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REPORT TO

THE CONGRESS OF THE UNITED STATES

REVIEW OF ECONOMIC ASSISTANCE PROVIDED TO THE REPUBLIC OF THE PHILIPPINES FOR DEVELOPMENT PURPOSES

AGENCY FOR INTERNATIONAL DEVELOPMENT
DEPARTMENT OF STATE

This material contains information affecting the national defense of the United States within the meaning of the espionage laws, Title 18, U.S.C., Secs. 793 and 794, as respectively amended, the transmission or revelation of which in any manner to an unauthorized person is prohibited by law.

Declassified pursant to review by AID and the Department of State

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BY

THE COMPTROLLER GENERAL
OF THE UNITED STATES

APRIL 1965

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COMPTROLLER GENERAL OF THE UNITED STATES
WASHINGTON, D.C. 20548

APR 21 1965

B-146984

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

Our review of selected United States grant aid and loan assistance projects disclosed that economic assistance provided at a cost of about $70.2 million exceeded the capability of Philippine recipients to effectively absorb, maintain, and utilize and had not, therefore, achieved the results in developing the Philippine economy that otherwise could have been reasonably expected. Foreign currency contributions by Philippine recipients, needed to make effective use of this assistance, had been insufficient and a number of projects also had not been effectively planned or administered by United States officials. A fundamental limitation on the effectiveness of the economic assistance program has been the inability or unwillingness of Philippine recipients to provide the foreign currency resources needed to adequately support United States development assistance projects. ([redacted]

Our review of selected grant aid projects disclosed that projects costing $54.7 million had not met their interim or long-range objectives, principally because the Philippine Government was unable or unwilling to provide enough foreign currency funds to permit effective utilization and maintenance of equipment, material, and services provided by the United States. (UNCLASSIFIED)

Our review of development loans totaling $27.9 million, of which $15.5 million had been disbursed, disclosed that the loans had not been successful in meeting their economic development goals about 5 years after they were made, and that repayments on two of the loans were seriously delinquent. We believe that development loans, which were made to both the public sector and the private sector, were approved and disbursed without sufficient reviews of their economic and technical feasibility and without adequate surveillance of the management of the loan proceeds. The ineffective use of this assistance had created an economic burden to some of the borrowers rather than an economic benefit. [redacted])

[redacted]

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A fundamental problem in making effective use of development loans, aside from weaknesses in managing and controlling projects, has been the limited foreign currency financial resources devoted to the projects by the borrowers. (UNCLASSIFIED)

In commenting on our findings, the Agency for International Development agreed generally that the Philippine Government had not contributed sufficiently to the foreign currency costs of certain projects. The Agency commented that it had planned for and obtained commitments of foreign currency financing in advance and that Philippine executive agencies had signed agreements in good faith and had "appropriated" sufficient funds. However, insufficient revenues were collected to fund the appropriations and inadequate procedures and practices created problems in making use of such funds as were available. The Agency commented that its program had been directed for several years toward certain of these fundamental problem areas existing in the Philippines, particularly in the fields of tax administration, civil service, budgeting, management of financial and material resources, and maintenance of equipment and facilities. [redacted]

The Agency for International Development commented also that there were reasonable prospects of meeting development loan project goals eventually and of being repaid the amounts loaned. [redacted]

The need to assure adequate levels of financial support by the Philippine Government before making any additional United States dollar commitments has been recognized by the Agency for International Development in recent years. The Agency has indicated that specific measures are planned to persuade the Philippine Government to provide resources needed to make effective use of capital equipment for development projects undertaken with United States funds in the past. [redacted]

The Agency for International Development, in its strategy for the current and future years, has expressed a willingness to consider making development loans to the Philippines of from $20 million to $25 million annually, with emphasis on public development projects. The problems experienced by the Philippine Government in making effective use of (CONFIDENTIAL)

United States loan and grant assistance in the past, however, indicate that this proposed level of assistance should not be provided until and unless the Agency for International Development has first assured itself that the Philippines (1) has a demonstrated capability of effectively absorbing, maintaining, and utilizing the assistance previously provided and (2) has provided positive assurances of its capability of effectively absorbing additional assistance. ([redacted])

The Agency for International Development has advised us that our conclusions are in accord with the position it has taken with respect to providing future dollar loan assistance to the Philippines. The Agency commented further that it has repeatedly emphasized to the Philippine Government that it stands ready to consider future financial assistance only if projects are technically sound, are supported adequately with assurances of local currency funding, and have competent management available. The Agency also pointed out that, although from $15 million to $50 million for development loan to the Philippines has been included in annual budget presentations to the Congress for planning purposes and has been earmarked within the internal budget processes of the United States Government over the last several years, there have been no development loans to the Philippines since fiscal year 1959, except for one 1961 loan, since canceled. ([redacted])

The Agency did not explain why it has continued to include in its appropriation requests large amounts for development loans to the Philippines when that agency had abundant evidence to indicate that such loans would not materialize and when the executive branch has repeatedly asserted that appropriations being sought from the Congress for the economic assistance program represent minimum requirements computed on a realistic basis. In view of the likelihood that the Agency will continue its past practice of including unrealistically high amounts for development loans in its budget requests for the Philippines, we believe that the Congress may wish to scrutinize, with particular care, the economic assistance program for the Philippines proposed for fiscal year 1966 in light of the findings contained in this report. (UNCLASSIFIED)

B-146984

Copies of this report are being sent to the President of the United States; the Secretary of State; and the Administrator, Agency for International Development. (UNCLASSIFIED)

Joseph Campbell

Comptroller General
of the United States

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REPORT ON REVIEW OF ECONOMIC ASSISTANCE PROVIDED TO THE REPUBLIC OF THE PHILIPPINES FOR DEVELOPMENT PURPOSES AGENCY FOR INTERNATIONAL DEVELOPMENT DEPARTMENT OF STATE

INTRODUCTION

The General Accounting Office has reviewed selected aspects of United States foreign assistance, both economic and military, provided to the Republic of the Philippines. This report includes matters involving the administration of the economic assistance program in the Philippines, with particular emphasis on grant aid and loans provided for development purposes. A separate classified report on "Review of Military Assistance Provided to the Republic of the Philippines" (B-133359) was transmitted to the Chairmen of Committees of the Congress Concerned on March 26, 1965.

We transmitted our findings to the Agency for International Development on July 31, 1964, and received the Agency's comments on November 12, 1964. Subsequently, we performed a limited follow-up review in Washington on certain aspects of our findings.

Our review was made pursuant to the Budget and Accounting Act, 1921 (31 U.S.C. 53), and the Accounting and Auditing Act of 1950 (31 U.S.C. 67).

The scope of our review is described on page 61.

BACKGROUND

Overall responsibility for United States foreign assistance is vested in the Secretary of State by the Foreign Assistance Act of 1961, as amended, and by predecessor legislation. The Secretary of State has delegated responsibilities for the planning and execution of economic assistance programs to the Administrator, Agency for International Development (AID). (UNCLASSIFIED)

Within the Philippines, the United States Country Team is responsible for coordinating and administering United States foreign assistance programs. The Country Team is headed by the Ambassador and includes the Director, United States Operations Mission to the Philippines. A list of the principal officials responsible for administration of economic assistance programs to the Philippines during the period of this report is included as appendix I. (UNCLASSIFIED)

The objectives of United States economic assistance are to give stability and growth to Philippine society through economic and social development; to develop Philippine self-sufficiency; to demonstrate to other Asian nations the advantage of a free society; and to ensure that the Republic remains an independent, democratic nation with close political ties to the United States. Current AID strategy emphasizes a grant aid program of slightly more than $3 million annually, principally for technical assistance to strengthen basic Philippine institutions, and a tentative development loan program of from $20 million to $25 million annually. ([redacted])

Economic assistance provided to the Philippines from the time the Republic attained its independence on July 4, 1946, until June 30, 1963, has amounted to about $1.4 billion, as follows: (UNCLASSIFIED)

	(in millions)
Agency for International Development (note a):	
Loans	$ 53.2
Grants	222.4
Export-Import Bank:	
Loans	185.8
Public Law 480:	
Title I sales agreements planned for loans and grants	25.0
Title III relief	50.3
Other	.5
Other United States economic contributions:	
Philippine rehabilitation grants	634.6
Reconstruction Finance Corporation loan	60.0
Debt fundings	37.5
Civilian supplies	28.3
Surplus property credits	9.2
United Nations Reconstruction and Rehabilitation Agency	7.7
Philippine war damage claims	73.0
Peace Corps	6.8
Total	$1,394.3

[a]The Agency for International Development (AID) is used throughout this report to identify AID and its predecessor agencies.

FINDINGS

LIMITED ACHIEVEMENTS OF GRANT AID DEVELOPMENT PROJECTS

We reviewed selected grant aid development projects for which $54.7 million in assistance was furnished and found that the amount of aid provided exceeded Philippine capabilities to effectively absorb, maintain, and utilize with the limited country funds allocated for this purpose. As a result, the projects did not achieve the economic development benefits that could have been reasonably expected had adequate levels of support been made available by the Philippine Government. A fundamental limitation on the effectiveness of the AID program has been the inability or unwillingness of the Philippine Government to provide the foreign currency resources it had agreed to provide in support of United States development assistance projects. [redacted]

We found that highways, bridges, and construction equipment had not been effectively maintained; well drilling equipment had not been effectively utilized and wells had not been properly maintained; enlargement of a pier had progressed slowly and AID-financed material had not been used 5 years after its delivery; and harbor and river dredges had not been effectively utilized. (UNCLASSIFIED)

The Mission generally has been aware that Philippine fund shortages and other problems have limited the effective use of United States grant aid for development purposes after it was furnished. These problems have been a factor in the decision to phase down additional grant aid assistance after 1961. Nevertheless, at the time of our review we could find little evidence that the Mission had attempted to persuade the Philippine Government to devote

[redacted]

enough resources to permit effective maintenance and utilization of United States assistance after its delivery. [redacted]

We believe that the difficulties encountered on these projects illustrate a need for AID to obtain firm assurances of adequate levels of financial contributions from recipient countries before making United States dollar commitments. In the Philippines, it may well be that the "appropriation" of funds does not offer the needed assurance of sufficient financial support since the Philippine Congress historically has been more optimistic than realistic in making appropriations that exceed revenues available to carry out plans. [redacted]

We believe also that the Mission should attempt to persuade the Philippine Government to devote the necessary resources to effectively utilize AID project assistance furnished in the past, both to maximize the benefits of this assistance and to gauge Philippine capabilities of effectively absorbing additional development assistance in the future. [redacted]

Highways, bridges, and equipment

A $40 million AID project to assist the Philippine Bureau of Public Highways in the maintenance and construction of highways and bridges has had only limited success in achieving these objectives, principally because the Philippine Government has been unable or unwilling to provide sufficient funds for the subsequent maintenance of highways, bridges, and construction equipment. Although the project met many of its initial objectives, we found that (1) many of the highways required extensive repairs or resurfacing, (2) sections of several roads were in bad condition because of inadequate construction or maintenance of bridges, and (3) a

(UNCLASSIFIED)

significant amount of the construction equipment provided by AID at a cost of more than $20 million had deteriorated as a result of poor maintenance.

