the administration has proposed providing $90 million in emergency food aid. The longer term will be addressed by the proposed Economic Policy Initiative for Africa, which will provide funds to nations which have reformed or are in the process of reforming major food production and marketing policies.

In September 1983, we reported on AID's efforts to reform host-government agricultural policies in Sub-Sahara Africa. At the Washington level, AID had extensively promoted host-country policy reform through policy papers, country strategy guidance, and congressional testimony. However, at the country level, AID often does not have an ongoing viable program in place which recognizes the inherent difficulties in realizing policy reform and the potential long-term effort involved. In addition, AID missions in Sub-Sahara Africa had generally not taken substantial actions to promote policy reform, even though these policies contribute to declining food production. Planned and ongoing reform efforts were minimal in many countries. We recommended that AID missions identify developing country agricultural policies which inhibit food production and distribution and develop plans to address them. We also recommended that AID appropriately reward missions and staffs for their policy reform efforts.

AID agreed with our observations and recomendations and has asked African missions to develop 5-year policy reform strategies and action plans.

Our work in process includes reviews of the Sahel Development and Public Law 480, Title III (Food for Development) Programs. Since 1981, rising donor commitments have translated into the operation of 700 donor-sponsored projects in the Sahel. This expansion of economic assistance and the proliferation of donors has imposed heavy burdens on the limited Sahelian governments administrative capabilities and may be weakening rather than fortifying them. Our review will examine the extent and impact of this problem and explore possible alternatives.

Developing countries in all regions face financial management weaknesses which reduce the performance of their development programs. The lack of host-country management capability is most serious in Africa. Training programs to improve accounting, budgeting, and auditing systems in developing countries will require the major donors to address financial management assistance as a distinct factor in the development process. We have in process a review designed to identify how the major donors can systematically define such training needs and provide related assistance.

As in the past, questions surround the current U.S. bilateral assistance program and its future direction. Our office will continue to review issues of congressional interest to assist it in considering the direction of the U.S. bilateral assistance effort.

This concludes my prepared remarks, Mr. Chairman. We will be pleased to answer any questions you may have.

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