

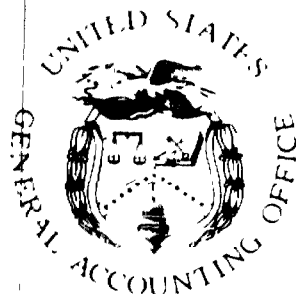
BY THE COMPTROLLER GENERAL
 Report To The
 Committee On Foreign Affairs
 House Of Representatives
 OF THE UNITED STATES

**Economic Support Fund Assistance
 To The Philippines**

In support of the 1979 Amendment to the Philippines - U S Military Bases Agreement, the United States has provided \$200 million in Economic Support Fund assistance to the Philippines over fiscal years 1980-1984. At the request of the Committee on Foreign Affairs, GAO reviewed the assistance program and found that problems were encountered in implementation. Problems stemmed, in part, from delays in designating a Philippine government agency to coordinate the program and from disagreements between the U S and Philippine governments over how much control the United States should exercise over the aid.

In June 1983, as a result of a review of the Agreement, the United States pledged an additional \$475 million in Economic Support Fund aid over fiscal years 1985-1989. GAO believes that key issues need to be resolved as early as practicable to avoid a repetition of earlier implementation problems. These issues include (1) reaching agreement on the purposes and uses of the aid, (2) deciding the type of aid to be provided, and (3) designating the coordinating Philippine government agency.

This is an unclassified version of an earlier GAO report on this subject.



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

B-211263

The Honorable Dante B. Fascell
Acting Chairman, Committee on Foreign Affairs
House of Representatives

Dear Mr. Chairman:

In response to interest expressed by your Committee, we reviewed Economic Support Fund (ESF) assistance to the Philippines. The study examined (1) the progress and constraints in implementing the ESF program and (2) the implications of current program experience for future ESF assistance.

ESF, which finances assistance to countries where the United States has special strategic interests, was initiated in the Philippines as a result of the 1979 amendment to the Philippines-United States Military Bases Agreement of 1947. In support of that agreement, the United States pledged \$200 million in ESF aid over 5 years, beginning with fiscal year 1980. As of January 1984, \$200 million had been appropriated and obligated. The program is administered by the Agency for International Development (AID).

Consistent with commitments to the Congress, the aid has been used to finance seven development projects. Projects include ones specifically focused on the areas surrounding the military bases as well as those responding to Philippine national priorities.

Composition of the program reflects U.S. political concerns--the desire for visible activities and rapid disbursement of the aid--as well as administrative concerns, that is, the need to administer the program with limited AID staff while maintaining adequate control over the assistance.

Procedures have been devised to relieve AID of staff-intensive management tasks. Significant responsibility for day-to-day management of the program has been delegated to the Philippine Ministry of Human Settlements, headed by Imelda Marcos, wife of Philippine President Ferdinand Marcos.

Partially because the 1978-79 negotiations did not address key program issues, considerable problems were encountered in developing the program. A lead Philippines Government agency to work with AID in programming the ESF was not designated until May 1980, nearly 1-1/2 years following the conclusion of the negotiations. Disagreements between the U.S. and Philippine Governments over whether the ESF aid was to be programmed in accordance with the normal AID procedures, also had to be resolved. This latter disagreement stemmed from differing U.S. and Philippine Government views on the purposes of the aid.

Additional difficulties in program development included (1) conflicting directions to the AID mission from AID headquarters concerning appropriate uses of the assistance and (2) problems in determining the extent to which the aid would be used to develop the base lands returned to Philippine jurisdiction under the 1979 agreement. These problems limited the time available for program development.

Additional ESF assistance for the Philippines is planned as a result of the June 1, 1983, Memorandum of Agreement on U.S. access to military facilities, negotiated by the Department of State. In support of that agreement, the President pledged his best efforts to obtain appropriations for \$475 million in ESF aid over the 5 years beginning with fiscal year 1985.

To avoid a repetition of the problems encountered in implementing the current program, we believe that several key issues need to be resolved as early as practicable. These include (1) clarification of the purposes and uses of the aid; (2) designation of the lead Philippine Government agency or agencies for programming the assistance; and (3) determination of the type of ESF aid. Various types of ESF aid are possible including project aid, as is now provided, and nonproject aid. Nonproject aid can be provided through cash transfers, commodity import financing, or sector assistance. Additional details on these issues are presented in the attached appendix.

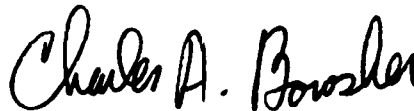
OBJECTIVES, SCOPE AND METHODOLOGY

In order to examine the implementation of the current (fiscal year 1980 to 1984) ESF program and to analyze the implications of the current program for future ESF assistance, we developed data from records of the Department of State, the Agency for International Development, and the Department of the

Treasury. Discussions were also held with officials of these agencies in Washington, D.C. and the Philippines. The Department of State provided us an oral briefing in lieu of documents, due to the sensitivity of the negotiations, on matters pertaining to (1) the 1983 negotiations; (2) the programming of future ESF aid; and (3) the current ESF program when such documents also contained references to the 1983 negotiations. Our fieldwork was conducted from February 1983 to July 1983. As agreed with your office, official agency comments were not obtained. The draft report was, however, discussed with AID and Department of State officials. Except as noted above, this review was conducted in accordance with generally accepted government audit standards.