In 1951, AID undertook a project to assist the Philippine Bureau of Public Highways in expanding and maintaining the existing countrywide highway system and its bridges. Among the specific project goals were the construction of 768 kilometers of roads on Mindanao Island, the nationwide installation of 188 bridges, and the training of personnel in highway and equipment repair. AID financial assistance to the project terminated in 1961, at which time about $27.5 million in AID-financed commodities and $11.5 million in United States owned or controlled foreign currency had been made available to meet project goals.

A considerable amount of equipment provided to the Philippines was not adequately maintained, principally because of shortages of Philippine funds. This problem, coupled with an inadequate range of spare parts, had a detrimental effect on the maintenance of AID-financed highways and bridges which, in many cases, required extensive repairs and maintenance at the time of our review.

In December 1963, we visited Mindanao Island and observed the condition of 404 kilometers of the 713 kilometers of roads built with AID assistance. We also visited maintenance facilities to observe the condition of equipment and the extent of deferred maintenance. We were accompanied by Civil Engineering personnel of the Philippine Government as well as by Mindanao Island District Engineering personnel.

During our field trip, we observed that highways, bridges, and road equipment were not being maintained effectively, as shown by the following examples:

1. Most sections of the roads had worn down to the base course because of insufficient maintenance. These roads required gravel resurfacing to restore them to their original condition. District Engineers estimated that resurfacing would cost from 15,000 to 20,000 pesos per kilometer, or the equivalent of from $1.5 million to $2 million for the 404 kilometers we observed. District Engineers further stated that many sections of the roads would require major repairs or reconstruction unless resurfacing was done within the next 2 to 3 years. (UNCLASSIFIED)

2. Several sections of the AID-financed Davao-Agusan Road had been impassable for up to 2 years because five poorly constructed or maintained AID-financed bridges were severely damaged by flood waters. We were informed that support pilings were improperly driven on three, which caused bridge spans to drop or collapse. They either were closed to all traffic or could accommodate only limited traffic. Approaches were either completely or partially washed away on the remaining two. One bridge was not usable, and traffic had to ford a shallow river crossing. The other was open only to one-way traffic. (UNCLASSIFIED)

3. During visits to several depots and repair shops, we observed large quantities of AID-financed roadbuilding and maintenance equipment that had become inoperative because parts were lacking. Some of this equipment had been awaiting repair since 1958, including dump trucks, bulldozers, and road graders. In order to obtain parts to repair some of this equipment, parts were being removed from other items of equipment. (UNCLASSIFIED)

The Mission has received numerous comments from its auditors and United States Bureau of Public Roads (USBPR) advisors to the Philippine Government regarding the misuse, idleness and disrepair of United States-financed equipment. USBPR employees have described this situation to the Mission in terms ranging from subnormal to appalling. In this respect, a Philippine Bureau of Public Highways report dated October 22, 1963, showed that 2,123 items of

[redacted])

construction equipment were inoperable, or 58 percent of the 3,718 items reported on. [redacted]

In commenting on our findings, the Mission stressed that the initial objectives of the highway program had been met, in that the agreed-on development roads in Mindanao had been constructed over difficult terrain and under very trying conditions; a large number of Filipinos had been trained; and repair shops had been established and adequately equipped, for the most part. The Mission acknowledged, however, that a number of unforeseen obstacles had limited subsequent maintenance of the roads, bridges, and equipment, including difficulties in getting appropriated Philippine funds released for important maintenance work, problems of buying spare parts and essential materials as foreign exchange reserves began to fall, interjection of political pressures at provincial and municipal levels and organizational difficulties of the Philippine Bureau of Public Highway (BPH) in administering projects covering wide geographical areas. In summary, the Mission commented:

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> "In retrospect the highway project may have been ambitious in light of the several obstacles ultimately encountered. On the other hand, the need for such a project has never been questioned, and therefore, A.I.D. undertook it in good faith and carried it out in a reasonably effective manner. The Filipinos have learned much from this project. The BPH has been reorganized so that it now is administratively structured to do a good job. Filipino engineers have been trained while at a lower level others have learned the essentials of repair and maintenance. Millions of dollars of good equipment have been imported and with the eventual filling of the backlog of spare parts (in large part being remedied by

(UNCLASSIFIED)

> [Development Loan Fund] DLF #67) [note 1] much of this equipment will be available to build a road system which the Philippines needs and Filipinos can be proud of. Finally, the question of foreign exchange seems to be considerably eased for the present, but the problems involving releases of public funds for adequate operational maintenance and development, and the removal of political pressures from District Engineers will still have to be solved if real progress in developing an adequate highway system is to be made. Only the Filipinos can solve these problems."

The Mission's comments acknowledge a number of problems adversely affecting the development of an adequate highway system. Nevertheless, these problems appear to have been given little weight in the approval of additional financial assistance provided to the Philippine Government for highway maintenance and construction. As disclosed in another section of this report (pp. 34 to 40), the Development Loan Fund loan made in 1959 for this purpose had been poorly planned and administered and had contributed little toward improving the usage or condition of equipment, or the development of additional highways and bridges, at the time of our review.

Agency comments and evaluation of comments

AID generally agreed that the maintenance of roads and bridges on the Davao-Agusan road had been limited because of insufficient Philippine funding for maintenance purposes. An inspection by USBPR and Philippine Bureau of Public Highways officials showed that, as of September 1964, maintenance of the Davao-Agusan road was still bad and some bridges were open only to one-way traffic.

[1] An $18.75 million loan for the importation of spare parts, construction equipment, and materiel needed to maintain and construct roads and bridges.

AID expressed the belief that it had taken adequate steps in the past to provide a sufficient source of income for the maintenance of the AID-financed highways. AID commented that "nearly every piece of programming documentation contains clauses alluding to the GOP's responsibility" for highway improvement and maintenance activities. Moreover, AID stated that it had required the establishment of a fund, to be accumulated from license fees and gasoline taxes paid by highway users, as a prerequisite for approval of the second main segment of dollar-financed highway equipment. According to AID, this fund still exists but the Philippine Government "borrows" from it for other purposes, leaving inadequate funds for highway uses.

The foregoing comments show that, despite understandings AID had with the Philippine Government that adequate measures would be taken for the maintenance of highways and equipment, sufficient Philippine resources had not been devoted for that purpose. So far as we could determine, AID had not taken active measures to persuade the Philippine Government to meet its commitment at the time of our review.

AID amplified on the Mission's comments that United States efforts in support of highway projects had yielded constructive benefits, such as increases in road mileage in the Philippines, increases in the number of bridges and allied structures, the introduction of new highway concepts into legislation, and other innovations. AID also commented on the achievements of the road program in developing formerly inaccessible areas.

AID has advised us that the Mission is continuing to impress on the Philippine Government the problems of maintenance and the need for emphasis on road maintenance. AID reported in July 1964 that, since the end of our field work in December 1963, 75 units of heavy road equipment having an acquisition value of $1.5 million had been rebuilt.

Wells and springs

A $9.8 million AID program for the development of wells and springs had fallen short of its interim objectives and had not been successful in achieving its long-range objective of developing country self-sufficiency. One of the major impediments to the success of the program has been a shortage of funds to be furnished by the Philippine Government in support of the program. We found that (1) substantially fewer wells were drilled than were originally planned, (2) many of the wells that were drilled had become inoperative for lack of maintenance, (3) well drilling equipment had been inefficiently utilized, and (4) a training demonstration program financed by AID had been unsuccessful in improving utilization of the equipment. At the time of our review, well drilling operations had been virtually discontinued as a result of the cessation of United States assistance and the Philippine Government had submitted a proposal for additional assistance.

In fiscal year 1952, AID undertook a grant aid program to assist the Philippine Government in improving its water supplies by financing the import of drilling equipment and supplies and by providing technical advice and training. One of the principal reasons advanced for undertaking the program was that a joint United States-Philippine public health program had pinpointed the lack of potable water in some 18,000 communities as a source of widespread water-borne diseases, causing a generally low standard of health, involving much illness and many unnecessary deaths, and constituting a serious social and economic problem to the Philippines. AID support of this program ended in 1961, at which time about $6.8 million in commodities, $670,000 in technical services and training, and $2.3 million of United States owned or controlled Philippine currency had been furnished.

Our review of program achievements from fiscal year 1957 to the present disclosed that the program had fallen far short of its interim or long-range objectives. For example, proposed goals for fiscal year 1957 called for the drilling of 6,500 wells and an anticipated production of 10,000 wells annually thereafter until the completion of the program 4 years later. Annual reappraisals that showed limited progress under the program resulted in lowering project goals from this estimate of 46,500 wells to only 17,900 wells. We found, however, that even these reduced goals had not been met, since only 11,043 wells were reportedly drilled, as shown in the following schedule:

Fiscal year	Estimated number of wells	Actual number of wells
1957	6,500	3,893
1958	3,000	2,415
1959	2,400	1,334
1960	3,000	1,353
1961	3,000	2,048
	17,900	11,043

The long-range objective of this program was the development of Philippine self-sufficiency in well drilling and spring development to cope with the nationwide water shortage in rural areas after the phaseout of United States assistance. At the termination of the program in fiscal year 1961, there was an immediate need for 60,000 more wells, plus an annual requirement for 3,000 wells because of population growth. Yet in the years following the termination of United States assistance, accomplishments were even more limited. For example, only 1,257 and 616 wells were constructed by the Philippine Government in fiscal years 1962 and 1963, respectively.

Our review of available documentation disclosed that the principal problem encountered in achieving project goals and in making effective use of AID assistance has been a shortage of Philippine funds. Moreover, the funds provided have not been released in a timely manner, and this has resulted in irregular employment of skilled personnel, an inefficient work force, and idle equipment. The following problems were among those we noted:

1. Well drilling equipment furnished by AID at a cost of about \$460,000 had not been used effectively. During fiscal years 1959 and 1960, a demonstration financed by AID at a cost of an additional \$350,000 had shown that from 60 to 100 wells could be drilled annually by each drilling rig. We found, however, that the demonstration had not been successful in stimulating effective use of this equipment. For example, during fiscal year 1961, an average of only five wells were drilled by each rig, and, during fiscal year 1963, output declined to less than two wells per rig.

2. Many wells were not kept in operating order after they were drilled. At the time of our review, about 1,200 United States-financed wells had become inoperative because part of the pump mechanism required repair. Although these repairs are relatively simple to perform, they could not be accomplished expeditiously since it was a Philippine Government policy to provide only two maintenance personnel in each province.

