United States General Accounting Office

GAO

Report to the Chairman, Subcommittee on Europe and the Middle East, Committee on Foreign Affairs, House of Representatives

January 1987

FOREIGN AID

Potential for Diversion of Economic Support Funds to Unauthorized Use

037915

GAO/NSIAD-87-70

GAO

United States General Accounting Office Washington, D.C. 20548

National Security and International Affairs Division

B-225870

January 14, 1987

The Honorable Lee H. Hamilton
Chairman, Subcommittee on Europe
and the Middle East
Committee on Foreign Affairs
House of Representatives

Dear Mr. Chairman:

In response to your September 16, 1986 letter, we have reviewed Economic Support Fund (ESF) programs. Specifically, you asked us to determine whether any of these funds had been diverted to military use and whether controls placed over these programs leave open the possibility for diversions to unauthorized purposes, including military use.

To meet your requested reporting date, we confined our work to reviewing control mechanisms contained in Agency for International Development (AID) handbooks, program documents, and grant agreements for programs funded from fiscal year 1986 ESF appropriations. We discussed control features with AID officials in Washington but did not conduct any fieldwork to test AID's implementation of the controls. We intend to incorporate such testing into our continuing work on controls and accountability over foreign aid programs in selected countries during 1987.

This letter briefly summarizes our findings. Appendix I provides background on the ESF program, summarizes responses to our inquiries on diversion of ESF for military purposes, and discusses the potential for diversion. Appendix II describes controls over the various types of ESF. Appendix III shows fiscal year 1986 ESF country allocations by type of program.

Growth of the ESF Program

ESF is a flexible type of economic assistance which can be given under diverse circumstances to support U.S. economic, political, and security goals. It can be provided as project assistance, as a commodity import program, as a cash transfer[1] for general budget or balance-of-payments support, or as a combination of these forms. About 65 percent of the dollar value of the 1986 program consisted of cash transfers.

[1] A cash transfer is a direct transfer of resources—usually in U.S. dollars—to the recipient's bank account where they become part of the country's overall foreign exchange holdings.

ESF has grown dramatically in relation to the two other major foreign economic assistance programs, development assistance and food aid. ESF increased from about $2.2 billion to about $3.7 billion between fiscal years 1981 and 1986 and is now the largest of the major economic assistance programs, representing about half of the total. The number of country recipients has increased from 20 to 49 over this same time period. About $1.9 billion—over 50 percent of all fiscal year 1986 ESF resources—was provided to Egypt and Israel. (See pp. 7 to 8 and app. III.)

Possible Diversion of ESF to Military Use

Section 531(e) of the Foreign Assistance Act specifically prohibits the use of ESF for military or paramilitary purposes. To obtain information on possible diversion of funds to military use in recent years, we requested U.S. officials in ESF recipient countries and AID's Office of the Inspector General to report any known diversions of ESF to military use during the last 3 fiscal years. We also reviewed recent GAO reports dealing with ESF programs to identify any such diversions.

AID's Office of the Inspector General was the only office to identify a possible diversion. That office told us that jeeps imported by Somalia in 1984 under a commodity import program had later been resold by a private concern to the military. AID lawyers are questioning whether this constitutes an actual diversion since there was no evidence that the original importer intended the vehicles to be used by the military. The case is currently under review. (See pp. 10 to 13.)

U.S. officials gave a variety of explanations as to why they believe that ESF funds are not being diverted to military use. These included control provisions in grant agreements; payment verification procedures; program audits and evaluations; AID review of recipient government reports; and AID monitoring of project sites, commodity distribution, and local currency accounts. (See pp. 10 to 11.)

Potential for Diversion

Although we identified only one recent case of a possible diversion of ESF funds, based on our past and ongoing audit work and that of AID's Office of the Inspector General, there is potential for such diversions. The following factors contribute to the program's potential vulnerability.

