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UNITED STATES GENERAL ACCOUNTING OFFICE
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NATIONAL SECURITY AND
INTERNATIONAL AFFAIRS DIVISION

MARCH 8, 1984

B-214457

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The Honorable Michael D. Barnes
Chairman, Subcommittee on Western
Hemisphere Affairs
Committee on Foreign Affairs
House of Representatives

Dear Mr. Chairman:

Subject: U.S. Economic Assistance to Central America (GAO/NSIAD-84-71)

On October 24, 1983, you asked us to study how U.S. economic assistance to Central America is administered and controlled. To provide this information in time for the Subcommittee's review of the fiscal year 1985 foreign aid request, we agreed to perform limited field work and to brief the Subcommittee in February 1984 on the results of our survey of the Agency for International Development (AID) programs for Central America over the last four years.

In responding to your request, we gathered program data and met with officials at AID headquarters. We also visited AID missions in El Salvador, Honduras, and Costa Rica in December 1983. Given the time constraints, we relied heavily on AID evaluations and audits and discussions with agency officials. We did not attempt to verify AID and recipient country control systems on the various types of assistance.

We briefed the Subcommittee on February 15, 1984, presenting an overview of AID assistance to Central America during 1980 through 1983. We provided statistical data and reported on AID procedures for (1) controlling dollars provided for balance-of-payments support through cash transfers, (2) monitoring and controlling local currencies generated by cash transfers and Public Law 480 concessional food sales, and (3) implementing development assistance projects. The data presented during the briefing is outlined in the enclosure.

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We did not obtain agency comments, however, we did discuss the contents of our briefing with AID officials.

Copies of this report are being provided to the Senate Budget and Foreign Relations Committees and the House and Senate Appropriations Committees.

Sincerely yours,

Frank C Conahan

Frank C. Conahan
Director

Enclosure

U.S. ECONOMIC ASSISTANCE TO CENTRAL AMERICA

The Agency for International Development administers U.S. economic assistance programs. During 1980 through 1983, AID's program for Central America exceeded $1.4 billion. Proposals by the National Bipartisan Commission on Central America for sizable program increases have raised questions on how assistance funds have been used to date. To help answer these questions, we gathered data in Washington on AID's programs throughout Central America and visited AID missions in El Salvador, Honduras, and Costa Rica in December 1983.

AID assistance to Central America increased from $178 million in 1980 to $634 million in 1983, as shown in table 1. During this period, AID's program composition has changed substantially. In 1980, AID provided $134 million for development projects and $34 million for concessional food sales and donations. Since then, these program levels have grown somewhat.

Table 1

Economic Assistance to Central America

	Fiscal Year				
	1980	1981	1982	1983	Total
	(millions)				
El Salvador	$ 58.5	$104.5	$189.5	$247.8	$ 600.3
Costa Rica	13.6	13.3	50.6	212.3	289.8
Honduras	50.7	36.1	78.1	102.7	267.6
Nicaragua	37.0	51.6	6.4	-	95.0
Guatemala	11.4	16.7	13.8	27.6	69.5
ROCAP[a]	4.2	9.7	13.1	19.4	46.4
Panama	2.1	10.5	13.0	7.3	32.9
Belize	-	-	-	16.7	16.7
Total	$177.5	$242.4	$364.5	$633.8	$1,418.2

