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BY THE U.S. GENERAL ACCOUNTING OFFICE

Report To The Administrator, Agency For International Development

Improved Management Of Productive Credit Guaranty Program Can Minimize U.S. Risk Exposure And Costs

AID's Productive Credit Guaranty Program provides partial guaranties to private credit institutions that lend to small entrepreneurs engaged in credit and self-help development projects. Since 1981 the program has been at a virtual standstill in several countries due to economic recessions in the recipient countries and problems with program management. In 1982 all new program authority was transferred from one bureau to another and efforts were made to streamline the program and improve its operation.

This report discusses the problems the program has faced and actions which can be taken to determine AID's actual program liability and to improve program management.

UNITED STATES GENERAL ACCOUNTING OFFICE

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UNITED STATES GENERAL ACCOUNTING OFFICE
WASHINGTON, D.C. 20548

NATIONAL SECURITY AND
INTERNATIONAL AFFAIRS DIVISION

B-207814

The Honorable M. Peter McPherson
Administrator, Agency for International
Development

Dear Mr. McPherson:

We reviewed the Productive Credit Guaranty Program (PCGP) through which AID provides partial guaranties to private credit institutions in recipient countries. The guaranties are made to encourage lending to organized groups and individuals to carry out credit and self-help community development projects. Congress is currently considering a bill which would extend the program through September 1985 and remove the restriction limiting it to six Latin American countries. Our conclusions and recommendations are included in this letter and our findings are presented in the appendix.

Since 1981, the program has been at a virtual standstill in Paraguay, Bolivia, and Costa Rica due to economic recessions in these countries and problems with the in-country program administrators (central banks) and AID management. The Paraguay PCGP was terminated by AID in September 1983, and the Costa Rica PCGP is being incorporated into a new program. The program in Nicaragua was terminated by AID in 1982 due to a change in the country's banking system.

Severe economic recessions contributed to declines in loan activity, high interest rates, greater arrearages, and restrictions on the money supply. As the primary function of the central banks is currency regulation, for the most part little time or interest was accorded to the PCGP. The central banks have not fulfilled their responsibilities as program administrators. This has resulted in poor program monitoring, control, evaluations, recordkeeping and reporting. AID exacerbated the situation by shifting lead program responsibility between AID headquarters and the missions. This caused substantial delays in program implementation, problem identification, and corrective action.

Poor reporting by the central banks, and in some cases by the missions, led to a lack of up-to-date, complete data on loan activity; thus, AID's financial liability is unclear. Although there has been little loan activity in recent years, arrearages and defaults have occurred. We found AID has little information on this. AID has, however, recognized the need to have such data on hand to verify the validity of a recent claim from Paraguay and to decide whether to extend programs in Paraguay and Bolivia.

In 1982, all new program authority shifted from the Bureau for Latin America and the Caribbean (LAC) to the Bureau for Private Enterprise (PRE). Of the $20 million in funding authorized, about one-half remained for PRE's use. In July 1983, PRE signed its first project agreement with a private bank in Jamaica. The major change PRE made was to eliminate participation by central banks and technical assistants. The lender will assume many of their functions and AID will deal directly with the lender. Although these and other program changes proposed by PRE appear to focus on some of the major deficiencies, they raise new issues that need to be addressed. In light of the past problems, there is a need to reexamine the role of the missions, adequacy of reserve funds, and specificity of lenders' reports. During our review, we also noted that the exchange of program information between AID bureaus was inadequate. Until recently, PRE was unaware of the financial status of LAC's program and plans for existing projects in Paraguay and Bolivia, both of which have an impact on PRE's authority. Efforts should be made to improve communication between the two bureaus and to consolidate the PCGP in one bureau.

CONCLUSIONS, RECOMMENDATIONS, AND AGENCY COMMENTS

Decisions have already been made to terminate the PCGP in Nicaragua and to incorporate the Costa Rica PCGP into a new program. In a draft of our report, we proposed that the Paraguay program be terminated because it had been inactive since 1981 and its financial status was uncertain. LAC subsequently decided not to extend the program past September 30, 1983, based on these reasons.

Our draft report also recommended that the Bolivia program be terminated. LAC, however, has extended this program through fiscal year 1984 at the mission's request because of the severe economic recession in Bolivia and the anticipated demand for the program. Under the Bolivia guaranty agreement, the original PCGP termination date was December 31, 1981. LAC subsequently extended the program for several years due to the economic recession. The mission's position is that AID's participation will be gradually withdrawn once the Bolivian economy begins to stabilize. We believe that since the program has maintained a low default rate it can be successfully turned over to the central bank--this was the original intent of the program. After 7 years of program involvement, the central bank should have sufficient knowledge and experience to assume responsibility for it without AID's involvement. We recommend, therefore, that AID's involvement in the program be terminated as soon as possible.