Copies of this report are being forwarded to appropriate House and Senate committees; the Director, Office of Management and Budget; the Administrator, Agency for International Development; and the Secretary of State.

Sincerely yours,



Comptroller General
of the United States

GAO note: This is the unclassified version of our report Economic Support Fund Assistance to the Philippines. Classified sections of the original report have been modified or deleted to permit issuance in unclassified form. In addition, sections of the original report discussing the fiscal year 1984 program and the Philippines economic situation have been updated.

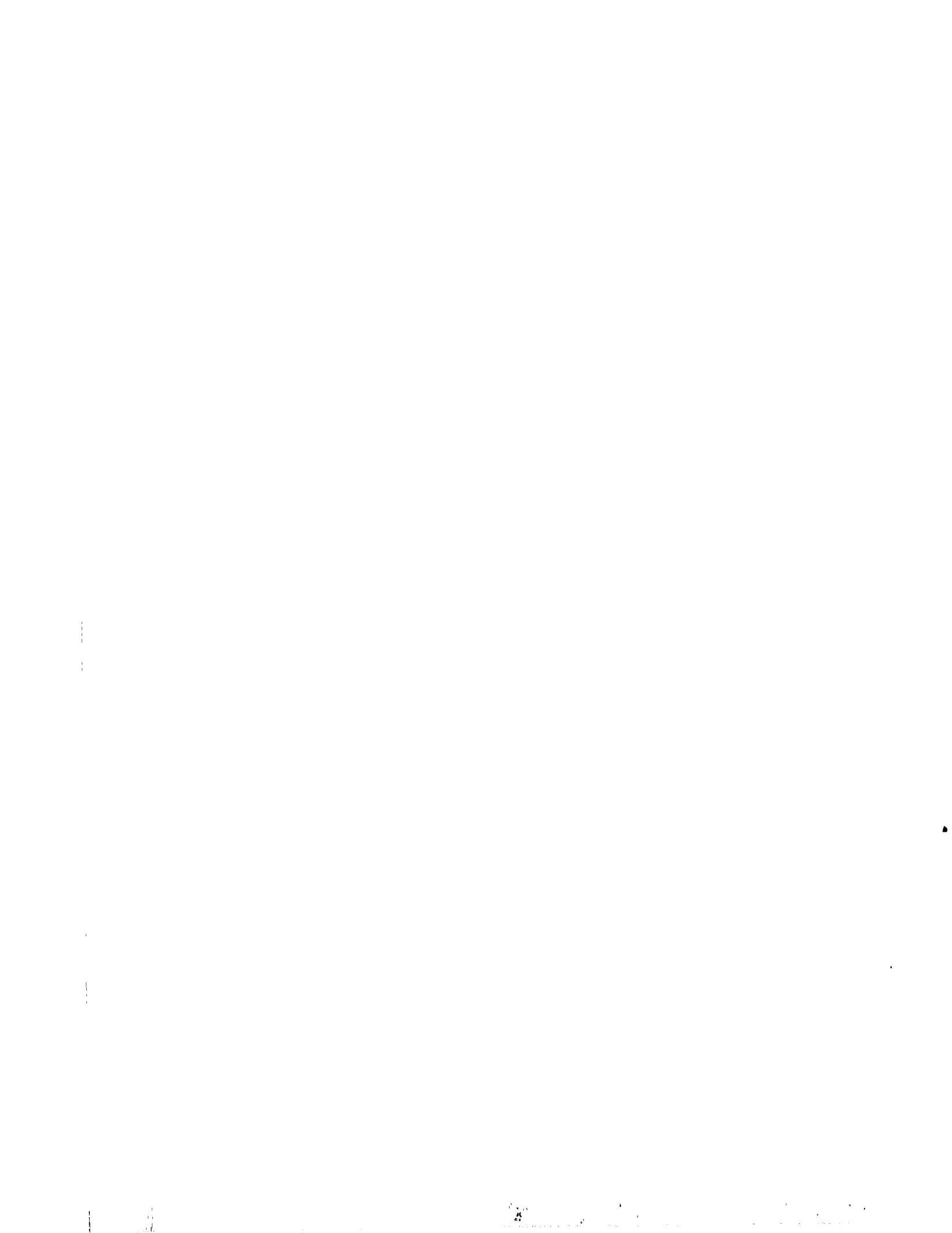


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ABBREVIATIONS

AID	Agency for International Development
CDSS	Country Development Strategy Statement
DA	Development Assistance
ESF	Economic Support Fund
GOP	Government of the Philippines
MHS	Ministry of Human Settlements
NEDA	National Economic and Development Authority



ECONOMIC SUPPORT FUND ASSISTANCE
TO THE PHILIPPINES

INTRODUCTION

Agreement amending the Philippines-U.S. Military Bases Agreement of 1947 was reached on January 7, 1979. In support of that agreement, the United States pledged its best efforts to obtain congressional appropriations for \$500 million in security assistance. The \$500 million compensation package included \$200 million in Economic Support Fund (ESF)¹ aid in addition to \$250 million in Foreign Military Sales Credits and \$50 million in grant Military Assistance; the aid was to be provided over 5 years, from fiscal year 1980 to 1984.

As of January 1984, \$200 million in grant ESF aid had been appropriated and obligated. ESF is authorized by Chapter 4, Part II, of the Foreign Assistance Act of 1961, as amended (22 U.S.C. §2346 et seq.).