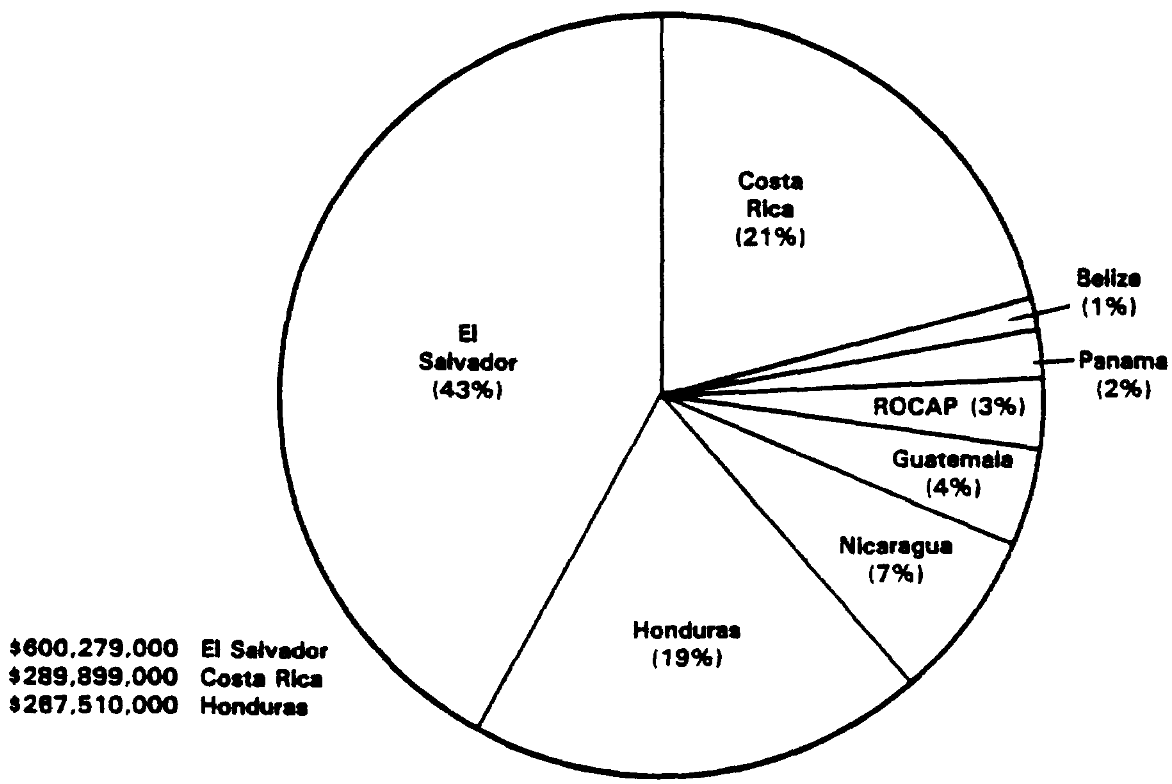
[a]AID's Regional Office for Central America Programs. This office funds projects that transcend country boundaries.

Economic Support Fund (ESF) assistance, which can be used as a quick disbursing mechanism to promote economic and political stability for countries of strategic importance to the United States, grew from $10 million to $373 million. This increase in ESF accounts for most of the overall increase in AID's assistance program in Central America.

ASSISTANCE RECIPIENTS

AID assistance has gone to all Central America countries (Belize, Guatemala, El Salvador, Honduras, Nicaragua, Costa Rica, and Panama) and to AID's Regional Office for Central America Programs. El Salvador, Costa Rica, and Honduras have been the primary recipients, accounting for about 80 percent of all assistance provided during 1980 through 1983, as shown below.

Recipients of Assistance 1980-1983



CASH TRANSFERS

About 41 percent of AID's assistance has been in the form of cash transfers which provide direct balance-of-payments support to help pay for imported goods and services. (See table 2.) These cash transfers are tied to host-country reform of macroeconomic policies. For example, El Salvador agreed to limit credit expansion and to modify wage and price controls as part of the agreement for the fiscal year 1982 cash transfers.

Table 2

Cash Transfers to Central America

	Fiscal Years				
	1980	1981	1982	1983	Total
	(000 omitted)				
Belize	$ -	$ -	$ -	$ 4,600	$ 4,600
Costa Rica	-	-	20,000	155,735	175,735
El Salvador	3,250	44,900	100,000	120,000	268,150
Guatemala	-	-	-	10,000	10,000
Honduras	-	-	35,000	56,000	91,000
Nicaragua	-	40,000	-	-	40,000
Panama	-	-	-	-	-
Total	$3,250	$84,900	$155,000	$346,335	$589,485[a]

[a]Includes $3,250,000 in support of AID's Agrarian Reform Support project in El Salvador.

The AID cash transfer payment procedure is the same for all recipients and begins with U.S. dollars being electronically transferred directly to a recipient country's bank account where they are commingled with funds from other sources. At this point, AID's dollars lose their identity and, according to AID, its financial controls cease. AID does include in its loan and grant agreements requirements that recipient countries comply with certain covenants and conditions.