In addition, to minimize U.S. costs and risk exposure, we recommend that the AID Administrator determine whether a financial audit is needed to determine AID's liability in the recipient countries, examine the recoupments made, assess whether the guaranty funds have been adequately protected, and ensure that any future claims are valid.

Further, to improve program management, we recommend that the AID Administrator:

--Improve coordination between LAC and PRE so that PRE can benefit from LAC's experience and determine the authority it has remaining under the program.

--Consolidate the PCGP in one bureau by transferring all existing program authority to PRE.

From our review of PRE's efforts to improve program performance, we believe particular aspects of the Jamaica agreement should be modified to carry out the program more effectively and to minimize potential costs to the United States. In particular, we noted that the Jamaica agreement excluded a provision to limit the percentage of discounting the bank could do through public institutions. Extensive discounting through public banks reduces the use of private sector funds. The agreement also excluded a provision concerning the collection of fees on each loan as required by the legislation, specific reporting requirements for the lender to follow, and a monitoring role for the mission. Further, in light of past experience, we believe the guaranty reserve may be insufficient to sustain potential losses and to make the program self-sustaining. Thus, we recommend that the AID Administrator seek to amend the Jamaica agreement to:

--Limit the percentage of loans that can be discounted through public institutions.

--Increase that portion of the reserve fund reserved to pay AID's share of the guaranty.

--Collect a fee on each guaranty, to be deposited in a revolving fund of the U.S. Treasury as specified in sections 223(a) and (b) of the Foreign Assistance Act.

--Require that PRE, in conjunction with the Royal Bank Jamaica Limited, prepare a detailed reporting format to include an accounting of the reserve fund, technical assistance provided, collateral held, interest earned, recoupments, and other data deemed necessary to fully monitor the program.

--Specify a more active role for the mission in program monitoring.

We believe that PRE should consider these points in drawing up any future agreements with the recipient countries.

Finally, we view the Jamaica PCGP as critical to the future of the overall program. Therefore, we recommend that the AID Administrator direct that

--PRE establish quantifiable indicators to measure success and

--the Jamaica project be evaluated after 1 year of issuing guaranties to determine whether AID should continue the PCGP or terminate it.

We have discussed the above matters with program officials and have incorporated their views where appropriate. In commenting on the recommendations in our draft, LAC officials agreed that the program in Paraguay should be terminated and they subsequently took action to do so. However, although they initially agreed with our recommendation that the Bolivia program should be terminated, they subsequently decided to extend it through fiscal year 1984 for the reasons discussed above. With regard to our recommendation that AID should determine whether a financial audit is needed to determine AID's liability in the recipient countries, LAC officials stated they would consider undertaking such an audit. Both LAC and PRE officials agreed with our recommendation that coordination between the two bureaus can be improved and they cited some examples where coordination has recently taken place. LAC and PRE officials generally agreed with our recommendation that the PCGP should be consolidated in one bureau; however, they have not yet taken action to do so. With regard to our recommendations covering modifications in the Jamaica agreement, PRE officials stated that they had no objections to the suggested changes and they will consider amending the agreement to include them.

OBJECTIVES, SCOPE, AND METHODOLOGY

Our review was directed toward evaluating the current status of the PCGP and determining whether planned revisions would avoid some of the past problems. Work was performed in Washington, D.C., where we focused primarily on LAC and PRE. We interviewed headquarter's program officials and analyzed documents, files, and independent evaluations to gain insight into the problems encountered in program implementation. We did no specific fieldwork; however, we talked with the current mission directors from Paraguay and Bolivia and the deputy director from Costa Rica while they were on temporary duty in Washington to obtain information on current program developments and financial data. We also cabled the missions on follow-up points. In addition, GAO staff on other assignments in Peru, Costa Rica, and Kenya (a potential PCGP recipient if the program is expanded outside of Latin America) obtained additional information on the need for and suitability of the program.

We analyzed PRE's proposed changes through discussions and a review of project documents, such as the Jamaica project paper and agreement. To gain perspective about loan guaranty programs in general and to discuss AID's PCGP, we contacted officials of the Inter-American Development Bank, the Inter-American Foundation, and the Overseas Private Investment Corporation.

Our review was conducted between February and September 1983. It was done in accordance with generally accepted government auditing standards.

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As you know, 31 U.S.C. §720 requires the head of a federal agency to submit a written statement on actions taken on our recommendations to the Senate Committee on Governmental Affairs and the House Committee on Government Operations not later than 60 days after the date of the report and to the House and Senate Committees on Appropriations with the agency's first request for appropriations made more than 60 days after the date of the report.