3. Wells and springs had been drilled in many cases without regard to the priority of need because of political pressures that favored certain districts at the expense of others.

4. Agreements for the usage of piping were not adhered to. AID furnished 2,460,000 feet of pipe for the development of 1,500 springs on the understanding that, if additional pipe were needed, the Philippine Government would provide it. This was not done, and, as a result, AID furnished 1,105,000 feet of pipe in excess of the quantity originally contemplated.

The Mission advised us that the program had been successful, despite unfavorable factors, because well construction had been increased substantially, essentially all commodities had been properly and effectively used, a capability for carrying out a program on a large-scale basis had been developed, and 5 million additional people had been provided with a potable water supply.

Even though we agree that the AID program has been beneficial, we do not believe that its achievements have been commensurate with its costs. With assured Philippine financing and better use of well drilling equipment, we believe that far more wells could have been drilled. Moreover, there is little evidence that the program has been placed on a self-sustaining basis since United States assistance was discontinued. In this respect, the Mission advised us that, primarily because of a lack of Philippine funds required to buy pipe, pumps, and other commodities, little has been accomplished since 1961, when materials furnished by AID were used up.

At the time of our review, negotiations were being held with a Philippine Government entity for a $6.2 million AID loan to reactivate and expand the wells and springs program. We were advised that a number of conditions would be imposed if the loan were favorably considered, including (1) a guarantee of adequate Philippine foreign currency support, (2) the assurance of sound technical and administrative support, (3) the elimination of political influence and interference, and (4) the adherence to realistic plans and specifications in carrying out all phases of the program.

Agency comments

AID expressed disappointment that the lack of Philippine funds and the sheer lack of administrative capacity had prevented the wells and springs program from being carried on more effectively by the Philippine Government and commented that in retrospect the original project goals were overambitious. AID also reiterated the Mission's comments on achievements that had been realized in the face of the obstacles the program had encountered.

AID confirmed its intentions not to consider loans for additional wells and springs until (1) adequate improvement is made in the organization of the Philippine Government entity responsible for implementation of the project and (2) the Philippine Government is able to demonstrate the availability of local currency support.

Pier enlargement

An AID project for the enlargement of a Philippine pier had not met its objectives of improving berthing facilities in Manila harbor, and AID-financed steel pilings costing about $726,000 had not been installed 5 years or more after they were delivered to the Philippines. Extended delays have been experienced in completing the project because of delays in awaiting completion of related projects, shortages of cement, and administrative problems. We could not find any evidence that the project had been accorded a high priority or that AID had actively sought to expedite its completion, notwithstanding the importance attached to improving berthing facilities in Manila harbor.

As part of an overall program to expand berthing facilities for ships in Manila Harbor, AID furnished grant aid in 1957 to assist the Philippine Government in the lengthening of pier 9, the construction of pier 5, and the widening of pier 13, which had originally been constructed by the United States Army Corps of Engineers under the Philippine Rehabilitation Act of 1946. At the time the program was initiated, berthing facilities in Manila Harbor were inadequate and delays were being experienced in loading and discharging cargo. The widening of pier 13, together with the other improvements, was expected to relieve these adverse conditions at least in part, and project goals called for needed improvements to be completed by June 1960.

We found that little progress had been made toward the completion of planned work on pier 13. The scope of the project generally consisted of widening both sides by driving steel piles, pouring reinforcing concrete around them, and erecting a substructure to support the surface of the pier. At the time of our review in late 1963, progress had been far from satisfactory since work had been started to widen only one side of the pier and nothing had been done to widen the other side. For the one side being widened, steel piles had been driven; however, 34 percent of the reinforcing concrete had not been poured, 60 percent of the substructure had not been erected, and work was at a virtual standstill at the time of our review.

We could not find any evidence that the completion of pier 13 had been accorded a high priority by the Philippine Government, notwithstanding the importance attached to the project at its inception, as borne out by the following observations:

1. The original AID project justification called for completion of the pier by June 30, 1960; however, a contract to start the work was not awarded until September 29, 1962, more than 2 years after the expected completion date.

2. Progress on the project had been delayed because sufficient quantities of cement had not been allocated to the construction contractor by the Philippine Government.

At the time of our review, steel piles for the project, furnished by AID between 1957 and 1958 at a cost of about $726,000, had not been installed. Although Mission personnel had inspected the inventory of uninstalled pilings from time to time, we found no evidence at the time of our review to indicate that efforts had been made to assist or persuade the Philippine Government to expedite the completion of the project.

The Mission advised us that (1) because of the shortage of docking facilities, the work on piers 5, 9, and 13 had to be done in stages: pier 5, which was completed in October 1960, was scheduled first; the lengthening of pier 9, which was completed in December 1961, was scheduled next; and the widening of pier 13, one side at a time, was scheduled last, (2) work on pier 13 was scheduled to start immediately after completion of pier 9, but, with a change in Philippine Government administration in January 1962, all construction work was temporarily suspended and it was not until September 1962 that work was undertaken on pier 13, (3) the construction contract called for completion of work by June 1963 but had not been completed because of shortages of cement, a prolonged strike of pier workers which interfered with construction operations, and an unforeseen foundation condition which complicated driving of the pilings, (4) completion of the pier superstructure was dependent on the availability of cement, and until such time as the work then in progress was completed the Philippine Government would be unable to proceed with the widening of the other side of pier 13, (5) the Mission did not have any authority to interfere with or enter into the supervision of construction and such action would probably be completely unacceptable to the Philippine Government, and (6) unless shortages of cement were apt to continue indefinitely, the Mission had been and was reluctant to get directly involved in the problem of cement allocations, since this was an internal matter and a very complicated and controversial one.

Agency comments

AID commented in November 1964 that the widening of pier 13 had not progressed as rapidly as planned but that it was moving.

We were advised by AID that, after the completion of our field work in December 1963, the north side of the pier had been completed and that bid specifications for the south side had been prepared. We were advised also that the Mission had approached appropriate Philippine Government authorities and that progress reports were being requested on a regularly scheduled basis.

Harbor dredging

AID-financed harbor dredging equipment valued at about $2.5 million has not been used effectively and project goals for the improvement of Philippine harbors have not been attained, principally because of Philippine Government problems of supplying spare parts and operating supplies needed to ensure effective equipment use. Although the Mission had been generally aware of these shortcomings, we could find no evidence that the Mission had assisted or encouraged the Philippine Government to make effective use of AID-financed equipment in the furtherance of project goals.

On the basis of studies that showed a serious problem of silt accumulation in Philippine ports and harbors, the United States undertook in 1954 to assist the Philippines in a 10-year program of harbor dredging. This program was considered necessary because:

1. Dredging equipment previously made available from United States Government surplus and under the Philippine Rehabilitation Act of 1946 was in generally poor condition.

2. Philippine harbors had an accumulated backlog of silt in excess of 14 million cubic meters (CM).

3. Harbor dredging capacity was only 2.5 million CM annually, which was insufficient to meet even the annual recurring maintenance requirements of 2.9 million CM.

4. Silting of harbors was resulting in costly damage to vessels, restricting normal ship operations within the harbors, and leading to extra costs in loading and unloading of oceangoing vessels.

As a major part of the program, AID financed the importation of a pipeline suction dredge costing about $2.5 million, together with supporting dredge equipment. The dredge was expected to overcome the then-existing inability to meet recurring maintenance requirements; eliminate the backlog over the 10-year period; permit some degree of harbor improvement; and allow for the periodic overhaul of previously furnished United States dredges, thus increasing their capacity. In 1963 the Export-Import Bank of Washington (EIB) financed an additional harbor dredge costing $1.3 million, and, in recent years, the Philippines also obtained dredges financed by the World Bank and from Philippine funds.

Achievements of the United States program have fallen short of expectations. For example, the original 14 million cubic-meter dredging backlog, rather than decreasing, has increased to a current 25 million cubic meters because of poor utilization of dredging equipment. Moreover, we noted that:

1. Dredges on hand at the inception of the program were still being operated at only a fraction of their rated capacity, and few dredges had undergone repairs as initially contemplated.

2. The AID-financed dredge had been used at only about 41 percent of capacity between fiscal years 1959-63.

3. The EIB-financed dredge, which was acquired in April 1963, was used at only 15 percent of capacity during the July to September 1963 period, the only period that information was available.

A variety of reasons have been advanced as to why this program has not been more successful. The principal one is that maintenance spare parts must be imported on an as-needed basis, since there are only limited sources of local supply and the Philippine Bureau of Public Works is prohibited by administrative regulation from stocking parts, although it has the funds to do so. This results in prolonged delays, an inability to make timely repairs, the progressive deterioration of equipment, operational breakdowns, and an inability to operate equipment at rated capacity. For example, during a field trip we were informed by Philippine officials that (1) the AID-financed dredge had run out of common lightbulbs, which contributed to the suspension of night work, (2) dredging operations had shutdown periodically for lack of fuel, and (3) parts were urgently needed to prevent silt in the waste pipes from leaking back into the harbor before reaching the dumping grounds.

We were informed by the Mission that it was never contemplated that United States assistance would completely satisfy the continuing requirements of this activity but that it would only serve to help meet the minimum of immediate needs of the program. It was hoped that, in addition to actual work accomplishment, the impetus given by the assistance would result in the Philippine Government's moving ahead on its own initiative to eventually overcome the deficiency in portworks facilities. The Mission also stated, in part, that direct assistance to the project terminated in 1959 but that the Mission continued to check on the utilization of United States-furnished equipment and, to the extent practicable, to encourage increased efficiency of operations, although full technical assistance and supervision were unrealistic.

We found that the Mission had accumulated statistical information and had performed a number of internal reviews on the utilization of dredging equipment. Although the Mission was aware of poor utilization of this equipment and many of the problems impeding its effective use, we could not find any evidence of an attempt to assist or persuade the Philippine Government to use the equipment effectively. In this respect, the Mission advised us that continued surveillance could not be justified because of Mission personnel and fund limitations, the belief that the equipment was serving the purpose for which it was furnished, and the belief that the country should be taught to be self-sufficient.

Agency comments

AID emphasized the Mission's comments that United States assistance for harbor dredging was not intended to satisfy continuing harbor dredging requirements but was intended to help meet only minimum and immediate needs and to encourage the Philippine Government to expand dredging operations.

AID also commented that the Mission had reported a 77-percent rate of utilization of the AID-financed dredge on a three-shift basis during the year ended September 1963. AID commented that, although the efficiency of the operation was perhaps low, the equipment was being used and productive work was being accomplished.