The Military Bases Agreement

The Military Bases Agreement of 1947 affirmed U.S. access to military bases in the Philippines. The 1979 amendment to the Military Bases Agreement recognized Philippine sovereignty over the bases while providing for continued, unhampered U.S. access to the military bases, which include Clark Air Base, Subic Bay Naval Base and other facilities. Among other provisions, the amended Agreement also provided for the return of some of the base lands--largely in the area of Clark Air Base--to Government of the Philippines (GOP) jurisdiction. The exchange of letters amending the agreement also took note of the "economic and social conditions in the areas surrounding the bases" and expressed "joint interest in developing programs designed to upgrade them." Moreover, a letter from the Secretary of State in support of the 1979 amendment provided for U.S. consideration of assistance for the areas surrounding the bases and for utilization of the returned base lands. The 1979 amendment also established a procedure for a 5-year review of the Agreement.

The 5-year review concluded on June 1, 1983, with a Memorandum of Agreement. In support of that agreement, the President pledged his best efforts to obtain appropriations of \$900 million in assistance in the following categories:

--Economic Support Fund Assistance.....	\$475 million
--Foreign Military Sales Credits.....	\$300 million
--Military Assistance.....	\$125 million

¹ ESF was then known as Security Supporting Assistance.

The assistance is to be provided over 5 years, beginning in fiscal year 1985. In a change from the prior package, concessional financing terms are proposed for the Foreign Military Sales Credits. ESF and Military Assistance will be continued on a grant basis.

Economic assistance to the Philippines

Initiation of ESF aid marked a new dimension in the U.S.-Philippines economic assistance relationship. U.S. economic assistance to the Philippines dates back to the 1940s. The primary component of U.S. aid efforts to the Philippines was, in the years immediately preceding the 1979 amendment, Development Assistance (DA) aid. As shown below food aid has also been provided.

U.S. ECONOMIC ASSISTANCE TO THE PHILIPPINES (in millions of U.S. dollars)

	<u>Fiscal Year</u>						
	<u>1978</u>	<u>1979</u>	<u>1980</u>	<u>1981</u>	<u>1982</u>	<u>1983</u>	<u>1984</u> (proposed)
ESF Assistance \$ -	\$ -	\$ -	\$20.0	\$30.0	\$ 50.0	\$50.0	\$50.0
Development Assistance	52.8	42.6	39.7	38.5	39.4	36.8	40.0
Food Aid	<u>21.7</u>	<u>25.1</u>	<u>20.0</u>	<u>24.0</u>	<u>12.6</u>	^a <u>10.0</u>	<u>7.8</u>
Total	<u>\$74.5</u>	<u>\$67.7</u>	<u>\$79.7</u>	<u>\$92.5</u>	<u>\$102.0</u>	<u>\$96.8</u>	<u>\$97.8</u>

^aEstimated.

Consistent with understandings reached in negotiations, DA levels have remained stable since 1980; ESF aid was intended as additional resources and not as a substitute for DA aid.

While both ESF and DA finance economic aid in support of a recipient country's development, legislative provisions governing the purposes and uses of the aid differ. The authorizing legislation declares that the principal purpose of DA is to address the critical problems facing the poor majority in developing countries. Key DA priorities established by the legislation include agriculture and rural development, education and human resource development, population, health, and energy. DA is generally provided through projects which finance discrete activities in these priorities.

ESF finances assistance to countries in which the United States has special strategic interests. Greater flexibility exists in the use of ESF aid. While the authorizing legislation provides that the policy governing DA be taken account "to the maximum extent feasible" in planning ESF assistance, ESF is not limited to the priorities set for DA. Moreover, while ESF can be provided through projects, nonproject modes are commonly used

although not, thus far, in the Philippines program. Nonproject modes include cash transfer for balance-of-payments or budget support, commodity import financing, and sector assistance which provides cash transfer or commodity import support for a discrete program.

Both ESF and DA are administered on the U.S. side by the Agency for International Development (AID). As is the practice with most bilateral assistance programs, AID maintains a mission in the Philippines to administer the assistance program.

On the Philippines side, the Management Advisory Committee, comprised of the heads of eight GOP ministries, was established to advise the President on use of the ESF aid. A Secretariat to the Committee was created within the GOP Ministry of Human Settlements (MHS); the Secretariat is responsible for day-to-day management of the program. The lead agency responsible for coordinating the DA program is the National Economic and Development Authority (NEDA). The role of the MHS Secretariat differs significantly from that of NEDA. The MHS Secretariat, with a staff of about 75 people, exists almost exclusively to administer the ESF program. AID works with the Secretariat in identifying and designing projects which are then implemented by a variety of GOP agencies. The Secretariat also has an active role in supervising project implementation. While NEDA has lead responsibility for identifying priorities for DA funding, a separate staff does not exist to administer the DA program and AID works directly with various GOP agencies in developing and implementing DA projects.

ESF aid funds development projects

The \$200 million in ESF aid is being used to support seven development projects. Projects include ones specifically focused on the areas surrounding the bases as well as those responding to Philippine national priorities. Three of the seven projects or about 64 percent of the \$200 million is directed to the base areas. The ESF-financed projects are described below.

Elementary School Construction financed construction of 895 typhoon-resistant schools throughout the Philippines. The project was selected because school construction was a tried and proven activity, which could be designed and implemented quickly, and which responded to a recognized development need.