Copies of this report will be provided to appropriate congressional committees and to the Director, Office of Management and Budget.

Sincerely yours,

Frank C Conahan

Frank C. Conahan
Director

Contents

ABBREVIATIONS

AID	Agency for International Development
FM	Office of Financial Management
GAO	General Accounting Office
LAC	Bureau for Latin America and the Caribbean
OPIC	Overseas Private Investment Corporation
PCGP	Productive Credit Guaranty Program
PRE	Private Enterprise Bureau

IMPROVED MANAGEMENT OF PRODUCTIVE CREDIT GUARANTY PROGRAM CAN MINIMIZE U.S. RISK EXPOSURE AND COSTS

BACKGROUND

The 1974 amendments to the Foreign Assistance Act authorized AID to conduct the Productive Credit Guaranty Program (PCGP) on a pilot basis to stimulate private sector participation in development programs in Latin America. Under the PCGP, AID can provide $20 million as partial guaranty to banks, cooperatives, and non-profit development organizations in recipient countries to encourage lending to small entrepreneurs (individual or group) in various productive activities--agricultural, small industry, or retail trade. The PCGP's goal has been to increase small entrepreneurs' access to the services of the credit system. The alternatives available to these individuals are not to use credit or to use sources that, because of their terms and conditions, impede economic gain and growth.

The PCGP, originally authorized by the Foreign Assistance Act of 1969, was administered by the Overseas Private Investment Corporation (OPIC). The OPIC program was generally unsuccessful, chiefly because its guaranty was less than 20 percent of each loan and it lacked in-country administrators. The Foreign Assistance Act of 1974, amended in 1979, transferred the responsibility for the program to AID and limited it to six countries in Latin America. The Bureau for Latin America and the Caribbean (LAC) assumed responsibility for the program. LAC developed a conceptual model involving five components: borrowers, lenders, technicians (consultants), AID, and a recipient in-country administrator (the central bank). The activities of the participants were to be guided by AID-approved manuals specifying the operational details of the program. Loans guaranteed under the program were to be made at market-based rates of interest.

Two statutory limitations affect AID's issuance of guaranties: (1) AID cannot guarantee more than 50 percent of the portfolio of any lender and (2) AID's liability for each loan is limited to a maximum of 75 percent.

In case of default, this guaranty commitment would be honored as follows.

--First, payment would be made from the guaranty fund administered by the central bank.

--Second, if and when the guaranty fund is depleted, payment would be made by AID subject to the 50-percent limit for a single lender and 75 percent for each loan.

--Third, if and when AID's liability limit is reached, payment would be made by the central bank.

The lender's risk is limited to 25 percent of the outstanding portfolio.

Under the LAC program, two sets of fees were collected. First, borrowers paid a one-time, 5-percent commission on each loan, which was used to capitalize an in-country guaranty fund. The guaranty fund was intended to be sufficient to cover all guaranty payments and administrative expenses. AID designed the guaranty mechanism to be self-sustaining to encourage the central bank to phase out U.S. involvement. Second, borrowers paid a 0.25 percent fee on the original principal of each loan, which reverted to a U.S. Treasury revolving fund account in accordance with section 223(a) and (b) of the Foreign Assistance Act, as amended. Section 222A(e) limited the revolving fund to $3 million. The revolving fund is to be used to discharge any liabilities or other costs incurred under the program. If the in-country guaranty fund is depleted, AID would make its share of the payment for defaulted loans from the revolving fund account.

Since 1977, LAC has developed guaranty systems in Paraguay, Bolivia, Costa Rica, and Nicaragua. As of 1981, 1,829 loans had been guaranteed, with the greatest number being issued in Bolivia (887) and the least in Nicaragua (185). The average loan size was $9,081; loan averages ranged from a high of $18,238 in Paraguay to a low of $3,178 in Bolivia.

The program's current potential liability is $9.36 million. Thus, $10.64 million is available for additional guaranties from the $20 million authorized in the legislation. Recently, AID received its first claims for guaranty payments under the Paraguay program amounting to almost $40,000. More claims are anticipated.

In 1982, responsibility for selecting new PCGP countries and managing all new programs was transferred from LAC to AID's Private Enterprise Bureau (PRE); existing PCGP programs remained under LAC's jurisdiction. PRE has streamlined the program--eliminating the central bank as the in-country administrator and the role of the technicians--and has thus far selected one country, Jamaica, as a PCGP recipient.

The Congress is currently considering a bill (H.R. 2992) which would extend the program 2 additional years through September 1985 and remove the restriction limiting it to six Latin American countries.