Evaluation of agency comments

We do not believe that AID's comments on project goals are in consonance with original project goals, which were stated in 1954 to be as follows:

> "The proposed ten-year dredging program will provide the following for 15 harbors of first importance:-

1. Completely dredge each year the 2,900,000 cubic meters of material annually deposited in the harbors' ship channels and ship basins.

2. In ten years completely eliminate the 14,000,000 cubic meter backlog of dredging for maintenance of channels and basins at planned depths which built up to an overwhelming amount during the 5 war years of no dredging.

3. Permit 6,800,000 cubic meters of dredging for improvement of ports and harbors."

We also do not believe that the AID-financed harbor dredge has been used as effectively as AID's comments seem to indicate. The 77-percent utilization rate cited by AID was based on the percentage of available operating hours that the dredge was reportedly operated. We believe, however, that a more fundamental measure of efficiency is the number of cubic meters actually dredged in comparison with the potential which might have been realized. On the latter basis, the dredge was used only 40.5 percent effectively since its receipt, as shown below:

Fiscal year	Rated capacity	Total dredged	Percent of utilization
	(cubic meters)		
1959	1,600,000	824,902	51.6
1960	1,600,000	445,485	27.8
1961	1,600,000	927,184	57.9
1962	1,600,000	577,057	36.1
1963	1,600,000	461,515	28.9
5-year average	1,600,000	647,229	40.5

AID did not comment on future prospects for improving utilization of the dredge.

River dredging

AID-financed river dredging equipment valued at $1.6 million has not been used effectively, principally because of Philippine Government problems in making needed operating funds available. The Mission generally has been aware of the poor utilization of equipment, a number of underlying causes, and the detrimental effect poor utilization of equipment has had on project objectives. Nevertheless, we could not find any evidence of attempts to assist or persuade the Philippine Government to improve the utilization of the river dredges.

As part of a project to control river flooding, AID provided the Philippine Government with five river dredges costing $1,632,000 in 1955 and 1956. The objective of the project was to assist the Philippine Government to organize and implement a flood control program on a continuing and nationwide basis, since annual damage resulting from uncontrolled flooding in the Philippines was considered to be greater than that from any other single natural cause.

To be used productively to combat silt accumulation, the dredges supplied by AID should be operated three shifts a day for 200 days a year. Since acquisition, they have been operated mainly one shift a day and have remained idle at project sites for prolonged periods of time. As a result, the project goals have not been achieved and the dredges were utilized at only 26 percent of their rated capacity between fiscal years 1956-63.

The principal factor limiting the progress of the program has been a lack of operating funds. About $6.8 million in Philippine funds was needed to effectively operate these dredges from the date of acquisition through the end of fiscal year 1963. The Philippine

Government expended only $1.8 million, or 26 percent, during this period. Because of this lack of operating funds, AID-financed dredges had been continuously idle at times for periods of as long as 14 months. The following table illustrates only some of the work stoppages we noted that had been caused by shortages of operating funds.

Dredge	Project title	Idle period
Damayan	Construction of access channel Sambulawun River Mouth	Apr. 1962 to Aug. 1962
10-1	Dredging of Labangan Flood Channel	June 1963 to Sept. 1963
10-2	Dredging of Malauay River	May 1960 to Mar. 1961
8-1	Bicol River Control Project	Nov. 1958 to July 1959
8-2	Abacan-San Fernando River Control Project	Sept. 1961 to Nov. 1962

In furnishing assistance, AID did not take necessary measures to ensure that funds needed to operate the dredges would be made available. For example, the Philippine Government had not made any specific funding arrangements to ensure the effective utilization of the United States-financed equipment or of river dredging operations. River control projects were funded by the Philippine Congress in total. River dredging operations, which were only one element of river control projects, were not specifically identified or funded and received only a small allocation of the funds made available.

We noted that the Mission was aware of the generally unsatisfactory utilization of equipment as well as many of the underlying causes thereof. We were unable, however, to find any tangible evidence of action taken to assist or persuade the Philippine Government to improve its utilization of these dredges.

We were advised by the Mission that (1) the initial goals of this project had been accomplished, (2) the main problem experienced had not been a shortage of appropriated funds but a problem of nonrelease of funds appropriated, (3) the dredging operation had not been efficient but the work done had been beneficial to the economy of the country, and (4) informal representations made to Philippine Government entities had carried considerable weight in achieving an improved position with respect to funding. The Mission indicated that little action on its part could or should be taken because of its contentions that Mission fund and personnel shortages limit its capability to monitor utilization indefinitely; continued surveillance would defeat the purpose of helping the country to attain self-sufficiency; and the major funding problem, hopefully, had been taken care of.

Agency comments

AID commented that the local funding problem for river dredges is part of the overall need in the Philippines to streamline fiscal procedures and to improve public sector management capability. AID commented that this problem had been recognized and acted on in concert with the Philippine Government since the inception of the program. Limited utilization of dredges was attributed by AID more to the nonrelease of available Philippine funds than to a lack of funds.

AID also commented that the dredges had been used substantially more than this report indicates, that in recent months they had been in more continuous use, and that the AID Mission had evidenced continuing concern about the use of the dredges. AID stated that, although in fiscal year 1962 the five dredges operated about 74 percent of the time (usually on a one-shift basis), the Philippine Government had increased the operation to two, or in some cases three, shifts a day, which was the goal of the project and is now also the goal of the Philippine Bureau of Public Works.

Evaluation of agency comments

AID had indicated agreement with our findings of low utilization of river dredging equipment. We do not agree, however, that AID-financed river dredges have been used as effectively as AID's comments seem to indicate. The 74-percent utilization rate cited by AID for the five dredges is based on the percentage of available operating hours that the dredges were reportedly operated. We believe, however, that a more fundamental measure of efficiency is the number of cubic meters actually dredged, in comparison with the potential which might have been realized. On the latter basis, the dredges had not been used effectively since their receipt, as shown below:

	Percentage of dredging capacity utilized by fiscal year				
	Dredge Damayan	Dredge 10-1	Dredge 10-2	Dredge 8-1	Dredge 8-2
Fiscal year 1956	67.3	-	-	21.2	104.9
Fiscal year 1957	65.0	61.2	62.6	73.8	58.4
Fiscal year 1958	13.6	5.1	20.0	53.0	19.2
Fiscal year 1959	72.4	5.3	1.5	18.3	9.0
Fiscal year 1960	8.7	10.1	8.6	.9	29.3
Fiscal year 1961	18.5	9.3	1.0	8.0	12.4
Fiscal year 1962	26.1	1.9	6.3	5.5	4.9
Fiscal year 1963	23.1	18.2	15.7	11.4	15.4
8-year average	36.8	16.3	15.2	24.3	24.1

Conclusions

AID provided more grant aid development assistance than the Philippines could effectively absorb, maintain, and utilize with the limited resources allocated by the Philippine Government. As a result, many projects did not achieve the economic development benefits that otherwise could have been reasonably expected had adequate levels of support been made available by the Philippine Government. (UNCLASSIFIED)

For each project we examined, the United States furnished equipment, material, and technical assistance; whereas the Philippine Government was to provide most of the foreign currency funds needed for utilization and maintenance. A fundamental limitation on the effectiveness of the AID program has been the inability or unwillingness of the Philippine Government to provide the foreign currency resources it had agreed to provide in support of United States development assistance projects. The need to ensure adequate levels of Philippine financial support in future programs has now been recognized by the Mission. For example, the Country Assistance Program for the Philippines dated July 1963 states: (UNCLASSIFIED)

> "Further, the program should be administered in a friendly but firm manner designed to create maximum self-help from the Filipino people and government in the form of mobilization of their natural, capital and human resources. The host government should be given to understand clearly that it is expected to demonstrate more initiative in carrying out its responsibilities concerning the aid program than it has in the past, and that it will be expected to commit itself in advance to make adequate provision for the local currency to support any U.S. dollar commitments. In addition thereto, a determination should be made that it is capable of such support before the U.S. dollar component is expended." ([redacted])

In view of the Mission's avowed intention of obtaining assurances of adequate levels of Philippine support before providing additional United States assistance, we are not making any recommendations with respect to this matter. [redacted]

The Agency for International Development pointed out that basic political and economic policies of the United States had influenced certain of the program actions we reviewed. In particular, the Agency cited the highways, wells and springs, and river dredging projects. The Agency commented that these projects were important elements of the Philippine President's successful counterinsurgency program of the early 1950's against communist guerrilla forces (Huks). [redacted]

Although a number of the projects we reviewed were initiated during periods of intensive guerrilla activity in the Philippines, we could not find any evidence that the projects had been initiated for political, rather than economic, purposes. To the extent that the projects would improve the living conditions of the Philippine population inhabiting the areas affected, or the Philippine economy as a whole, we agree that the projects could be important elements of a counterinsurgency program. Nevertheless, we do not believe that the Agency can reasonably contend that the projects we reviewed made a significant contribution to the Huk campaign of the early 1950's. Most of the assistance was furnished after the backbone of the Huk movement was crushed in mid-1953, and the poor utilization of United States assistance since that time has largely detracted from the achievement of project goals of improving the Philippine economy. [redacted]

AID responses to our findings pointed out that technical assistance is being, and will continue to be, provided to the

[redacted]

Philippines to attack broad problem areas, such as taxation, customs administration, civil service, and budgetary and financial management. The Agency has indicated that positive measures are being undertaken to persuade the Philippine Government to provide resources needed to make effective use of specific items of capital equipment delivered for development projects supported by AID in the past. For example: [redacted]

1. In a message from the Mission to AID dated August 25, 1964, the Mission commented on adverse effects on AID-financed projects because of the failure of the Philippine Government to meet its commitments to support the projects. The Mission stated that the question of Philippine Government contributions had been continually hammered at in messages to that Government and that the Mission had recently pleaded, cajoled, and made threats at all levels from staff counterparts to high Philippine Government levels. The Mission reported also that the Philippine President at one point directed the Budget Commissioner to release funds for all United States economic assistance projects and that AID on two recent occasions had threatened to cut off assistance to projects which were foundering because of Philippine Government failure to meet its commitments. [redacted]

2. In a message from the Mission to AID dated September 4, 1964, the Mission stated that it was organizing a committee which would gather data on the grant projects commented on in this report, with the objective of making representations to the appropriate offices of the Philippine Government in the hope of obtaining corrective actions needed to make these projects more effective. [redacted]

3. In commenting on the matters presented in this report, AID advised us on November 12, 1964, that it shared our concern with the problems of proper utilization and maintenance of equipment and facilities financed by AID and stated that added emphasis was being placed on a solution to this problem throughout the Far East on both a project-by-project basis and an across-the-board supply-management basis. [redacted]

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> AID stated that some new features were being introduced which it expected would improve the utilization and maintenance of equipment already delivered or to be furnished. [redacted]

The above measures indicate that increased attention is now being given by AID to the problems of ensuring effective use of United States assistance after it is furnished. As shown elsewhere in this report, we could find little evidence at the time of our review of a serious attempt in this direction by the AID Mission in the Philippines. [redacted]