Project Design finances the operating expenses of the MHS Secretariat responsible for coordinating the ESF program as well as technical assistance and pilot projects. Major pilot activities funded thus far include a \$2 million rural energy technical assistance project and a \$1 million shelter materials activity.

Rural Energy supports the development of renewable energy resources by financing (1) construction of three wood-fired

power plants; (2) development of tree farms and charcoal production units; and (3) modification of diesel-driven irrigation pumps with the addition of wood-burning gasifier units. This 8-year program grew out of the DA program; it is more capital-intensive than projects typically funded under DA.

Philippines Markets finances construction and rehabilitation of public markets used by private entrepreneurs, producers and consumers in selected growth centers. Funding for this activity was seen as responsive to the agenda of MHS's National Livelihood Movement, a program intended to help development of more productive rural enterprises.

Municipal Development Fund finances local development projects in municipalities and cities² most directly affected by the presence of U.S. military facilities. The project is one of the primary efforts directed at improving living conditions in the areas surrounding the military bases.

Regional Development Fund also provides assistance to areas adjacent to the bases by financing (1) development projects in the six provinces making up Region III, the region where Clark Air Force Base and Subic Bay Naval Base are located; and (2) assistance to squatters residing along the perimeter of U.S. military facilities or within the reverted base lands. Communities eligible for assistance include the 106 municipalities in Region III which are not covered under Municipal Development.

Early in fiscal year 1984, the Regional Development project was modified. Besides financing assistance to areas adjacent to the bases, the revised project funds nationwide construction of rural roads and elementary schools. Fiscal year 1984 funding has been increased from \$20 million to \$50 million. The increased funding and geographic expansion of the project will facilitate rapid implementation and thus, early disbursement of the full \$50 million in fiscal year 1984 funds. Accelerating disbursement of the aid was seen as desirable in light of a deterioration in the Philippine's balance-of-payments and budgetary position.

Clark Access Road and Feeder Roads finances construction of an access road within a portion of the Clark returned base lands

² The Philippines is divided into 13 administrative regions. Each region is comprised of provinces and cities which, while physically located within provinces, operate independently of provincial governments. Provinces are subdivided into municipalities which operate under the jurisdiction of provincial governments. Nationally, there are 72 provinces, 1,500 municipalities, and 60 cities.

as well as feeder roads and soil and water conservation activities along the road. Construction of the road is the sole activity thus far approved which focuses on development of the returned lands.

Funding for these projects is shown below.

ESF PROJECT FUNDING
(in millions of dollars)

	-----Obligations-----					Cumulative Disbursements as of 9/1/83	
	<u>Total</u>	<u>FY 1980</u>	<u>FY 1981</u>	<u>FY 1982</u>	<u>FY 1983</u>		<u>FY 1984</u>
Elementary School							
Construction	\$18.0	\$18.0	\$ -	\$ -	\$ -	\$ -	\$18.0
Project Design	7.0	2.0	3.0	2.0	-	-	3.2
Clark Access and							
Feeder Roads	5.0	-	5.0	-	-	-	1.3
Municipal Development							
Fund	68.0	-	22.0	13.0	20.0		16.2
Regional Development							
Fund	55.0	-	-	20.0	15.0	^a 50.0	12.5
Philippine Markets	21.0	-	-	4.0	8.0		1.7
Rural Energy	26.0	-	-	11.0	7.0		4.0
Total	\$200.0	\$20.0	\$30.0	\$50.0	\$50.0	\$50.0	\$56.9

^aIn October 1983, AID notified the Congress of revisions in the fiscal year 1984 program. Prior to this revision, the planned program called for \$13 million for Municipal Development, \$20 million for Regional Development, \$9 million for Philippine Markets, and \$8 million for Rural Energy.

Political, economic and administrative concerns shape program composition

A variety of concerns shaped the decision to provide the aid through projects and defined the kind of projects funded. Key concerns included economic, political, and administrative issues.

Development goals shape composition

Understandings were reached between the Congress and executive branch that the program should, like Development Assistance, be oriented to addressing the basic human needs of the people. In addition, understandings reached with the GOP provided that a portion of the aid be targeted on the base areas. Project assistance was seen by AID as the most appropriate mode for achieving these dual objectives. Nonproject assistance is

generally used for balance-of-payments or budgetary support and is more difficult to focus on a particular geographic region.

Political concerns influence program

In addition to the understanding on the base areas, the political framework led to a concern with rapid disbursement of the aid and visibility of the assistance. Rapid disbursement of the aid was a concern for several reasons. First, the GOP perceived the aid as rent for the use of the bases, and as such that the funds should be transferred in the year for which they were obligated. Second, the United States was concerned that disbursement of the assistance provided under the 1979 Amendment would be an issue in the review of the agreement which began in 1983. The United States thus saw it as desirable that a significant portion of the \$200 million ESF package be disbursed by this time. Concern with disbursement of the ESF aid was accentuated by slow disbursement of the military aid portion of the compensation package. The \$500 million package included, in addition to ESF, \$50 million in grant military aid and \$250 million in Foreign Military Sales Credits. Because of the relatively high interest rates applying to Foreign Military Sales loans, and the critical balance-of-payments situation confronting the Philippines, these credits were being drawn down at a very slow rate.

The concern with rapid disbursements and implementation influenced the selection of projects. In particular, infrastructure construction projects as well as activities which could be implemented through GOP agencies familiar with AID procedures were emphasized.