ECONOMIC RECESSION AND PROBLEMS WITH PROGRAM MANAGEMENT DECREASE LOAN ACTIVITY

The LAC programs in Paraguay, Bolivia, Costa Rica, and Nicaragua have met with little success. The central banks seemed to lose interest in the programs and defaults and arrearages began to increase. In Paraguay and Costa Rica, the central banks suspended the programs in 1981, when loan delinquency rates exceeded the maximum of 10 percent permitted under the terms of the guaranty agreements. The Paraguay PCGP was terminated by AID in September 1983, and the Costa Rica PCGP is being incorporated into a new guaranty fund to be set up under an Economic Support Fund program. The program in Nicaragua was terminated by AID in 1982 due to a change in the country's banking system. In Bolivia, loan activity has been infrequent since early 1982.

There are many reasons for the problems experienced under the PCGP, some of which are the result of specific circumstances in the recipient countries. In Costa Rica, for example, the program failed primarily because the nationalized banking system was unsuitable for successful implementation of the program. According to mission staff, nationalized banks have not been efficient in administering credit in Costa Rica. In Nicaragua, the program was terminated because banking practices after 1979 did not require the pledging of collateral for small business loans. For the most part, however, the most critical problems common to all the recipient countries appear to involve economic recession and program management.

Economic recession

Like other countries in Latin America and other parts of the world, the PCGP recipient countries experienced severe economic recessions in the early 1980s. According to mission staff, loan activity in both Paraguay and Bolivia declined beginning in 1980, the same time the economy in those countries entered a recessionary period. Similarly, mission staff attribute the suspension of the PCGP in Costa Rica in part to that country's adverse economic conditions.

In Bolivia, severe droughts coupled with a period of political instability led to high inflation and interest rates in the early 1980s. In early 1983, for example, Bolivian interest rates averaged 38 percent. These factors, AID officials maintain, were the principal cause of the discontinuation of most PCGP loan activity beginning in early 1982.

Paraguay also experienced an economic crisis in the early 1980s due mainly to a collapse in the economies of its major trading partners, Argentina and Brazil, and an increase in unemployment caused by completion of a large hydroelectric facility. Beginning in 1979, Paraguay experienced a rate of inflation which departed significantly from the moderate trend of earlier years. AID officials contend that to lower the inflation rate, the central bank acted to tighten credit expansion in 1980 and it was at that point that PCGP loan activity began to diminish and arrearage rates began to rise. Paraguay mission staff, in fact, attribute the suspension of the program in part to the central bank's desire to restrict the money supply.

Costa Rica experienced sizable balance-of-payments deficits beginning in 1980, due primarily to high levels of debt service and slow export growth. Inflation accelerated from 20 percent in 1980 to over 60 percent in 1981. According to mission staff, the economic recession was at least partly responsible for suspension of the PCGP in 1981.

Program management

There appear to be three main problems with the management of the PCGP involving (1) shift in lead program responsibility between the missions and AID/Washington, (2) central bank management, and (3) inadequate technical assistance.

Shift in program responsibility

Since the development of guaranty systems under LAC, responsibility has shifted between the missions and AID/Washington. At the outset of the program in 1977, LAC's assistant administrator assigned responsibility for administrative support and supervision to an office in LAC. This office was given responsibility for designing, promoting, administering, and evaluating the programs in each recipient country, while the missions were to serve primarily in a backstopping role. This represented a marked departure from past modes of operation for AID programs. As a result, there was some disagreement between the missions and AID/Washington on program administration, with the missions being reluctant to follow all the guidelines established by LAC. In Bolivia, for example, program implementation was delayed for up to 2 years due to a disagreement between the mission and LAC on some of the procedures established by LAC in the project manuals. Exacerbating the problem was the fact that LAC and the missions generally had differing views on program administration, with the missions emphasizing the developmental aspects of the program and LAC being mainly concerned about minimizing AID's risk exposure. LAC's dominant role in the program was somewhat perplexing to the central banks, since they had been accustomed to dealing only with the missions on past AID programs.

In 1981, a decision was made to transfer responsibility for implementing and monitoring the program from LAC to the missions. It was believed that the program could not be successfully administered or monitored from Washington. In the past 2 years, the missions have taken the lead in administering the programs and LAC involvement has been minimized to the point where LAC receives little up-to-date information on program developments or loan activity.

The shift in program responsibility over the years appears to have impeded its successful implementation. Although program officials have agreed for years that changes are needed in the overall program, the suggested changes either have not been made or are just beginning to be made. Delays in program changes were primarily due to conflicting ideas between LAC and the missions about program administration.