We believe that the considerable amount of equipment delivered by the United States in the past, if put to effective use, could have a significant impact on the development of the Philippine economy, and we therefore endorse the efforts reportedly being made by AID to seek improvement in equipment utilization, thereby helping to achieve the original goals of United States assistance. Our observations of the management of the program both in the field and at the Washington level, however, lead us to the view that the consideration of matters involving projects funded in past years is easily overlooked in the press of more current demands on the time and energy of the AID staff. We therefore believe that the effective implementation of the Mission's plans requires a system of periodic reporting to AID setting forth specific performance goals and the measure of progress being achieved against these goals. (UNCLASSIFIED)

We believe also that the degree of success in improving utilization of United States assistance provided in the past should be taken into account in assessing the type and level of assistance to be provided to the Philippines in the future. (UNCLASSIFIED)

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[redacted]

FAILURE OF DEVELOPMENT LOANS TO CONTRIBUTE TO ECONOMIC DEVELOPMENT

Development loans totaling $27.9 million, of which $15.5 million had been disbursed, had been almost completely unsuccessful in meeting their economic development goals about 5 years after they were made. We believe that the loans, which were made to both the public sector and the private sector, were approved and disbursed without sufficient reviews of their economic and technical feasibility and without adequate surveillance of the management of the loan proceeds. We found that, as a consequence, (1) an $18.75 million loan, of which $6.4 million had been disbursed, had not been successful in improving the operating condition of about $20 million worth of construction equipment and in improving the Philippine highway system, as intended, (2) a $3.7 million loan to finance dollar costs of a cement plant was in default, the plant had been unable to produce cement, and many misrepresentations or unethical management practices apparently had been resorted to by the corporation's management, and (3) a $5.4 million loan to finance foreign exchange costs of a paper and pulp mill was in default and the plant was able to produce paper products only intermittently and at a substantial loss.

AID, in its strategy for the current and future years, has expressed a willingness to consider making development loans to the Philippines of from $20 million to $25 million annually, with emphasis on public development projects. The problems experienced in the past in making effective use of United States loan and grant assistance in the Philippines, however, indicate that this proposed level should not be provided until and unless AID has first assured itself that the Philippines (1) has a demonstrated capability of effectively absorbing, maintaining, and utilizing the assistance previously provided and (2) has provided sufficient assurances of its capability of effectively utilizing still more assistance. In this respect, the Philippine Government has had notable difficulties in adequately funding development projects in the past, and, at the time of our review, we could not find any evidence of a significant improvement in its capabilities to absorb additional development assistance. [redacted]

Highways, bridges, and equipment

An $18.75 million development loan, approved in June 1959 for assisting the Philippine Government in improving and constructing highways and bridges and in repairing inoperable equipment, had yielded few tangible benefits at the time of our review in December 1963. About $6.4 million of the loan had been disbursed, yet our review disclosed that (1) the proper range and depth of spare parts needed to repair equipment had not been ordered because of inadequate technical inspections of equipment to establish parts requirements, (2) most of the spare parts received had not been issued because of internal Philippine funding problems, (3) significant amounts of construction equipment had not been used because certain parts and components were damaged, were missing, or had been stolen, and (4) highway and bridge projects had been delayed by fund and material shortages, problems in acquiring rights of way, and administrative delays. We believe that many of the problems experienced on this loan could have been foreseen and prevented with better planning and improved loan administration. For example, we believe that (1) difficulties encountered by the Philippine Government in providing funds for maintaining equipment,

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bridges, and roads previously financed with grant aid should have alerted the Development Loan Fund (DLF) to the need for obtaining firm assurances of adequate levels of Philippine financial support before making loan disbursements and (2) the procurement of several million dollars worth of spare parts should not have been approved by DLF until technical inspections have been made to determine what parts were actually needed to repair inoperative equipment.

Background

As previously disclosed in this report (pp. 5 to 11), equipment received in the Philippines under a grant aid highway program had become inoperative or was in poor operating condition because of poor maintenance resulting from parts and fund shortages. This had contributed to the inability of the Philippines to properly maintain roads and bridges built with AID assistance.

To assist in restoring highway equipment to operating condition and to assist in improving or constructing highways, DLF approved a loan of $18.75 million in June 1959 for use by the Philippine Department of Public Works and Communications (DPWC). The following schedule shows the amounts approved, by purpose, as well as the value of material and equipment received in the Philippines at the time of our review:

	Amount approved	Material and equipment received as of September 30, 1963
Spare parts to rehabilitate DPWC equipment	$ 9,000,000	$3,257,000
Equipment and material for installation of permanent bridges	4,650,000	2,389,000
Equipment and material for improvement of highways	1,000,000	825,000
Equipment and material for construction of highways	4,100,000	-
Total	$18,750,000	$6,471,000

It was also anticipated that the Philippine Government would make about $20 million of its own funds available in support of these objectives.

Ineffective use of equipment spare parts

When the loan was considered by DLF in 1959, about 40 percent of DPWC's highway and public works equipment, valued at about $47 million, was inoperative or operating in need of repairs and thus at low efficiency. We found that DPWC's equipment had further deteriorated since the loan was approved, and conservative estimates were that at least 50 percent was inoperative or in need of repairs at the time of our review.

Among the reasons for not making needed repairs were that the quantities of parts ordered had not been based on adequate technical inspections to determine actual parts requirements. Subsequently, it was found that the needed depth and range of parts had not been ordered. Moreover, many of the parts, after receipt, could not be issued to the Philippine organizations needing them because of internal funding problems. For example:

1. Visits to several DPWC facilities disclosed that little rehabilitation work was being performed on equipment. Responsible USBPR and Philippine personnel advised us that many required parts inadvertently had not been ordered and that available DLF parts could not be obtained from DPWC because of fund shortages. Also, funds were not available to hire enough equipment repairmen.

2. Of the $3.2 million worth of repair parts received in the Philippines, only $620,000 worth had been issued as of September 30, 1963. Basic causes for the low rate of issues included shortages of funds in Bureau of Public Works operating units, which were required to reimburse DPWC for parts issued to them.

Ineffective use of highway and bridge equipment and material

Equipment, spare parts, tools, and structural steel valued at about $2 million had not been effectively utilized because of delays in starting projects; damaged, missing, or stolen parts that made equipment inoperable; and other problems. We found, for example, that:

1. As of October 31, 1963, 77 items of major equipment valued at $687,000 had never been used since they were delivered because of missing, stolen, or damaged parts. Most of this equipment had been delivered more than 1 year previously for use on highway and bridge projects. Among the unused items of equipment were 29 dump trucks valued at $422,800 which lacked fuel injector pumps, starting motors, generators, and other parts estimated to cost about $19,000; 9 trailer-mounted lubricators valued at $28,000 which lacked parts estimated to cost less than $30; 10 concrete mixers valued at $46,577 which lacked wheels, magnetos, pumps, chains, and other parts estimated to cost about $1,500; and a rock crushing and screening plant valued at $80,775 which lacked parts valued at $440.

2. As of October 31, 1963, 166 items of major equipment in usable condition valued at $406,700 had not been issued since it was received up to 18 months previously. This included 4 crane trucks valued at $171,920, 14 batching plants valued at $54,700, and 2 crawler cranes valued at $48,200. We were advised that the equipment had not been issued because projects on which it was to be used had not been started or were experiencing delays.

3. The construction of five bridges had been delayed because DLF-financed structural steel costing about $63,000 had not been furnished to the contractors by DPWC. The steel was received and placed in a private warehouse by a stevedoring company. DPWC was unable to locate it for almost a year after its arrival in November 1962, and when it did the company requested about $13,000 in warehousing and handling costs. Payment was declined, the steel was still in the warehouse at the time of our review, litigation was

contemplated, and there was no foretelling when it would be removed and furnished to the contractors.

4. Spare parts, tools, and components valued at about $294,000 were either lost, damaged, or stolen because of inadequate controls over receipts or unsatisfactory arrangements for identifying and removing the material from the Manila Port area. Claims had been processed by the Philippine Bureau of Public Highways against insurance and shipping companies, but, at the time of our review, replies indicated that few, if any, would be paid, presumably because of inadequate proof of loss and the excessive time that had been permitted to elapse before submitting claims.

5. Although structural steel valued at $982,000 had been received in the Philippines between December 1961 and July 1963, it had been possible to issue only $336,000 worth of the steel because of delays encountered in starting or continuing bridge construction. Significant quantities of steel were missing or unaccounted for at the time of our review.

The achievement of project goals had also been hampered because of delays in acquiring rights-of-way for segments of the Manila North and South diversion roads.

The Mission advised us that inadequacies in carrying the projected program through with efficiency and dispatch had been recognized, including lack of sufficient Philippine funds, poor administration, and poor planning. The Mission also commented that (1) all further releases of letters of commitment had been stopped in December 1962 until action could be taken on some of the basic bottlenecks that prevented efficient execution of the program, (2) understandings had been reached with DPWC as to conditions that must be met before any further releases of funds could be made, (3) additional United States Bureau of Public Roads consultants had been made available to DPWC, and (4) a study had been undertaken to relate the loan specifically to the Government's socioeconomic development program, with particular emphasis on availability of local currency financing to support the project.

Agency comments

AID agreed that it had not accomplished all of its original objectives through the loan. AID commented that some of the delays were the result of AID's stringent management control under which disbursements were approved only after administrative deficiencies on the part of the borrowers were corrected. In this respect, AID referred to its decision in December 1962 to halt disbursements pending evidence that action had been taken to correct apparent deficiencies in loan implementation and pointed out that the alternatives to this course of action (cancellation of the loan or disbursement of funds without due consideration of existing problems) might not have resulted in quicker completion of the projects and would most assuredly have been less efficient.

AID also informed us that a reevaluation of the loan undertaken by AID, USBPR, and the Phipippine Government in the spring of 1964 had indicated that the projects being financed were sound from an economic and technical viewpoint. On the basis of improvements evidenced to date, AID stated that disbursements had been resumed for additional spare parts and that disbursements for specific highway projects were anticipated when warranted by sufficient Philippine local currency support and improvements in administration.

AID also commented that the prospects were good that the highway improvement loan would achieve nearly all of its original objectives within the coming 2 to 3 years, although Philippine local currency funding and administrative deficiencies would continue to be problems.

Evaluation of agency comments

We have not contested AID's decision to halt additional disbursements on the loan for highway and equipment improvement, and we agree that this was a prudent action in light of the abundant evidence that spare parts, equipment, and material imported with loan proceeds were not being used effectively. We believe, however, that the basic reason for delays in achieving project objectives was not "AID's stringent management control" exercised after the deficiencies became known, but rather the deficiencies which permitted the ordering of significant amounts of material which could not be put to effective use after its delivery. Had it been possible to use this material effectively, it is evident that there would have been no need for AID to halt disbursements and that project objectives could have been achieved in a timely manner.