Disbursements were also accelerated through the use of unusual cash disbursement procedures. Dollars are transferred annually to cover local currency (Philippine peso) obligations over the following year; the GOP obtains full use of the dollars and makes the local currency available as it is needed.³ Under normal procedures, dollar disbursements are made to fund project inputs as they are required, with 90-day advances applying, or are disbursed as agreed-on performance targets are achieved.

³ An AID Inspector General report (No. 2-492-82-12) on the School Construction and Project Design projects identified problems in financial procedures. As a result of the audit, the offices of the Inspector General, General Counsel, Controller and other AID management are reviewing the procedures. The key remaining issue concerns accountability procedures for use of local currency. Because of the attention directed to this issue, we did not attempt to assess disbursement procedures.

Visibility of the assistance was also a key concern. The United States viewed it as desirable that the Filipinos were aware of the economic benefits derived from continued U.S. use of the bases. Accordingly, activities which were physically visible such as schools and other physical infrastructure, were emphasized.

Administrative concerns influence program

An important consideration was the need to implement the program with a limited number of AID staff. Because of agency-wide staff reductions, staffing of the AID mission was being reduced, from 49 U.S. staff in fiscal year 1980 to 36 in fiscal year 1983. At the same time, the economic assistance program was growing through the addition of the ESF aid to a stabilizing DA level.

Additional administrative issues influencing program composition involved maintaining adequate control over the aid. The Congress was concerned that sufficient control be exercised so as to preclude diversion of the aid for unintended purposes. The desire to maximize AID control conflicted with GOP views that the assistance should not be subject to normal AID control, given that the assistance was intended, from a GOP perspective, as rent.

To balance these conflicting administrative concerns, arrangements were worked out with the MHS Secretariat and the "funds" approach was devised. Under the funds approach, broadly scoped projects--intended to finance specific types of subprojects--are identified and policies and procedures for design and implementation of the subprojects are defined. AID relies on the Secretariat for design and execution of the subprojects; AID does not approve nor does it monitor all subprojects. Each fund project defines criteria for AID approval. For example, under Municipal Development, only subprojects which exceed \$1 million or which do not appear on a pre-approved list, require AID approval. Those subprojects requiring AID approval will be directly monitored by AID while only a sample of other subprojects will be monitored. This arrangement relieves AID of many staff-intensive tasks within a framework which provides that the assistance be used for intended purposes.

While we recognize that the funds approach could be considered as an appropriate means to administer the program, given AID staffing constraints, we do not believe that it can be determined, without further implementation experience, whether GOP agencies can perform as expected. Until assumptions concerning GOP agencies' capabilities are proven valid, flexibility on AID mission staffing levels should be maintained.

PROBLEMS ENCOUNTERED IN
ESTABLISHING ESF PROGRAM

Considerable problems were encountered in developing the ESF program. Problems occurred, in part, because the 1978-79 negotiations did not address key program issues. The most troublesome issues proved to be (1) designation of a GOP counterpart agency to work with AID in developing the program and (2) agreement on the procedures governing implementation of the program including the amount of control AID should exercise over the funds. Problems also arose as a result of conflicting directions from AID headquarters and difficulties in defining base area activities.

Key issues not addressed
in 1978/79 negotiations

During the negotiations that led to the first 5-year package of ESF aid in 1979, although comparisons were drawn between the grant Military Assistance Program and ESF, similarities and differences between ESF and DA were not discussed in detail. As a result, some GOP officials came away with the perception that the aid would be provided as a lump sum available for GOP programming.

AID officials attribute GOP misperceptions of ESF in part to a lack of clear understanding within the U.S. negotiating team as to how ESF operates. In a January 1983 memorandum to the Ambassador, the AID Mission Director stated that ". . . ESF was added as a late comer to the compensation package, and guidance given to Ambassador Murphy by Washington regarding how the ESF program would operate was inaccurate and could have contributed to the misunderstandings on this issue." AID officials blame the absence of AID involvement in the negotiations for these misunderstandings.

The first implementation problem arose almost immediately. Agreement could not be reached within the Philippine Government as to which agency should be accorded responsibility for programming the ESF aid. Designation of a counterpart agency to work with AID in identifying and designing prospective activities took nearly a year and a half, from January 1979 until May 1980, a loss of time that proved costly in the design of project activities.

There was considerable competition among Filipino agencies for control of ESF programming. The National Economic and Development Authority (NEDA), AID's traditional counterpart agency responsible for coordinating the DA program, was initially presumed by AID to be the lead agency. The Armed Forces of the Philippines also held a strong interest; the military's interest in ESF stemmed from ESF's link to the Military Bases

Agreement as well as the U.S. and Philippine presumption, at that time, that ESF aid would be used to develop the military-controlled reverted lands. The Ministry of Agriculture also competed for control since the anticipated development of the reverted lands would be largely agricultural. The Ministry of Human Settlements, which viewed itself as the lead Philippine Government development agency, also sought control of the ESF aid.

MHS was the eventual winner of the internal struggle over control of the ESF. The Management Advisory Committee, comprised of the ministers of eight GOP agencies and chaired by the Minister of Human Settlements, was established and assigned responsibility for programming ESF monies. MHS was designated as the Secretariat to the Advisory Committee. The Committee, which meets quarterly, advises the President on the allocation and utilization of ESF; authority for approving ESF-funded activities rests with the President.