Central bank management

Under the terms of the guaranty agreements, the central banks were to act as the in-country administrators of the programs, managing the guaranty funds, supervising the technicians and the lenders and taking remedial action when necessary, transmitting periodic financial and status reports to AID, and evaluating the programs. The central banks, however, did not adequately carry out many of these responsibilities; several 1980-81 evaluations of the PCGP showed that the banks did not

--dismiss incompetent technicians or suspend lenders that did not comply with program regulations;

--submit financial reports to AID in a timely and accurate manner; or

--conduct program evaluations required under the terms of the guaranty agreements.

According to AID program officials, the central banks' problems are due in part to their lack of experience with loan guaranty programs. The central banks, they point out, are traditionally oriented to and staffed for currency regulation and other functions unrelated to PCGP-type lending and are thus ill-equipped to administer such a program. In addition, AID officials attributed the central banks' limited program administration to their lack of interest in the program. The PCGP involves a relatively small amount of money and no direct transfer of U.S. dollars. As a result, AID officials maintain that the central banks, in some cases, attached a relatively low priority to the program, assigning inadequate staff to oversee the programs and providing little support to the lenders.

Inadequate technical assistance

The technicians' role was to identify eligible borrowers, conduct feasibility studies of potential projects to determine their financial and technical viability, provide follow-up technical assistance as needed, and report to the lenders and central banks on operating projects.

The technicians, however, generally did not fulfill their responsibilities, particularly in monitoring projects and providing follow-up assistance. According to AID program officials and independent evaluations of the PCGP, the technicians' involvement in projects generally ceased once the feasibility studies were completed and the projects were approved. A 1980 evaluation of the Paraguay program showed that although some technicians had performed well, others had submitted sub-standard feasibility studies, incorrectly stated information regarding borrower eligibility, and did not provide follow-up technical assistance. In the study, only 4 of the 16 cases examined in detail were correctly identified as eligible projects and benefitted from competent technical assistance.

Most AID program officials agree that a main reason for the problems was that the technicians received fees regardless of the quality or eligibility of the projects. Thus, they had an incentive to bring forth loan guaranty applications irrespective of their merits. Another reason was that many of the technicians had little training and few qualifications. In Paraguay and Costa Rica, for example, many technicians were students, with little experience.

CURRENT STATUS OF LAC/PCGP

The missions requested extensions of the PCGP in Paraguay and Bolivia through fiscal year 1984, but only the Bolivia program has been extended. Although the Paraguay program was terminated, claims for defaulted loans can still be submitted to AID for payment in the future. In Costa Rica, the PCGP is being incorporated into a new $10-million loan guaranty program, which will be funded by AID and administered by the central bank. In Nicaragua, the program was terminated in 1982, but claims for defaulted loans can be submitted to AID for payment in the future. AID has no accurate data on its liability in Nicaragua.

Paraguay

In September 1983, LAC decided not to extend authorization of the Paraguay PCGP though fiscal year 1984. This decision was based on the program's uncertain financial status and the fact it had been inactive since 1981. For these reasons, we had proposed termination of the program in a draft of our report. The problems experienced by the program are highlighted below.

The program's financial status has been tenuous. The guaranty fund was recently depleted due to payments made for over 60 defaulted loans. As a result, AID paid its first claims, totaling $37,848, in May 1983; from an analysis of loans in arrears, the mission has projected that AID may be liable for an additional $200,000 to $300,000 in claims in calendar year 1983. As of April 1983, 43 percent of the loans in the PCGP portfolio, totaling $774,024, were in arrears.

Contributing to the program's financial problems is the fact that less than 10 percent of the losses have been recouped from the borrowers to replenish the guaranty fund. The central bank informed the mission that it has collected some collateral from delinquent borrowers but will not liquidate the collateral until economic conditions in the country improve.

AID's Office of Financial Management (FM) is concerned about the financial status of the Paraguay program, particularly about the recent claims paid. According to FM officials, when FM gave preliminary approval to the mission to pay the claims, it requested the mission to examine each claim to determine the eligibility of the lender and the borrower. The mission, however, paid the claims without providing any information to FM as to their validity. Although the 1982 AID evaluation indicated there was no misrepresentation on the part of the lenders that would prohibit AID from paying the claims, FM still needs information as to the status of the program's guaranty fund and details about the defaulted loans. It recently requested this information from the mission.

The Paraguay PCGP had been inactive since 1981 when it was suspended by the central bank because arrearage rates exceeded the maximum of 10 percent permitted under the terms of the guaranty agreement. The central bank had recently discussed reactivating the program and had requested that AID extend its authorization through fiscal year 1984.