Mindanao Portland Cement Corporation

The Development Loan Fund granted a $3.7 million loan in June 1959 to the Mindanao Portland Cement Corporation (MPCC) on the basis of data which was misleading and which, in some cases, appears to have been misrepresented by project sponsors. Before approving the loan, the DLF was placed on notice by the Mission that the sponsors' integrity was questionable, but this information was discounted as a result of independent investigations conducted by DLF. At the time of our review in December 1963, the corporation had been unable to produce cement, the loan was in default, unpaid interest and principal repayments totaled $1.1 million, and a number of reviews strongly indicated that material misrepresentations had been made in obtaining the loan and that unethical and questionable transactions had been subsequently resorted to by the management of the corporation.

Background

On June 30, 1959, DLF approved a $3.7 million loan to MPCC, a private Philippine corporation, for financing the foreign exchange costs of equipment, materials, and services for the establishment of a cement plant on Mindanao Island. It was anticipated that the plant would produce about 150,000 tons of cement a year, which would benefit the economic development of the Philippines by (1) assisting to alleviate the critical shortage of cement within the country, (2) saving about $1.9 million annually in foreign exchange occasioned by imports of this commodity, and (3) assisting in the development of Mindanao Island. The plant was scheduled to be in production by the middle of 1962. Up to the end of our review in December 1963, however, there had been no production and there was no indication as to when production would start. The loan was in default, and as of October 1, 1963, nothing had ever been repaid.

incurred, which had eroded stockholders' equity by about 45 percent.

Lack of technical capability

One of the problems experienced by the Corporation in producing paper and pulp products has been a lack of technical knowledge and capability in managing and operating a complex industrial processing plant. So far as we could determine, the project management was relatively inexperienced in the operation of a plant of this type and its problems were further complicated by use of bamboo as a raw material, since this is an uncommon raw material for use in making paper. Mission records show that the corporation had difficulties in obtaining technically qualified plant personnel, yet little effective action had been taken by AID to overcome this obstacle as the time of our review.

For example, one of the problems experienced by the corporation has been its persistent inability to produce paper and pulp at a cost less than its selling price. In February and March 1963, the cost per ton of paper was 1,348 pesos compared with a net sales price of 834 pesos. It is not clear from the record what the exact reasons were for the high costs; however, there is considerable evidence that unprofitable operations were due in large measure to inefficient operations. The Mission has recognized the lack of technical knowledge. For example, internal correspondence has referred to the first plant manager as incompetent and to his assistants as lacking practical experience.

Indications of inadequate market for plant output

In May 1959, the Mission advised DLF that, on the basis of available market studies, there appeared to be an excess capacity purposes. Subsequently, however, it was found that not all rights had been acquired that would permit mineral extraction on a commercial scale.

3. Capital stock of 1.3 million pesos was not purchased in cash but was issued in payment for mineral deposit surface rights. The rights were sold to the corporation by a company controlled by the same individual involved in the land sale discussed above. Available evidence indicates that the rights were considerably overvalued. It thus appears that the corporate sponsors acquired a significant percentage of the capital stock with a minimum investment and that asset data presented to DLF was overstated and did not reflect the corporation's true worth.

4. In the construction of this plant, inadequate provisions were made with regard to its foundations and this was not corrected when the condition became known during construction. As a result, parts of the plant had settled and cracks had developed at the time of our review, and this was contributing to the lack of production.

5. Analyses of raw materials to be processed were considered to be of a proper chemical and moisture content when submitted to DLF. Subsequently, however, it was found that the corporation did not have rights-of-way to the quarry from which the samples had been obtained. The silica, when obtained from an alternate source, was found to have a high alkali content which would adversely affect the quality of the end product. Furthermore, the limestone had too high a water content which had resulted in the clogging of the plant's machinery. This would necessitate the unforeseen addition of drying equipment.

We also noted that, in the fiscal year 1964 budget presentation to the Congress, AID reported with respect to MPCC that:

> "It has had more than its share of the usual start-up difficulties that are inherent in any new manufacturing unit ***."

In view of the circumstances surrounding the approval and implementation of this loan, we do not believe that MPCC's difficulties are usual or inherent. Moreover, it is evident that this was recognized by AID. For example, the Inspector General, Foreign Assistance, pointed out to the AID Administrator by letter dated October 8, 1962, that there could be serious conflicting interests on the part of a corporate officer. A subsequent AID reply to the Inspector General stated, in part:

> "Present indications reflect that conflicting interests were present in relations between MPCC and other companies. MPCC and these companies were interlocked through the personal control of the Chairman of the Board of the borrowing company. Contractual provisions purportedly designed to prevent such developments appear to have been inadequate. A number of irregular and unethical practices were uncovered which involve local currency assets derived from investments by stockholders. Dollar assets made available under the loan agreement were not affected, since these funds are disbursed directly to suppliers by the U.S. bank holding the Letter of Commitment and are subject to rigid A.I.D. controls. Irregularities affect U.S. interest only indirectly through a general weakening of the financial position of the borrowing firm."

Although the irregularities uncovered have involved only the local currency assets of the corporation, it is evident that they have jeopardized its profitable operation, as well as prospects for repayment of the DLF loan. In our opinion, AID should be seriously concerned at any unethical practices involving corporate assets particularly since DLF did not obtain a mortgage on the equipment it financed and the repayment of the loan is possible only if the corporation's operations are profitable. In this respect the corporation's financial position throughout its history has been so weak that it has had to raise much of its working capital by resorting to short-term borrowing at high interest rates.

In transmitting our findings to AID for its comments, we expressed the belief that AID should be concerned over the likelihood that material misrepresentations were made in obtaining the loan and proposed that AID consider whether this constitutes a basis for initiating civil action to recoup its investments from the corporation or its sponsors.

Since it assumed administrative responsibility for this loan, the Mission has attempted to assist in putting the plant into productive use. At the conclusion of our review in December 1963, however, its efforts had not been successful. Negotiations had been held with other cement companies to invest in or purchase MPCC, but the offers were withdrawn for a number of reasons.

Agency comments

On November 12, 1964, AID commented that it had been attempting since 1962 to provide the addition of new management and financing and that negotiations had been under way intermittently with both Philippine and United States companies since that time. AID expressed the belief that the protection of the United States Government's position could best be served by correcting technical difficulties, by adding new financing, and by infusing new management rather than instituting legal action in the form of involuntary insolvency. It was felt that the last course of action would not result in the recovery of anything near the full amount of the loan and accrued interest outstanding and would have the additional drawback of precluding any possibility of the plant's operating for an extended period.

With respect to the possibility that material misrepresentations had been made in obtaining the loan, AID has advised us that this matter is under study. AID commented that the parties involved are citizens of the Philippines who reside there, the transactions involved took place in the Philippines, the existence of the property rights which appear to have been misrepresented depends on Philippine law, and the existence of civil remedies will depend on Philippine law. AID advised us that, upon conclusion of its investigation, it would take any further action available or necessary in the circumstances for the protection of the interests of the United States.

Current loan status

As of December 31, 1964, the corporation had still not been able to produce cement and delinquent interest and principal repayments totaled $1,928,249. AID's efforts to attract new management and financing, however, had culminated with the signing of a memorandum agreement between MPCC and an American cement corporation and its Philippine affiliate.

Under the terms of the memorandum agreement, which was entered into on December 17, 1964, the Philippine affiliate of the American corporation will be authorized and empowered to operate the cement plant of MPCC and to manage all phases of its business affairs, including complete authority over production, engineering, plant corrections, maintenance, sales, supervision, purchasing, recordkeeping, financial management, and reporting. The agreement also provides for new financing arrangements, including infusion of additional capital by the American corporation and the rescheduling of indebtedness on loans made by the Development Bank of the Philippines and AID.

Bataan Pulp and Paper Mills, Inc.

A $5.4 million DLF loan to assist in establishing an integrated pulp and paper mill had not been successful in contributing to economic development in the Philippines. From a review of available evidence, we believe that DLF approved the loan, and disbursed loan proceeds, without adequate consideration of material factors having a bearing on the economic feasibility of the venture and without assurances that sufficient local funds would be available for plant construction and working capital. Successful operation of the plant, which was completed about July 1962, had not been possible because of insufficient working capital and a lack of technical capability on the part of the project sponsors. At the time of our review in late 1963, the loan was in default, only $20,000 in principal had been repaid, and arrearages of principal and interest totaled $1,244,332. In addition, the success of the venture was in doubt, particularly in view of the corporation's high debt structure and uncertainties that there is an effective demand for its output in the Philippines.

Background

On July 10, 1959, a development loan of $5.3 million, later increased to $5.4 million, was granted to Bataan Pulp and Paper Mills, Inc. (BPPM), for financing foreign exchange costs of equipment to be used in establishing a pulp and paper plant with a daily capacity of from 55 to 65 short tons of paper products. The company's organizers were to provide the peso equivalent of about $2.8 million for local costs and working capital. In approving the loan, it was expected that plant output would replace imports estimated to cost about $5 million annually, provide increased employment, expand the usage of paper and help meet the demands of the

Philippine economy, and make use of locally available bamboo as a raw material. The plant was originally scheduled to be in full production by March 1962. Production had been sporadic, however, at the time of our review, and there was no indication as to when the full productive capacity of the plant would be utilized. The loan was in default and as of July 1, 1963, arrearages of principal and interest totaled $1,244,332.

Shortage of operating capital

A staff paper dated April 1959, presented for the consideration of the DLF Board of Directors in appraising the soundness of the $5.3 million loan to BPPM, pointed out that total peso requirements for capital were estimated at 5,534,414 pesos (equivalent to $2,767,207). The only evidence we could find as to the amount of capital that would be needed for a paper mill utilizing bamboo as a raw material, other than the project sponsor's representation, was data obtained by the Mission indicating that a similar plant of 100-ton-per-day capacity in India was estimated to require $7 million in foreign exchange and the equivalent of $9 million in local currency, or a much higher ratio of local currency than that for the proposed plant. We also found that the major paper mills operating in the Philippines in 1959 had much higher capital investments, relative to debt, than BPPM, as shown in the following table:

Firm	Capital to debt ratio
A	2.1 to 1.0
B	1.7 to 1.0
BPPM	1.0 to 1.9

It thus appears that local currency capital requirements for BPPM were grossly underestimated and that this could have been known before the loan was approved had AID examined into disparities in capitalization between BPPM and other paper mills.