- Many cash transfers have been commingled with other recipient government revenues, which has made a specific accounting for some of these resources impossible.
- Providing dollar assistance frees up other resources to be used as the recipient chooses. The extent to which a country could use these other resources for other purposes, including military expenses, depends on many factors including its political stability, economic well-being, and the military assistance it receives compared to its defense requirements.
- AID operates in an environment which makes the funds it administers vulnerable to misuse without detection. It must rely on recordkeeping by recipient country institutions beset by administrative weaknesses and must monitor projects and commodities at remote locations and large numbers of sites.
- Weaknesses exist in AID's implementation of the controls it has placed over economic assistance programs, including ESF, and in the recipients' compliance with agreed upon controls. (See pp. 13 to 16.)

We note that new legislation requires that, after February 1, 1987, any country receiving cash transfers totaling over $5 million must maintain the funds in separate accounts. Whether this improves accountability over these resources depends on how AID implements this new requirement.

Controls Over ESF Programs

Appendix II summarizes controls over the three types of ESF programs. ESF-funded projects and commodity import programs are controlled in a fairly standard manner; however, controls over cash transfer programs vary widely from country to country according to individual country needs and U.S. objectives. Some large programs, including those in Israel, Egypt, and Turkey, which are based on political and security considerations, have few associated controls.

AID has not usually required an accounting for dollars transferred under cash transfer programs, however, AID has frequently specified uses for recipient-owned foreign exchange and/or local currencies equal to the cash transfers. Some AID officials believe that this system of accountability over equal amounts of resources compensates for the lack of controls over the dollars transferred. (See pp. 17 to 24.)

As agreed with your office, we did not obtain formal agency comments. However, AID officials provided informal comments on the draft report, and we have incorporated their suggestions where appropriate. These officials felt that since we identified only one possible diversion of ESF to military use, the systems in place must afford an acceptable level of control. However, as our report points out, we believe diversions without detection are possible, particularly since past audits have noted weaknesses in AID control systems.

Over the last year we have examined controls over U.S. economic and security assistance programs and have tested compliance with these controls in the Philippines, Liberia, and Indonesia. During 1987 we intend to review AID's implementation of key controls over the major economic assistance programs in other selected countries. We are also reviewing controls over commercial military sales financed by the Foreign Military Sales program.

The results of these reviews should provide more information on the questions which have been raised concerning the accountability and control over U.S. foreign assistance.

Sincerely yours,

Frank C Conahan

Frank C. Conahan
Assistant Comptroller General

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Abbreviations

AID	Agency for International Development
CIP	Commodity Import Program
ESF	Economic Support Fund
GAO	General Accounting Office