In its past Congressional Presentations, AID said that cash transfer dollars are used to import productive raw materials and spare parts from the United States. In describing its control process to Congress, using El Salvador as an example, AID stated in August 1982 that:

> ". . . each transaction generates documentation evidencing the financial flow and movement of the imports. The Central Bank, which monitors these transactions closely, maintains complete files on each transaction which is attributed to the AID program. AID receives regular reports from the Central Bank and periodically audits the complete files."

We were told that the operative word in this statement is "attributed" and that AID funds are not required to be used in any specific fashion. AID mission officials in the three countries we visited explained that they obtain documentation from the central banks showing purchases of eligible U.S. goods and services in amounts equivalent to the dollars transferred.

Because normal imports of eligible items from the United States have exceeded cash transfer assistance, this attribution process has not required a change in what these countries buy with their foreign exchange or from whom they buy. In other words, cash transfers are not directly linked to procurement of specific goods and services from the United States, but they do enhance recipient country ability to import all types of goods and services from the United States, Japan, Germany, or elsewhere. In its recently completed 1985 Congressional Presentation, AID has more accurately described its cash transfer assistance as balance-of-payments support, with the recipient country pledging to allocate foreign exchange to imports of eligible U.S. goods and services in an amount at least equivalent to the cash transfer.

The recipient country is responsible for determining who will receive foreign exchange and what it will be used for and for limiting illegal foreign exchange practices, such as capital flight. While we were in El Salvador, mission officials told us that El Salvador's foreign exchange allocation procedures were found to be somewhat arbitrary, thereby not always favoring imports which would have the greatest economic effect.

We were told that controls to limit capital flight in the countries we visited were weak. One way capital flight can occur is when importers send additional dollars out of the country by arranging to have the price of imports overstated on invoices. By reviewing import prices to assure their reasonableness, the Central Banks can limit potential abuse. But, in El Salvador, AID auditors have reported that price checking control units were ineffective. In Honduras, a Central Bank official told us that controls were rudimentary, and in Costa Rica, Central Bank officials told us that no such controls exist. AID officials we contacted could not give us data on the magnitude of capital flight through overstating prices of imports on invoices but they doubted that this was a serious problem.

LOCAL CURRENCIES

In exchange for cash transfer assistance, recipient governments are required to allocate equivalent amounts of their own currencies for mutually agreed development purposes. These local currencies are used to meet local government cost-sharing obligations on donor development projects, fund private voluntary organization activities, provide credit for the private sector, and fund local government development projects. Local currencies are also used for budget support--that is, for items already in the host-country budget which might not receive full funding without AID support.

AID officials told us that they do not attempt to closely control or monitor local currencies. They receive data on local currency uses but do not always visit the activity sites to determine how the funds are actually used.

PUBLIC LAW 480

The Public Law 480 program provides assistance to Central America through U.S. transfers of food commodities, such as wheat, on a concessional sale or donation basis. During the last 4 years, this assistance totaled about $251 million. (See table 3.) Over two-thirds of this amount was provided directly to the recipient government, thereby freeing up foreign exchange which otherwise could have been used to purchase the food commercially. The remaining one-third of assistance has been provided to private organizations, like CARE and the U.N. World Food Program, for distribution to the needy.

Table 3

Public Law-480
Assistance to Central America

Country	Fiscal Year 1980	1981	1982	1983	Total
	(millions)				
Belize	-	-	-	-	-
Costa Rica	$ 0.1	$ 1.8	$ 19.1	$ 28.2	$ 49.2
El Salvador	6.3	26.3	34.9	46.7	114.2
Guatemala	3.7	7.6	5.6	5.3	22.2
Honduras	4.8	10.4	10.1	15.5	40.8
Nicaragua	17.6	1.2	0.6	-	19.4
Panama	1.1	1.9	1.4	1.0	5.4
ROCAP	-	-	-	-	-
Total	$ 33.6	$ 49.2	$ 71.7	$ 96.7	$ 251.2

Commodity transfers directly to the governments generate local currencies which are to be used for specific development activities. Again, AID's oversight of the actual use is limited.

DEVELOPMENT ASSISTANCE

A third category of economic assistance is called "development assistance" because it, unlike cash and food transfers, funds specific activities or projects to improve the development status of the country. AID has obligated about $513 million for such projects in the last 4 years, as shown in table 4.