AID control challenged

Signing the first project agreements sparked debate over whether ESF projects were subject to the same procedures, and thus AID control, as DA projects. While the GOP accepted that ESF be used for mutually agreed on projects, GOP officials argued that the projects should not be subject to AID's standard procedures, including AID procurement regulations and approval of contracts. They contended that, while DA was grant assistance, and thus subject to the aid donor's conditions on its uses, ESF was perceived by the GOP as rent for use of the military bases.

Although this difference in approach has never been fully resolved, several factors contributed to defusing the situation. First, it was recognized by some GOP officials, that only limited modification in the procedures governing DA was feasible since significant changes could jeopardize congressional support for the program. Second, the United States agreed to modify the cash disbursement procedures applying to the projects. GOP officials requested that the money be disbursed more rapidly than normally since the GOP had already incurred expenses in operating the military bases. The timely provision of foreign exchange was also seen as easing the foreign exchange shortage facing the Philippines. Therefore, with the dollars transferred in advance, the GOP saw itself gaining full control over the dollars with AID controls applying only to the use of local currency.

Subsequently, two other factors contributed to easing of the controversy. In accepting AID procedures, MHS's control over the program was also increased. Moreover, the "funds" approach, in which significant responsibility is given to the GOP, was adopted for programming the bulk of the ESF aid. While

motivated primarily by the need to manage the program with less AID staff, the funds approach resulted in a reduced AID role and greater GOP responsibility for day-to-day management of the program.

Conflicting directions
from AID headquarters

Conflicting directions from AID headquarters also added to problems in establishing the program. Shifts in position occurred concerning the desirability of nonproject aid and concerning the acceptability of projects focused on local government development.

While DA is normally provided through projects, it is not uncommon for ESF to be provided through nonproject modes. Nonproject modes include cash transfers, commodity import programs and sector assistance.

In March 1978, the AID mission proposed that ESF aid be provided through a commodity import program. The proposal was rejected by AID headquarters and the exploration of project possibilities proceeded.

By March 1981, the AID mission, in cooperation with the Philippine Government, had agreed on several tentative projects for fiscal year 1981 funding which met with AID headquarters guidelines that ESF be focused on meeting the basic needs of the people. Project proposals for two funds, Municipal Development and Clark Area Development, were submitted to AID headquarters for review.

AID headquarters reacted to the proposals by recommending consideration of a nonproject approach, in preference to the proposed funds approach or a traditional project approach. The nonproject approach recommended was a cash transfer to support increased budget expenditures for development programs, including those oriented to the needs of people around the bases. Such an approach was favored because it would relieve the AID mission of the significant management burden inherent in a project approach and would permit prompt disbursement of the aid.

The AID mission opposed adoption of a nonproject approach. They argued that this approach, by eliminating AID influence on design and implementation, would have the significant long-term effect of reducing AID influence on overall economic development efforts in the Philippines.

The current "funds" approach was subsequently agreed on for fiscal year 1981 although consideration of a nonproject approach for fiscal years 1982 to 1984 continued for some time.

When the proposal for the Regional Development Fund was submitted to AID headquarters for review in 1982, it also encountered resistance. Concern was expressed that: (1) the project was in large degree a resource transfer; (2) the project did not address current AID priorities in private sector, technology transfer, institution building, or energy development; and (3) the project represented a further involvement with regional government planning agencies. Development of such local government agencies, while not a current priority, was an AID priority during most of the 1970s. The project was eventually approved because it provided some development benefits, met requirements stemming from the bases agreement, and could be readied for obligation of funds before the end of the fiscal year.

The inconsistency in directions from AID headquarters reflects, in part, the absence of an approved Country Development Strategy Statement (CDSS) covering ESF. Most ESF and DA programs are governed by a CDSS, prepared periodically and updated annually, which defines AID objectives and priorities in a country and provides the framework for selecting specific activities for funding. The Philippines CDSS covers only the DA program.

Difficulties arise in defining base area programs

Development of the program was also complicated by difficulties in defining the extent to which the ESF would be used to develop the reverted lands. Initially it was thought that such development would be a primary focus of the program. In 1979 a GOP inter-ministerial committee had been established to identify potential activities. Funds had been allocated for this purpose in fiscal year 1981 and again in 1982, and a proposal for a Clark Area Development Fund was submitted to AID headquarters. In 1982 it was finally recognized that a major development effort was not feasible in the near term. The Philippine military was not prepared to identify which lands could be released for civilian uses and no single Philippine agency had been given clear authority for development of the reverted lands.

Timeframe for program development compressed

As a result of these problems, the time available for program development was reduced. An indication that planning lagged behind normal schedules is that programs proposed in the Congressional Presentations for fiscal years 1980, 1981, and 1982 deviated significantly from programs actually funded. Compressing time for program design is undesirable; AID's handbook on Project Assistance highlights the importance of good project design to timely and effective project implementation, stating

that, "A completed project design is usually a blueprint for transforming a concept into reality . . . The thoroughness with which the blueprint is prepared will determine, in large measure, the speed and ease with which a project can be executed and its success in achieving the stated objectives."

KEY PROGRAM PARAMETERS NEED TO
BE AGREED ON TO AVOID REPETITION
OF IMPLEMENTATION PROBLEMS

Implementation of the 1980 to 1984 ESF program was adversely affected by failure to obtain agreement at the outset on key program parameters. To avoid a repetition of such problems, agreement should be reached, as early as practicable, on (1) the purposes and uses of the aid; (2) the mode of ESF funding, that is, whether the aid should be provided through projects, some form of nonproject aid, or through a combination of project and nonproject aid; and (3) the lead GOP agency or agencies for programming the aid.