The Potential for Diversion of Economic Support Funds to Military Use

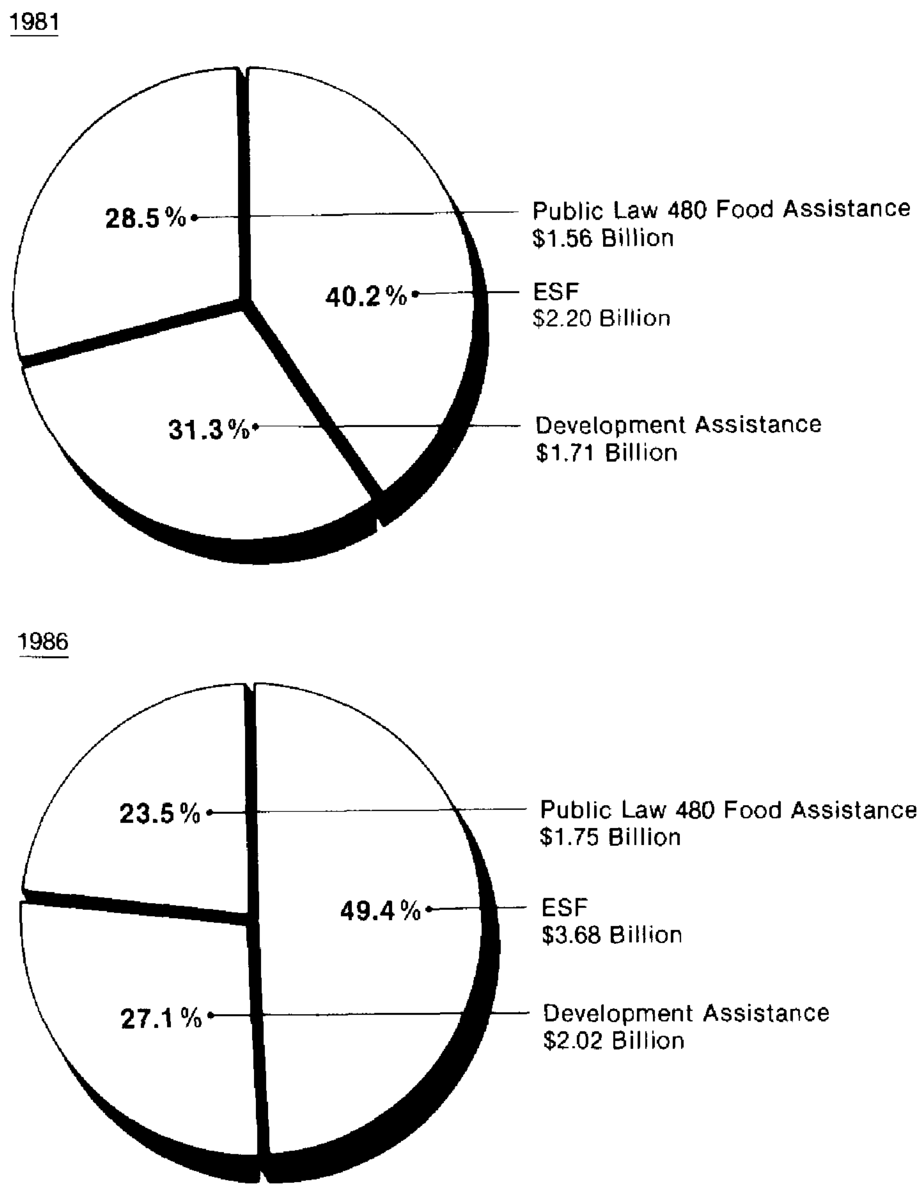
Growth of the Economic Support Fund (ESF) Program

The ESF program is a flexible type of economic assistance which can be given under diverse circumstances to support U.S. economic, political, and security goals. It has been used to enhance prospects for peace in the Middle East, seek economic reforms important to longer term development in Central America and Africa, promote economic stabilization through budget and balance-of-payments support in Latin America, and assist countries where the United States maintains military bases.

The ESF program has grown dramatically over the last 5 years in relation to the other two major forms of economic assistance, as shown in figure I.1. While development assistance and Public Law 480 food assistance programs grew modestly, the ESF program grew from about $2.2 billion to about $3.7 billion and the number of recipients grew from 20 to 49 between fiscal years 1981 and 1986. About $1.9 billion—over 50 percent of all fiscal year 1986 ESF resources[1]—was provided to Egypt and Israel.

[1] Includes all fiscal year 1986 appropriations but does not include funds deobligated from prior year appropriations and reobligated to programs in 1986.

Figure I.1: Funding for Major U.S. Foreign Economic Assistance Programs (Fiscal Years 1981 and 1986)

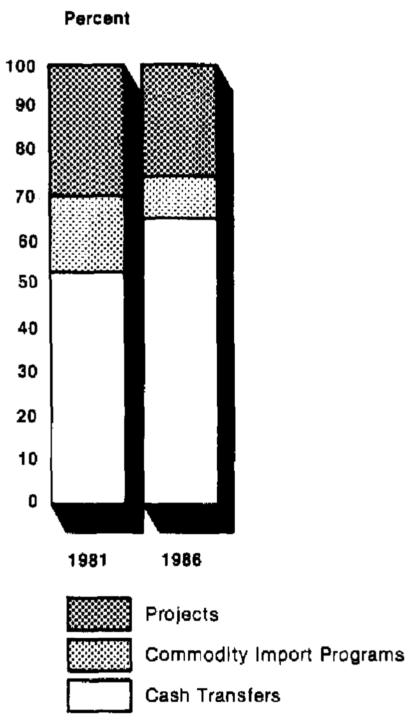


ESF assistance can be given as project assistance similar to development assistance, as a commodity import program (CIP) or special procurement activity[2], as a cash transfer for budget or balance-of-payments support,

[2]Under a CIP, AID agrees to finance certain categories of commodities to meet specific objectives, such as balance of payments. A special procurement activity is a type of CIP which is typically directed at a specific development activity and is of limited duration.