In our draft report, however, we proposed that the program be terminated because although the central bank had discussed reactivating the program for several years, no new loan activity had taken place. The central bank, moreover, did not adhere to at least two requirements of the operating manual by refusing to refinance delinquent loans and to make loans in installments. By refusing to refinance delinquent loans, the bank was at least partly responsible for the suspension of the program in 1981 which was caused by high arrearage rates. The central bank's handling of the recoupments from delinquent borrowers was also questionable. It seems clear that the bank should have liquidated the collateral as soon as possible to replenish the guaranty fund rather than wait for economic conditions to improve. For these reasons, we questioned whether AID should continue to support the central bank in future administration of the program.

We were further concerned about extending the program because of its uncertain financial status. With the guaranty fund depleted, current high arrearage rates, and payment of the first claims and the anticipation of more, it seemed ill-advised to further increase AID's liability under the program.

Bolivia

The Bolivian program has never been at a complete standstill, although loan activity has been fairly limited since early 1982. According to mission staff, however, loan activity has begun to increase in the last few months.

The financial status of the PCGP appears to be relatively sound. The mission maintains that as of August 1983 only 8 percent of the portfolio was in arrears and 2 percent was in default. The guaranty fund has remained solvent; as of August 1983, there was $119,043 in the fund. AID has paid no claims for the program.

The mission believes that the program has been generally successful, as evidenced by the low arrearage and default rates. The main criticism made by AID officials is that the loan sizes--averaging $3,178--have been so small that it is unlikely that the program has had much impact on economic development. Recently, the mission and the central bank have increased the maximum loan size from $25,000 to $100,000 and increased the percentage of discounting permitted, which they feel will enhance the appeal of the program to both the lenders and the borrowers. The guaranty agreement also has been amended recently to reduce AID's guaranty coverage from 50 to 20 percent to allow more funds to be leveraged.

LAC has recently extended authorization of the Bolivia program through fiscal year 1984 at the mission's request. The mission envisions that AID's participation in the program will be gradually withdrawn once the Bolivian economy begins to stabilize. In the mission's view, because of the severe economic recession in Bolivia, it is important that AID maintain its support for the PCGP and allow the program to realize its full potential for guaranteeing loans.

We believe, however, that AID should not continue its involvement in the PCGP. The program already has been extended for several years due to the economic recession, which is expected to continue for some time. Under the guaranty agreement, the original PCGP termination date was December 31, 1981. LAC subsequently extended the program for 9 months and in October 1982 approved an additional year's extension due to the recession. Despite the recession, the program has managed to have low arrearage and default rates; thus, it would seem that it can be successfully turned over to the central bank. This was the original intent of the program. After 7 years of program involvement, the central bank should have sufficient knowledge and experience to assume responsibility for it without AID's continued presence.

Costa Rica

The central bank suspended the PCGP in September 1981 because loan delinquency rates exceeded the maximum of 10 percent permitted under the guaranty agreement. Before the program's suspension, very little loan activity occurred in Costa Rica; only 207 loans were guaranteed in the 2 to 3 years the program was in operation.

According to mission staff, the Costa Rica program has not been officially terminated because the mission and central bank wanted to allow time to determine the reasons for its failure. Currently, the mission does not have accurate records of the financial status of the program, including the balance of loans in arrears and default, recoupments made, or status of the guaranty fund, because the central bank and the commercial banks did not adequately report lending activity. To address this problem, the mission contracted with a private consulting firm in early 1982 to determine AID's financial liability in Costa Rica and the reasons for the program's failure. This audit has not yet been completed.

A decision has been made to incorporate the Costa Rica PCGP into a new $10-million guaranty fund to be set up as part of an Economic Support Fund program for Costa Rica. AID and the Costa Rican central bank have informally agreed to establish this new fund and to assume the liabilities of the PCGP as determined by the financial audit. Thus, any claims growing out of the PCGP will be paid from funds earmarked for the new program.

Mission staff believe the new loan guaranty program will be more successful than the PCGP because (1) it involves a $10-million rather than a $3-million guaranty, so the central bank will assign a higher priority to the program and do a better job in promoting and administering it, (2) it will be geared for larger businesses than the PCGP and will have a larger maximum loan size, and (3) it will have some private banks participating, whereas the PCGP had only nationalized banks. It is viewed that private banks have been more efficient than nationalized banks in administering credit in Costa Rica.

AID'S FINANCIAL LIABILITY IS UNCLEAR

AID's financial liability under the PCGP is unclear, primarily because LAC has not received up-to-date information on the financial status of the programs and any information it has received is often incomplete.