Clarification of the purposes
and uses of the aid desirable

A key issue, never fully resolved under the current program, concerns the purposes and uses of the ESF. Agreement as to whether the primary purpose of the aid is to support the long-term development of the Philippines, or to provide rent, influences program composition. A second key issue in deciding the uses of ESF is the extent to which the ESF should be focused on the base areas.

The United States and the GOP have differed in their perceptions of the basic purposes of the assistance. While the United States views the aid as additional resources to support Philippine development, GOP officials view it as rent for the bases. Clearly placing the program in the context of supporting long-term development is viewed as desirable by AID because it would provide the basis for increasing the development impact of the aid.

Differences exist in the development objectives emphasized under the Philippine ESF and DA programs. The DA program is, according to AID, primarily concerned with developing innovative approaches to key problems; because of the desire for rapid disbursements and visibility, less opportunities exist for such high risk, experimental programs under ESF. The ESF and DA programs are also distinguished by their emphasis on institution building. Although institution building is not absent from the ESF program, ESF projects tend to utilize the institutional capacity built under prior DA-financed programs. Institutions experienced in working with AID are also emphasized in order to facilitate rapid implementation and disbursement of the aid. In

contrast, expanding the institutional capabilities of public and private organizations is a key component of the DA program. The DA program also places greater emphasis than ESF on poverty alleviation through its focus on poorer population groups and regions; the CDSS strategy is one of poverty alleviation through employment generation. Poverty alleviation concerns also receive considerable attention in the design and implementation of some DA projects, a focus not generally found in the ESF projects.

Maximizing the development impact of the aid is also seen by AID and State as reinforcing security objectives, given the interrelationship between economic development, political stability and security.

The potential for using ESF to support CDSS objectives influences the desirability of continuing the DA program beyond fiscal year 1984.

Although understandings reached in negotiating the 1979 agreement provided that the DA level would not decrease--since ESF was not intended to substitute for DA--a similar understanding was not reached in the 1983 negotiations. It was decided that DA should be kept separate from the security assistance package and evaluated on its own merits.

Base areas focus

Defining the uses of ESF aid also includes deciding the extent to which the aid will be focused on the base areas. The 1983 agreement provided that suitable projects be promoted in the areas surrounding the bases and in the returned base lands.

Some view the base areas as having limited capacity to effectively absorb increased aid since the current program directs substantial resources to these areas. Moreover, efforts to develop the returned base lands still depend on resolution of the issues which precluded significant investment of funds under the current program.

On the other hand, reducing the sharp economic disparities between the bases and the surrounding areas remains a GOP priority. Continued emphasis on the base areas raises other issues in that Region III, the region including Clark Air Base and Subic Bay Naval Base, ranks higher on socio-economic indicators than all other regions except Metro Manila.

Several options exist for structuring ESF programs

After extensive discussions between AID headquarters and the AID mission, the ESF aid is currently being provided exclusively through project assistance. However, a full range of options exist for structuring the assistance called for under the June 1983 agreement. Options include continuing the current approach of DA-type projects, initiating projects meeting different criteria, adopting a form of nonproject aid, or using a combination of these options.⁴ The advantages and disadvantages of these options are discussed on the following pages.

Project aid

Project assistance is viewed as the vehicle for achieving an identifiable, long-range change in the condition of a target population. Objectives served by current projects include expanding access to and the quality of social and economic infrastructure such as schools, roads, water systems, and public markets. Projects also seek to improve the institutional capacity of government units serving the rural population, particularly people in the base areas.

Project aid offers several advantages. Projects provide the greatest visibility and can be targeted on a particular geographic region. They also provide a high degree of control over the aid and thus protection against diversion of resources for unintended purposes.

In addition, project assistance is traditionally viewed, according to an AID mission discussion paper on programming options, as having the broadest development impact. Achievements of an AID program using a project approach have been recognized by U.S. officials. One official view states that:

"the U.S. economic assistance relationship with the Philippines has been unique in its longevity and notable in its impact on the country's basic economic and development policies * * * These include * * * land reform, rural electrification, population planning, nutrition and strengthening local government administration * * * Our influence at the margin is both substantial and critical to many new activities in areas such as rural development in the uplands, private sector

⁴ The various forms of ESF aid are discussed in our report to the Chairman, House Committee on Foreign Affairs, Political and Economic Factors Influencing Economic Support Fund Programs (GAO/ID-83-43, Apr. 18, 1983).

development, local resources management, rural employment, and energy development."

A significant disadvantage of project aid is that normally, it is the slowest disbursing mode of assistance. However, innovative structuring of the program may accelerate disbursements, particularly the disbursement of the foreign exchange. Under the current program, foreign exchange intended to finance local currency costs is disbursed annually, rather than as expenses accrue, to cover anticipated expenditures over the following year.

Further acceleration of disbursements is possible, according to internal AID documents, if the foreign exchange were disbursed at the outset of the program. Requiring certain conditions to be met prior to disbursement--such as GOP appropriation of funds or deposit of local currency in a special account--would assure the availability of local currency needs.