Table 4

Development Assistance to Central America

Country	Fiscal Year 1980	1981	1982	1983	Total
	----------		(millions)		----------
Belize	-	-	-	$ 6.7	$ 6.7
Costa Rica	$ 13.6	$ 11.5	$ 11.5	$ 27.2	$ 63.8
El Salvador	43.2	33.3	39.6	61.0	177.1[a]
Guatemala	7.8	9.1	8.2	12.2	37.3[b]
Honduras	45.8	25.7	31.2	31.2	133.9
Nicaragua	18.3	1.8	0.7	-	20.8[c]
Panama	1.0	8.6	11.7	6.2	27.5
ROCAP	4.2	9.7	13.1	19.4	46.4
Total	$133.9	$ 99.7	$116.0	$163.9	$ 513.5

[a]Includes $6.2 million in Disaster Assistance/Refugee Programs.
[b]Includes $0.3 million in Disaster Assistance/Refugee Programs.
[c]Includes $0.3 million in Disaster Assistance/Refugee Programs.

Projects funded vary according to the needs of each country. In Panama and Costa Rica, projects stress credit and private sector activities; in Honduras, the projects provide basic social services; and in El Salvador, projects focus on providing jobs. In El Salvador, most project assistance pays for local costs, such as salaries, resulting in the flow of hard currency to the economy--an additional injection of balance-of-payments support. In 1982 and 1983, AID estimated that about 90 percent of development project funds in El Salvador were used for locally available goods and for salaries.

The success of AID's development assistance projects depends heavily on the capabilities of implementing organizations (usually host-country institutions) and on AID staff monitoring. AID officials told us that both are bottlenecks to providing assistance effectively. AID officials cited weaknesses in administrative practices in all Central American countries. In Honduras, an AID official told us AID is running out of good institutions with which to work and, according to AID auditors, the El Salvador government may lack the ability to administer complex AID-supported projects, such as Land Reform.

AID can help strengthen local capabilities by assigning sufficient AID staff to work with weak host-country institutions and to monitor and audit activities. But, according to AID testimony last March, assistance levels in Central America may have already exceeded "the limit of what our (AID) staff in the field can do as far as tracking development assistance type money." AID staff in El Salvador and Costa Rica complained of being so overtasked that they could not make field visits or do the monitoring and evaluation they felt were necessary. Further, at the time of our survey, the AID Regional Inspector General had only six auditors to cover activities in all of Latin America and the Caribbean. Since then, he has hired three additional auditors. He stated recently that he cannot provide the audit coverage needed and requested by mission directors.

Regional instability and hostility creates additional project problems. For example, in El Salvador's Agrarian Reform project, the spreading of pesticides to protect crops has been hindered because crop dusting planes have been shot down.

AID officials in several countries told us that it will continue to be difficult to deliver assistance through traditional projects. AID audits and evaluations document a number of project implementation difficulties, including institutional weaknesses, lack of infrastructure, entrenched bureaucracies, staff shortages, and project complexity. As a result, AID disbursements of large amounts of assistance have been slowed. The mission director in Costa Rica told us that he did not want more development project funds, and the mission director in Honduras was searching for ways to streamline assistance delivery.

QUESTIONS FOR CONSIDERATION

The Kissinger Commission recently recommended program increases which would more than double AID's program levels in Central America. In reviewing the administration's proposals to implement these recommendations, the Congress will be considering questions of program sizes and delivery mechanisms as well as controls in the broader economic, political, and security context of Central America. Recognizing the total economic and political dimensions, we present the following questions for the Subcommittee's consideration.

1. What are the Congress and the administration's expectations and objectives for cash transfer type assistance? To what extent should AID try to influence a recipient country's decisions on what it buys with its foreign exchange and from whom? Does AID's review of import documents for attribution against AID funds serve the needs of the Congress? Should AID describe its cash transfers simply as untied dollar transfers to help solve macroeconomic problems and not attempt to indirectly link AID funds to specific import transactions? What degree of programmatic and financial controls are practical?

2. On local currencies generated by cash and food transfers, what standards should AID set for control and monitoring? Closer monitoring could be done without adding AID staff by setting aside a small portion of local currency generations to employ local accounting firms or local hires to monitor the use of the funds.

3. On development projects, should AID increase its staff oversight of the implementation process? Given the host-country institutional weaknesses and AID's staff allocation, should AID allocate additional staff to its Central American missions based upon the increasing size and difficulties of the assistance program? Could this be coupled with more technical assistance efforts directed toward improving institutional development?