According to LAC officials, the missions in Costa Rica and Nicaragua have submitted no financial data to LAC since the programs were suspended in 1981, primarily because the central banks have not provided this data to the missions. The Paraguay mission has provided only limited data. Although there has been no loan activity in these countries since 1981, arrearages and defaults have occurred. However, LAC has little information on this. AID, thus, does not know whether defaults have exceeded arrearage limits, whether additional claims are forthcoming, or how much future claims will be. For Bolivia, the mission has recently begun to send reports on a regular basis, but they do not provide all the data required under the terms of the operating manuals, such as balance sheets, profit and loss statements, or information about collateral.

Although some LAC officials indicated they feel it is unnecessary for the missions to send monthly financial reports, it would seem important that LAC have up-to-date financial data in order to be aware of defaults and arrearages that may occur and any claims that may be submitted to AID for payment.

Complete up-to-date financial data would also be useful for AID's Office of Financial Management because it must approve payments of claims. FM officials have recently expressed concern about the lack of this data, particularly with regard to the validity of the recent claims paid by the Paraguay mission and the status of that country's guaranty fund. They indicated that they plan to establish specific procedures for paying claims and will not approve payments of future claims until they have received documentation as to the eligibility of the loans. To assess the validity of future claims and to determine the status of a recipient country's guaranty fund, FM has suggested that local accounting firms be hired to review claims and to assess whether the guaranty funds have been properly protected.

With legislative limits on the amount of PCGP funds and number of countries, it is important that AID determine its legal and financial obligations under the program. To accomplish this, we believe AID should determine whether an audit is needed (except in Costa Rica where an audit is ongoing) to determine its liability in the recipient countries, examine the recoupments made, see that the guaranty funds have been properly protected, and ensure that any future claims paid are valid.

LACK OF COORDINATION BETWEEN LAC AND PRE

Responsibility for all new PCGP programs was transferred from LAC to PRE in May 1982, but there has been little interaction between LAC and PRE in the past year. The two Bureaus are essentially operating independently, with little exchange of information. PRE, for example, has not kept abreast of developments in the LAC programs; in fact, it learned only recently of the claims paid by AID for the Paraguay program. Further, LAC has not shared the financial data it has with PRE. This information would be useful to PRE in determining the authority it has remaining under the program as well as the status of the revolving fund. In addition, PRE appears to be unaware of many of the problems in the LAC programs and thus has not benefitted from LAC's years of experience with the PCGP.

In commenting on our draft report, program officials agreed that coordination can be improved and cited two examples where coordination has already taken place--LAC requested PRE concurrence on cables to the Paraguay and Bolivia missions regarding program status and PRE solicited LAC comments on the Jamaica project paper.

Further, we believe the PCGP could be better managed if complete program authority were concentrated in one bureau, namely PRE. The knowledge and experience to be gained by PRE staff would be beneficial to future efforts. PRE's concern with this proposal is the additional staff time such a transfer would entail. We believe the staff time required would be minimal since Bolivia has the only on-going program and the termination of the Paraguay program is being handled by the mission.

PRE'S PROGRAM NEEDS SOME MODIFICATION

In 1982, PRE began to experiment with changes to the program. The major change eliminated the central bank and outside contractors as program participants and the lender assumed many of their functions. Using the simplified operational design, PRE identified Jamaica, Haiti, and Peru as potential program recipients. On July 14, 1983, AID signed an agreement with the Royal Bank Jamaica Limited, as sole lender. Haiti and Peru were subsequently considered inappropriate for the program when preliminary discussions and evaluations identified certain institutional problems.

Although PRE's changes appear to eliminate the sources of some of the past problems, new issues which need to be addressed include the assignment of loans, adequacy of the reserve fund, collection of fees, reporting requirements, and role of the missions.

Program revisions

Based on our review of the proposed Jamaica project, PRE is attempting to correct some of the problems the LAC program experienced, as listed below.

Program problems	Planned revisions
Central bank's lack of involvement and interest as program administrator.	Lending institution to act as administrator, without central bank involvement.
Technical assistance and loan application analysis were provided by independent technicians who were paid for producing applications regardless of applicants' quality or eligibility.	Lender's own in-house officers will analyze applications and pay hired technicians to provide technical assistance as needed.
Lender's share of the guaranty was 25 percent (compared to AID's 50 percent and central bank's 25 percent of the portfolio) so lender's risk was minimal.	Lender's share will be 50 percent, giving lender greater incentive to pursue sound credit practices.

It appears that these changes will overcome some of the past problems. However, we believe the program should be carefully monitored in its first year of operation to determine whether there are adequate controls on the system to assure its efficient operation. For example, the lender's own in-house loan officers have had little or no experience in dealing with the target group. The Royal Bank Jamaica Limited is accustomed to providing larger loans to borrowers that have better internal recordkeeping and management information systems, including financial statements, upon which to measure and analyze risk. AID may find it needs to provide some technical assistance in this area. PRE's plan includes other modifications, which are discussed in more detail below.