The rate of disbursements may also be influenced by whether funds are obligated at the outset to meet life-of-project costs or are obligated to cover anticipated expenditures for the next one to two years. Funding of life-of-project costs is the preferred AID practice since, normally, future years funding is unknown.

More rapidly disbursing projects may also be emphasized but, as discussed above, may bias the development impact of the program.

The staff intensity of project aid is also a disadvantage. Projects normally require intensive AID involvement in design and implementation. Nonproject modes are generally less staff-intensive, with cash transfers requiring the least AID staff support.

Staffing considerations have been a crucial, if not deciding, factor behind AID support for providing a portion of ESF aid to the Philippines in nonproject form. Nevertheless, senior AID mission officials told us that the mission could manage, with current staff, a substantially larger project portfolio--perhaps double the \$50 million a year now provided--because (1) arrangements with MHS provide for a reduced AID role in subproject design and implementation and (2) the number of DA projects is declining. These officials pointed out, however, that their ability to manage a larger portfolio depends on the kinds of projects financed. DA-type projects focused on addressing basic needs tend to be more staff-intensive than large capital development projects such as highway construction.

Cash transfers and commodity imports used for balance-of-payments and budget support

Cash transfers and commodity import programs are used to provide balance-of-payments support. The infusion of resources moderates the reduction in economic growth resulting from a financial crisis, thus offering protection against the political instability which an economic crisis invites. While all assistance has a balance-of-payments impact when the aid is disbursed, cash transfers and commodity import programs have an immediate impact since the aid is usually disbursed within one or two years.

The Philippines currently faces a critical balance-of-payments situation. The situation stems from the oil price increases of 1979 and the decline in the prices of its principal commodity exports. In February 1983, an economic adjustment program was agreed to with the International Monetary Fund. While the trade deficit was expected to improve markedly by 1985, continued demand for external financing was anticipated to finance the trade deficit and repayments on outstanding debt.

Various agencies have taken different positions as to whether balance-of-payments support should be a priority for the ESF program. According to one May 1983 expert analysis:

"Although the Philippine balance-of-payments situation will prompt a strong demand for foreign loans, such external disequilibrium does not constitute a tenable argument for large amounts of U.S. concessional balance-of-payment assistance. With a per capita income of about \$800, reasonably good economic management, and access to substantial amounts of both private capital and non-U.S. official assistance . . . there is little economic justification for this type of assistance. On the other hand, the Philippines' capacity to usefully employ U.S. project assistance is relatively high * * *."

AID officials disagreed with this analysis. They argued that a balance-of-payments deficit adversely affects development assistance activities and acts as a significant constraint on development. They also argued that this analysis was overly optimistic in its statement on Philippines access to other financing sources.

Further deterioration in the financial situation occurred after the August 1983 assassination of Philippine opposition leader Benigno Aquino. The political uncertainty which followed the assassination prompted creditors to reduce lending to the

Philippines and accelerated capital flight. In response, in October 1983, the GOP declared a moratorium on repayment of external debt and implemented austerity measures which included import restrictions, budget reductions, and domestic credit limitations. A new stabilization program is currently being negotiated with the International Monetary Fund. Moreover, the U.S. Government, other official (governmental) lenders, and commercial creditors have entered into negotiations with the GOP to reschedule outstanding debt.

Cash transfer for budget support purposes is another option. Provision of foreign exchange permits non-inflationary increases in domestic budget expenditures when, for example, the government sells the foreign exchange to importers in return for local currency. The local currency may be applied to a specific program, used to increase or maintain budget expenditures for certain categories such as agriculture or education, simply attributed to budget items in order to associate the aid with acceptable activities, or uses may not be specified at all. Because of the fungibility of cash, it is difficult to establish what items would have received funding in the absence of the aid.

The current economic situation has constrained Philippine spending on development activities. Belt-tightening measures have affected implementation of DA-financed programs where a minimum of 25 percent non-AID financing is required.

Local currency may be generated under both commodity import programs and cash transfers. The availability of local currency which can be applied to activities mutually agreed on by AID and the GOP is seen as advantageous; local currency could be applied to meeting GOP contributions to DA-funded projects, thus insulating these projects from the effects of budgetary restrictions.

Cash transfers and commodity imports are, as a rule, faster disbursing than project aid. Because commodity import programs require the identification, procurement, and delivery of needed commodities, they tend to disburse more slowly than cash transfers.

Other advantages are associated with these modes of ESF aid. Nonproject aid is normally less staff-intensive than project aid with cash transfers generally requiring less staff to administer than commodity import programs. An additional advantage of commodity import programs is the control offered--the aid is directly linked to the procurement of specific commodities.

Sector assistance

Sector assistance has received increased attention within AID because it is seen as a potential vehicle for improving the

development impact of nonproject aid. Under sector assistance, cash transfer or commodity import financing is provided in support of a specific, defined program addressing a key development problem. Such programs are based on detailed analysis of constraints on sector productivity. Local currency may be programmed, particularly when budget shortfalls are a primary constraint on sector development. Such assistance is appropriate when the recipient government has the institutional capability to carry out the agreed program.

Potential also exists for concentrating sector assistance or budget support on a region by financing increased budget allocations for the region or a region-specific problem. Sector assistance can also be structured to disburse rapidly.

Designation of lead Filipino agency critical

Delays over the designation of a lead Filipino agency to work with AID in programming ESF monies affected implementation of the current program. While largely a GOP decision, early resolution of this issue is seen as critical.

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