About 1 year after the loan was signed, it became apparent to the Mission that BPPM was undercapitalized. At that time, the Mission learned that revised estimates of peso costs were almost double those originally presented to DLF. In seeking explanations for the increased cost estimates, DLF was informed by a corporate official that the increases resulted primarily from new taxes imposed by the Philippine Government, plus expenditures for additional bamboo reserves. Subsequently, however, information submitted by the Mission to DLF pointed out that of even greater importance were the substantial increases in the estimated costs of equipment, furniture, vehicles, working capital, and preoperating expenses. The overall increase in total estimated local costs occurred despite an expected savings of 1.2 million pesos for the construction costs of the main building.

As of August 31, 1963, corporate financial statements showed that, despite stockholders' investments at that time of 9,716,000 pesos and an additional 11,664,000 pesos[1] in long- and short-term debts, the corporation was in dire financial straits. For example, the ratio of current assets to current liabilities was 1 to 5.3 and the ratio of capital to debt was 1 to 6. Moreover, since the corporation began its operations, losses of 4,361,000 pesos had been

[1]Exclusive of the debt to DLF.

incurred, which had eroded stockholders' equity by about 45 percent.

Lack of technical capability

One of the problems experienced by the Corporation in producing paper and pulp products has been a lack of technical knowledge and capability in managing and operating a complex industrial processing plant. So far as we could determine, the project management was relatively inexperienced in the operation of a plant of this type and its problems were further complicated by use of bamboo as a raw material, since this is an uncommon raw material for use in making paper. Mission records show that the corporation had difficulties in obtaining technically qualified plant personnel, yet little effective action had been taken by AID to overcome this obstacle as the time of our review.

For example, one of the problems experienced by the corporation has been its persistent inability to produce paper and pulp at a cost less than its selling price. In February and March 1963, the cost per ton of paper was 1,348 pesos compared with a net sales price of 834 pesos. It is not clear from the record what the exact reasons were for the high costs; however, there is considerable evidence that unprofitable operations were due in large measure to inefficient operations. The Mission has recognized the lack of technical knowledge. For example, internal correspondence has referred to the first plant manager as incompetent and to his assistants as lacking practical experience.

Indications of inadequate market
for plant output

In May 1959, the Mission advised DLF that, on the basis of available market studies, there appeared to be an excess capacity to produce writing, wrapping, and printing paper in the Philippines. The Mission pointed out that, even assuming actual demand for paper products 100 percent greater, there would still be an excess capacity and concluded that it was impossible to determine whether an additional producer would be able to compete profitably in a saturated market in view of the lack of reliable data covering production costs of existing plants.

The information presented to DLF by the Mission was at variance with that presented to the DLF Board of Directors in a staff paper dated April 1959. This paper stated "There is agreement that the market demand is much in excess of the proposed production of this plant."

In our current review, we were unable to ascertain from information available to the Mission whether there is sufficient effective demand to permit profitable operations of BPPM. Even though import statistics show that competing paper products are being imported, it was not known whether the BPPM could produce a high enough quality paper at a low enough cost to successfully compete with imports. In this respect, we noted that, in October 1962, information compiled by the United States Embassy indicated that paper mills in the Philippines were operating at only 60 percent of capacity and that measures were contemplated by a Philippine trade association to request substantial increases in import duties to enable domestic producers to compete, principally with American firms.

<u>Difficulties encountered in protecting the Government's loan investment</u>

A review of Mission correspondence disclosed that, although AID had knowledge at an early stage that the corporation was faced with production, management, and financial problems, little effective action was taken to remedy these problems at an early stage. The Mission's efforts, and those of the corporation's management, appear to have been principally directed toward the infusion of additional capital and borrowings. While money problems undoubtedly were a serious obstacle, it also appears evident that reasons for high production costs were not identified, a sound technical and financial plan was not developed, and realistic measures were not taken to place the corporation's operations on a sound basis. In view of the problems experienced, we believe that it would have been a prudent measure for AID to arrange for the corporation to promptly engage management consultants under a management contract, particularly since DLF did not make arrangements for obtaining a first mortgage on DLF-financed assets. Thus, the United States is in the position of a general creditor, with the loan repayment solely contingent on profitable operations.

We also noted a number of other factors which contributed to the difficulties of the corporation and appeared detrimental to the Government's interests. For example:

1. It appears that the corporation lost considerable sums through speculation in securities. In August 1960, it was found that investments valued in corporation financial statements at 998,171 pesos ($499,085) had an actual market value of only 643,400 pesos ($321,700).

2. Sales of the plant's output were arranged through two distribution firms, which advanced funds to BPPM in return for an 8-1/2-percent purchase discount. In June 1963, the Mission pointed out to AID that the firms were not appointed because of their market experience but were appointed because they were controlled by persons connected with members of the BPPM Board of Directors. One of the firms reportedly did not meet its payment obligations promptly,

unjustifiably complained about the quality of paper, and tried to get additional discounts.

In June 1963, the Mission pointed out to AID that the corporation faced a desperate financial situation and its future profitability was doubtful because of operational and management weaknesses. Accordingly, to arrive at a proper course of action, an immediate survey by a United States consulting firm was requested to consider technical, economical, and financial aspects. This request was approved by AID in September 1963. At the conclusion of our review, the results of this proposed study were not yet available.

Agency comments

AID advised us that, prior to making the loan, the DLF had given full consideration to all the material factors. AID agreed, however, that the BPPM had experienced difficulties in the start-up period because of a lack of sound technical management as well as a lack of realization by top management that quick action to correct this deficiency was necessary.

AID commented that, as the start-up period became prolonged, production could not be maintained at the rated capacity; as a result, operation losses began to eat into the reserves for working capital during the first year of operation. A contributing problem was also an increase in costs following in the wake of a decontrol of the Philippine peso. AID commented also that it was well aware of the reasons for high production costs; namely, the lack of sound technical management and the lack of sufficient working capital to provide for production at the rated capacity.

AID stated that, while efforts were being made to find a solution to the corporation's problems, it was mandatory that the plant be kept running. It expressed the opinion that it would have been impossible to find an American company which would take on the management responsibility and agree to further participation in its equity if the plant was shut down.

With respect to our observations that there might be insufficient effective demand for the plant's output, AID contended that there had been, and is, an adequate internal market for the corporation's output and stated that it was true that some tariff protection was necessary for Philippine manufacturers to compete with imported products.

Evaluation of agency comments

We do not agree that the DLF gave full consideration to all material factors before approving the loan to the BPPM. AID has admitted that the corporation lacked the requisite degree of technical management skills, which are fundamental to the success of any industrial venture, and it is clear from the record that the corporation was undercapitalized and lacked sufficient working capital at all stages of its operations.

We do not agree also that it has yet been conclusively established that there is an adequate internal market for the production of the corporation. Although it is true that the Philippines imports paper products similar to those which BPPM was designed to produce, it is not certain that there is an effective demand which could take advantage of this potential market, taking quality and price into consideration. As pointed out to AID in a technical and economical feasibility report dated September 1963:

> "The pulping process, such as that being used presently by Bataan, is a completely new field in the country, while the production of fine writings and printings, and coarse wrappings and container board, as made in modern high speed installations, is still a relatively unknown

> subject, especially when quality is of the essence in order to compete with the low priced, high quality imported products." (Underscoring supplied.)

In a report on the operations of the BPPM by technical consultants, dated October 22, 1963, it was pointed out that there is a market in the Philippines for the paper made of bamboo provided that home industry is given adequate tariff protection. The report also pointed out, however, that bamboo is not a particularly good papermaking fiber when compared with the strong fibers produced from most of the conifer trees in temperate climates and that bamboo ordinarily will not be acceptable in the world markets on account of its lack of strength characteristics. The report also pointed out that:

> "Unfortunately, this plant was located, designed and built to utilize a certain type of bamboo *** with the local name of 'Boho'. We were told in Washington, D.C., in visiting with the foremost bamboo authority in the world, *** that Boho was the poorest paper making material of all the bamboos."

A limited follow-up review we made in January 1965 also showed that it had not yet been demonstrated that the BPPM could produce its products profitably at a price that could successfully compete with imports of high-quality, low-priced paper products. The latest financial data available to AID showed that in the 8-month period ended December 1964 BPPM sold 7,806 tons of paper products at an average price per ton of 868 pesos; however, it cost an average of 1,052 pesos per ton to manufacture and market this output, exclusive of interest payments on loans. For the period, BPPM sustained a net loss on its operations of 2,769,171 pesos (about $718,000).

Current loan status

As of January 1, 1965, the corporation was delinquent in its principal and interest repayments in the amount of $2,720,337. AID's efforts to attract new management, however, had led to the signing of a management contract between BPPM and an American corporation.

Under the terms of the management contract, which was entered into on May 1, 1964, the American corporation has been employed as General Manager of BPPM for a period of 10 years, subject to compliance with specified terms and conditions of the contract. The American corporation has been given authority to fully manage and operate the company, including any and all duties necessary or incidental to the management and operation of a pulp and paper mill operation. According to AID, the corporation's stockholders have provided additional equity and the Government of the Philippines' institutions have loaned additional capital to meet the needs of the corporation.

Conclusions

Development loans in the Philippines have not proven to be an effective device for stimulating economic development. None of the loans we reviewed had been successful in achieving intended development objectives, and the ineffective utilization of some of the assistance was creating an economic burden to the borrowers rather than an economic benefit. We believe that the principal problems experienced in making effective use of development loan assistance were related to the inability or unwillingness of the borrowers to provide sufficient local currency resources and to manage available resources prudently.

In our opinion, DLF did not sufficiently evaluate the economic and technical feasibility of certain of these projects before approving loans and did not exercise adequate surveillance after loan proceeds were disbursed.

AID, in its development strategy for the current and future years, has expressed a willingness to consider making development loans to the Philippines of from $20 million to $25 million annually, with emphasis on public development projects. In this respect, however, we noted throughout our review that the Philippine Government has had notable difficulties in adequately funding development projects in the past. Moreover, this has been recognized by AID. For example, the Country Assistance Program for the Philippines dated July 1963 states, in part:

> "The consequence of this conservative fiscal policy was a great peso shortage for public capital infrastructure projects. This was particularly serious for capital projects involving foreign currency resources from loans and reparations, because the Philippine Government's budget had not programmed adequate pesos to support such foreign resources. Such capital projects as were undertaken did not require external foreign currency resources."

"The lack of peso support for public capital projects has been one of the most troublesome in programming Philippine economic growth. It has meant that the President could outline and publish plans showing his intentions for socio-economic programs, but these intentions were meaningless unless Congress was willing to make the necessary peso support appropriations. To date Congress has been unwilling to do so, and the success of the Five-year Socio-Economic Program hinges in great part upon the relationships of the Philippine Executive Office and the Congress."

"The correct allocation of capital resources in the public sector is a pressing problem in the effort of the Philippines to promote socio-economic growth. This problem involves monetary and fiscal policies, the lack of a cash budget, and the need for efficient planning and programming of government capital resources."