or any combination of these forms. Cash transfers involve a direct transfer of resources—usually in U.S. dollars—to the recipient's bank account, where they become part of the country's overall foreign exchange holdings. Such transfers have been the fastest growing component of the program due to deteriorating international economic conditions which have had a negative impact on countries' access to foreign exchange for essential imports and for repayment of debts. According to AID, cash transfers are attractive due to their fast disbursing nature, immediate effect on the recipient's economy, and greater leverage in encouraging policy reform as well as their less cumbersome administration. As shown in figure I.2, about 65 percent of the fiscal year 1986 ESF program was disbursed as cash transfers.

Figure I.2: ESF Funding by Program Type (Fiscal Years 1981 and 1986)



Objectives, Scope, and Methodology

At the request of the Chairman, Subcommittee on Europe and the Middle East, House Committee on Foreign Affairs, we conducted a limited review of ESF programs. Our objectives were to (1) determine whether there had been any documented cases of these funds being diverted to military use during the last 3 fiscal years; and (2) provide an assessment on the extent to which Agency for International Development (AID) controls over programs funded from fiscal year 1986 appropriations offer the potential for such diversions.

Throughout this report we use the term controls to refer to those internal control mechanisms which AID uses to ensure that funds are used as intended. These mechanisms include: (1) grant provisions requiring the recipient to use, administer, and account for its grant in specified ways, and (2) AID procedures for verifying compliance with grant provisions, approving expenditures, monitoring the use of funds, maintaining accountability over assets, and auditing and evaluating programs.

To determine whether there had been any documented cases of ESF funds being diverted to military use during the last 3 fiscal years, we reviewed past GAO reports and responses to written inquiries of U.S. officials in ESF recipient countries and AID's Office of the Inspector General.

To identify controls over ESF programs, we reviewed AID handbook guidance, ESF program approval documents, and bilateral grant agreements for programs funded from fiscal year 1986 appropriations. We also discussed control features of the programs with AID officials in Washington. (See app. II.)

We did not conduct any fieldwork to test AID's implementation of controls included in ESF grant agreements. Accordingly, our views on the potential for ESF diversions are based on previously identified weaknesses in AID's control systems for economic assistance programs, including ESF. We intend to test implementation of key controls over major economic assistance programs in selected countries during 1987.

AID officials provided informal comments on a draft of this report. We have incorporated their suggestions where appropriate. These officials generally believe that since we identified only one instance of ESF being diverted to military use, the systems in place must afford an acceptable level of control. As pointed out in the report, we believe the environment in which AID operates makes foreign assistance vulnerable to diversion and that such diversions could take place without detection. We believe this possibility is heightened by the fact that past audits have noted weaknesses in AID control systems.

We conducted our review from September through December 1986 in accordance with generally accepted government auditing standards.

Possible Diversion of ESF to Military Use

Section 531(e) of the Foreign Assistance Act specifically prohibits the use of ESF for military or paramilitary activities. In attempting to identify whether any of these funds were actually diverted to military use, we

- requested U.S. officials in ESF recipient countries to report to us any known diversions of ESF to military use during the last 3 fiscal years;
- requested AID's Office of the Inspector General to report to us any such diversions noted in its audits, inspections, and investigations during this same period; and
- reviewed recent GAO reports dealing with ESF programs to identify any such diversions.

U.S. Officials Reported No Specific Diversions of ESF

At our request, AID made inquiries of U.S. officials responsible for 52 bilateral and several regional ESF programs funded from fiscal year 1984, 1985, or 1986 appropriations[3]. We asked these officials to (1) identify and describe any instances of ESF being diverted to military use over the 3-year period and (2) explain how the controls on ESF-funded activities provided assurance that ESF would not be used for military activities.

We received responses to all of our inquiries. AID officials in Washington, rather than officials overseas, provided responses related to the regional programs and the programs in El Salvador[4] and Israel. None of these officials knew of any instances of ESF being diverted to military use during the 3-year period.

The officials provided the following explanations as to why they believed they had assurance that ESF funds were not being diverted to military use.