Assignment of loans

Under the agreement, the Royal Bank Jamaica Limited can discount some or all of its eligible loans to one or more Jamaican institutions, provided it retains all obligations to AID and all responsibilities under the program agreement. These discount facilities offer several advantages, including additional liquidity for the banking system and more favorable rates for the borrower. In Jamaica, the institutions available for discounting are the National Development Bank and the Agricultural Credit Bank. Both institutions are government funded and act as wholesalers of credit to the agricultural and non-agricultural sectors. The Agricultural Credit Bank is also funded, in part, by AID. But, according to PRE, the AID funds to the Agricultural Credit Bank are earmarked for medium-sized agribusinesses larger in size than those in the PCGP target group.

If this were not the case, the United States theoretically could be guaranteeing its own funds through the discounting process.

Section 222A of the Foreign Assistance Act aims "to stimulate the participation of the private sector in the economic development of less-developed countries in Latin America," a participation which customarily includes capital exposure as well as risk assumption. If the Royal Bank were to discount 100 percent of its guaranteed credits, it would move from being an investor to being simply a co-guarantor with AID. Moreover, the program would be mobilizing public sector funds rather than private sector funds. Discounting is an attractive selling feature to this type of program, but AID should attempt to limit this option since it may be defeating the purpose of the program.

Adequacy of the reserve fund

Under the Jamaica agreement, the Royal Bank will collect a one-time fee from the borrower, charged as a percent of the principal, for deposit in an in-country reserve fund. The reserve fund will be used to pay the costs of technical assistance and special reports requested by AID and payments to the Royal Bank pursuant to the guaranty. The share of the fund allocated for guaranty payments amounts to less than 1 percent of the portfolio, compared with 5 percent set aside under the LAC/PCGP. Although it is difficult to determine what would constitute an appropriate reserve fund, the following points should be considered.

--The Paraguay PCGP reserve fund (at 5 percent) has been exhausted.

--Jamaica's Royal Bank predicts the default rate among the target group will be about 2 to 2.7 percent.

--The program is expected to be self-sustaining, thus an established reserve fund should cover potential losses.

We are concerned that the reserve fund of less than 1 percent may be inadequate to sustain potential losses and make the program self-sustaining.

Collection of fees

PRE expects that if the reserve fund is depleted, AID will pay its guaranty from the revolving fund established under section 223(a) and (b) of the Foreign Assistance Act and limited by section 222A, subsection (e) to $3 million. Claims under the OPIC program and the current claims from Paraguay have reduced the reserve to about $2.8 million. This may be adequate at this time, but as PRE continues to initiate new programs the reserve fund may need to be replenished. PRE's loan agreement with the Royal Bank does not provide for the collection of a fee on each guaranty to be returned to the U.S. Treasury revolving fund as required under section 223. The LAC guaranty agreements provided for a 0.25 percent fee on each guaranty to revert to the revolving fund. We are concerned that PRE has excluded such a provision from its loan agreement with the Royal Bank. We believe the potential cost and risk to the United States can be reduced if PRE reconsiders this point.

Reporting requirements

The Jamaica agreement specifies that the Royal Bank shall give AID (1) quarterly reports describing each new loan and collection and delinquency activity and (2) annual reports of loan activity and independently audited financial reports. Although these reports are essential to AID's program management, the detailed information that AID requires to fully track program progress is not spelled out in the agreement. For example, a full accounting of the loan fees, technical assistance provided, collateral held by the Bank, interest earned on assets, and recoupments are not explicitly requested in the reporting requirements. These are important in determining AID's potential liability as evidenced by the Paraguay situation. LAC prepared manuals containing reporting format and a requirement that a balance sheet and income statement be submitted. Although the central banks did not fully comply with this, we believe the reporting requirements are sound. As the Bank's periodic reports are PRE's major tool for controlling the program, we suggest that PRE work with the Royal Bank in defining the reporting requirements to include these details.

Mission's role

PRE has designed the program so that the mission's role is minimal. We question this approach in light of prior experience. According to LAC officials, the mission is usually the recipient country's first contact point when a problem arises. If the mission has limited knowledge of the program, this could delay action as the mission awaits Washington feedback. Attempts by the mission to take action without complete information could be damaging to the program and U.S. relations. Further, the remote supervision planned by PRE was attempted by OPIC and failed. In fact, one reason the program was transferred to AID was because OPIC had no in-country presence available to assist the lenders. We believe PRE should reevaluate its position on this point, since its limited staff would make monitoring increasingly difficult if the program expands worldwide.

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