In view of the difficulties experienced by the Philippine Government in making effective use of development assistance, we proposed that the approval of additional development loans be made contingent on demonstrated improvements in the use of United States development assistance furnished in the past, whether in the form of loans or grants. Moreover, we proposed that additional development loan assistance not be provided until and unless (1) a firm determination is made by AID that the borrower has sufficient local currency resources to permit effective operation and maintenance of any equipment and facilities funded with loan proceeds and (2) a firm commitment is obtained from the borrower that sufficient local currency resources actually will be made available to permit the effective operation and maintenance of the equipment and facilities.

We proposed also that AID make a complete review of the loan to the Mindanao Portland Cement Corporation to determine whether material misrepresentations were made in obtaining the loan and to determine whether a sufficient basis exists for a civil suit against the corporation or its sponsors. On the basis of this study, we proposed further that AID take any action available and necessary for the protection of the Government's interest in this matter.

Agency comments

AID has advised us that our conclusions are in accord with the position it has taken with respect to providing future dollar loan assistance to the Philippines. AID has commented further that it has repeatedly emphasized to the Philippine Government that it stands ready to consider future financial assistance only if projects are technically sound, are supported adequately with assurances of local currency funding, and have competent management available.

AID pointed out that, although from $15 million to $50 million for development loans to the Philippines has been included in annual budget presentations to the Congress for planning purposes and has been earmarked within the internal budget processes of the United States Government over the last several years, there have been no development loans to the Philippines since fiscal year 1959, except for one 1961 loan, since canceled. AID presented data which showed the following levels of development loans requested for the Philippines in annual budget presentations to the Congress since fiscal year 1962:

Fiscal year	Amount
1962	$30 million to $50 million
1963	$30 million to $50 million
1964	25 million
1965	15 million

Matter for consideration of the Congress

AID did not explain why it has continued to include in its appropriation requests large amounts for development loans to the Philippines when that agency had abundant evidence to indicate that such loans would not materialize and when the executive branch has repeatedly asserted that appropriations being sought from the Congress for the economic assistance program represent minimum requirements computed on a realistic basis. In view of the likelihood that AID will continue its past practice of including unrealistically high amounts for development loans in its budget requests for the Philippines, we believe that the Congress may want to scrutinize, with particular care, the economic assistance program for the Philippines proposed for fiscal year 1966 in light of the findings contained in this report.

SCOPE OF REVIEW

In our review of the economic assistance program for the Philippines, we examined into the effectiveness of management controls within the Agency for International Development in developing and carrying out the program in accordance with established United States policies and objectives. Our review was directed toward (1) measuring the effectiveness of the program in achieving its intended economic goals, (2) identifying problems that restrict the effective use of assistance, (3) evaluating the utilization and maintenance of equipment and facilities provided as economic assistance, (4) considering whether the United States was providing assistance prematurely or unnecessarily, and (5) evaluating the administration of the program by United States agencies, including coordination with other agencies within the Philippines.

Our review was conducted both in Washington and in the Philippines. In Washington, we examined pertinent records of the Agency for International Development. In the Philippines, we discussed United States economic assistance objectives and programs with representatives of the United States Embassy and the United States Operations Mission to the Philippines. We also examined programs and project records and reports in detail and visited major economic assistance projects to observe the extent to which United States assistance was being used in the furtherance of program objectives.

Our field work was completed in December 1963.

APPENDIXES

LIST OF PRINCIPAL UNITED STATES OFFICIALS

RESPONSIBLE FOR THE ADMINISTRATION

OF ECONOMIC ASSISTANCE

DURING THE PERIOD COVERED BY THIS REPORT

	Appointed or commissioned
SECRETARY OF STATE:	
Dean Rusk	January 1961
Christian A. Herter	April 1959
John Foster Dulles	January 1953
UNDER SECRETARY OF STATE (note a):	
George W. Ball	February 1961
C. Douglas Dillon	February 1959
ADMINISTRATOR, AGENCY FOR INTERNATIONAL DEVELOPMENT (formerly International Cooperation Administration):	
David E. Bell	December 1962
Fowler Hamilton	September 1961
Henry R. Labouisse (note b)	February 1961
James W. Riddleberger	March 1959
James H. Smith, Jr.	October 1957
AMBASSADOR TO THE PHILIPPINES:	
William M. Blair, Jr.	June 1964
William E. Stevenson	February 1962
John O. Hickerson	January 1960
Charles E. Bohlen	June 1957
DIRECTOR, U.S. OPERATIONS MISSION TO THE PHILIPPINES:	
James H. Ingersoll	April 1962
Paul A. Summers	October 1957

LIST OF PRINCIPAL UNITED STATES OFFICIALS

RESPONSIBLE FOR THE ADMINISTRATION

OF ECONOMIC ASSISTANCE

DURING THE PERIOD COVERED BY THIS REPORT (continued)

	Appointed or commissioned
MANAGING DIRECTOR, DEVELOPMENT LOAN FUND (note c):	
Frank M. Coffin	February 1961
Vance Brand (note d)	September 1959
Dempster McIntosh	July 1958

[a]On February 3, 1959, the Secretary of State placed the International Cooperation Administration under the direction and control of the 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 the responsibilities for the mutual security program formerly carried out by Mr. Dillon.

[b]Mr. Henry R. Labouisse remained Director, International Cooperation Administration, until the agency terminated on November 3, 1961. Mr. Fowler Hamilton was named Administrator of the successor agency, the Agency for International Development, effective September 30, 1961.

[c]Position eliminated because of the abolishment of DLF by the Foreign Assistance Act of 1961.

[d]Mr. Brand assumed the position of Managing Director on September 2, 1959, succeeding Mr. Dempster McIntosh who resigned effective July 1, 1959.

[redacted]

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

NOV 12 1964

Mr. Oye V. Stovall
Director
International Operations Division
General Accounting Office
Washington, D. C. 20523

Dear Mr. Stovall:

Thank you for the opportunity to comment on the GAO draft report on the Philippines. I regret that work arising from the recent visit to the U. S. of Philippine President Macapagal has delayed our comments.

In the paragraphs which follow I have summarized our general reactions to the GAO report, particularly the "Highlights" section. The attachment offers more detailed comments and suggested corrections with respect to the findings and conclusions.

Your concern, that the Philippine Government has not contributed sufficiently to the peso support of certain projects is shared by us and has been a matter on which, contrary to the implications in the report, we have taken meaningful action to persuade the Philippine Government to devote enough resources to permit effective maintenance and utilization of U. S. assistance after its delivery. Numerous official undertakings by the Philippine Government to this end are embodied in project agreements.

As I am certain you recognize, the basic problem in the Philippines is not U. S. failure to plan for and obtain a commitment for local currency financing in advance. Rather, under the Philippine system executive agencies sign agreements in good faith and adequate funds are usually "appropriated," but inadequate revenues are collected to fund these appropriations and inadequate procedures and practices create problems in making use of available funds. Our program has been directed at these fundamental problems for several years, particularly in tax and customs administration, civil service, budgeting, management of financial

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Mr. Oye V. Stovall - 2 -

and material resources, and maintenance of equipment and facilities. In 1962, in a further effort to solve this problem, we gained Philippine adoption of a procedure under which the local currency component to finance new A.I.D. projects must be included in the Philippine National Budget and deposited to a special fund prior to initiation of the projects.

We hope that you will include in the "Highlights" section the thought expressed in the Conclusions and Recommendations concerning grant aid, that the A.I.D. Mission is aware of the peso support problem and has taken action to prevent similar problems from arising in future projects.

Although the report states that A.I.D. has "expressed a willingness to make" additional development loans, despite the above problems of peso support and other loan project problems, what was undoubtedly meant was the true statement of the position, namely, that A.I.D. has stated that it is prepared to consider future loans only if the projects are technically sound, are supported adequately with local currency and competent management is available. Except for one 1961 loan, since canceled, A.I.D. has made no loans to the Philippines since 1959.

The GAO draft report does not seem to take account fully of basic political and economic policy of the U. S. as it influenced certain of the program actions examined:

a) Several projects, particularly highways, wells and springs, and river dredging, were important elements in President Magsaysay's counter-insurgency program of the early 1950s, which defeated a serious communist attempt (the Huk rebellion) to capture the newly independent Philippines.

b) Difficulties with the loan projects, particularly the loan to the Central Bank of the Philippines for relending through commercial banks to finance equipment imports for private Philippine industries, stem in large measure from a fundamental economic reform long advocated by the U.S. and of great benefit to the Philippines, namely, removal of exchange controls. This loan, made in 1960, served to establish or expand 21 private industries. Its economic raison d'etre was diminished in 1962 when the Philippines made this fundamental reform and when new institutions such as the Private Development Corporation of the Philippines were established to offer investors long-term, non-governmental, development credit.

Mr. Oye V. Stovall - 3 -

May I reiterate our earlier suggestions that examination of the records and experience of the Bureau of Public Roads (BPR) would be helpful in assessing the effectiveness of the roads programs in view of the fact that since the beginning of the economic program in the Philippines, the Bureau of Public Roads has been the technical staff for the highway project. Prior to 1960, the BPR was part of the Mission staff to administer the grant highway projects. After 1960, the Bureau was under contract with the Government of the Philippines to implement the DLF loan for roads. The Philippine share in construction of roads was fully met, in fact, in the case of the Mindanao Road Development (about half of the total roads program), the Philippine contribution exceeded that of the U.S. by a ratio of 5 to 1. These facts should be more adequately stated in the report.

We share your concern with the problems of proper utilization and maintenance of equipment and facilities financed by A.I.D. We are this year placing added emphasis on a solution to this problem throughout the Far East on both a project-by-project and an across-the-board supply management basis. Some new features are being introduced which we expect will improve the utilization and maintenance of equipment already delivered and to be financed in the future.

Because of its prominent place in the report, may I note that the initial "Highlights" section may be misunderstood. The first two paragraphs in this section imply a sweeping condemnation of all A.I.D. loan and grant assistance. The majority of grant projects have successfully attained their goals; in three out of the four development loans the goals have been attained in substantial measure.

We regret that the nature of many portions of the report and our relationships with the Philippine Government require that portions of our attached detailed comments be classified in order that they might be properly responsive to the basic thrusts of the report.

It is requested that this letter be published along with your final report. If corrections are to be made in the body of the draft report itself, after consideration of this letter and our attached detailed comments, we will, of course, wish to revise the letter. Therefore, we would appreciate the opportunity to see your revised draft incorporating our reply before it is published in final form. The classification of the report and our reply is discussed on Page 21 of the attached detailed comments.

Our response has been coordinated with the Department of State.

Mr. Oye V. Stovall - 4 -

We will be glad to discuss any of our comments with you.

Sincerely yours,

William O. Hall

William O. Hall
Assistant Administrator for Administration

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