[3]The only programs not covered were 2 regional programs which financed only local support costs, a centrally-funded program administered by AID's Bureau for Science and Technology, and a new program for Ireland which will go into an international fund.

[4]According to an AID spokesman, officials in El Salvador did not respond directly due to a communications breakdown arising from the earthquake in October 1986.

- The recipient had agreed in the grant agreement or related documentation not to use the funds for military purposes.
- All the funds financed projects which had nothing to do with military activities.
- AID staff defined expenditures during the project development process to preclude the possibility of diversion.
- AID paid contractors directly for most project expenses, and AID staff verified that all vouchers were paid for legitimate claims through the agency's normal payment verification procedures.
- AID staff participated in programming the uses of local currency generated from dollar cash transfers and CIPs to ensure its use for economic or development purposes.
- AID staff reviewed host government or contractor documentation and reports required to be submitted on ESF-related resources.
- Special local currency accounts allowed AID staff to monitor deposits and expenditures.
- Latin American and Caribbean recipients attributed imports to an amount of foreign exchange equal to the dollar transfers and reported these imports to AID.
- AID staff, auditors, and other private evaluators monitored project activities and CIPs through site visits, audits, or review of records.
- In El Salvador, legislation requires a separate account for cash transfers. AID officials in Washington said the separate account allows the dollars to be tracked.

In addition to the above explanations, several AID officials said that they could deduce that funds were not diverted to military use because military expenses were financed from other assistance programs, implementation of required policy reforms were so costly that the country would be obliged to spend ESF resources to implement them, or ESF assistance was small compared with the country's balance-of-payments needs.

Possible Diversion Reported by the AID Inspector General

AID's Office of the Inspector General reviewed its audit and investigation work on ESF programs for the last 3 years and reported that it was aware of only one possible diversion. In 1984 a trading company in Somalia imported jeeps under a CIP and sold 23 of them to a buyer who later resold them to the military. In the draft report, the Inspector General noted the prohibition against using ESF for military use and recommended that AID either get the jeeps back or obtain a refund for their cost.

AID officials who responded to the report took the position that the mission should not have to obtain the jeeps' return. They cited an AID handbook provision that said that AID may finance common-use items that ultimately end up with the military if at the time of the sale there is no evidence that the items are destined for military use. AID legal staff are currently reviewing this case, and the draft report which described this incident has not been issued.

Although the Office of the Inspector General reported only this one instance of a possible diversion, that office has reported control weaknesses in several local currency programs under ESF during the last 3 years. In Latin America and the Caribbean, AID auditors found instances of recipient governments failing to promptly deposit the proper amount of local currencies into special accounts, to adequately document import transactions attributed to cash transfer dollars, and to submit required reports. One country had not fully reimbursed the special account 1-1/2 years after funds were found to have been spent for unauthorized purposes. The auditors also found that, in some instances, AID had not conducted financial reviews of local currency projects due to insufficient staff, was not verifying the receipt of required reports, and was not providing enough technical assistance to the recipient governments to implement these programs.

No Diversions Reported by GAO

We have not reported any specific instances of ESF being diverted to military use over the last 5 years. However, several reports on ESF assistance identified control weaknesses which could permit such diversions. For example, during our reviews of U.S. assistance to Central America and the Philippines, we noted that some cash transfers were being deposited directly into recipient bank accounts, where they were commingled with funds from other sources; U.S. dollars then lost their identity and could not be associated with specific government purchases. To improve accountability, Congress subsequently passed legislation requiring that a separate account be established for cash transfers to El Salvador beginning in fiscal year 1985. New legislation passed in 1986 requires that, after February 1, 1987, all countries receiving cash transfers totaling over $5 million must deposit them into separate accounts. At the time of our review, AID officials were working on procedures to implement this new requirement.

Our 1984 report on AID's Commodity Import Program noted inadequacies involving required documentation, price-checking, local currency accounts, follow-up on the distribution and end use of imported commodities, and overall evaluation of this program. Although some program improvements have been made, AID officials told us that management of local currency programs continues to be a problem for AID.

Potential for ESF Diversions

We did not conduct any field work on this assignment which would have enabled us to test whether controls over ESF programs are being implemented and, if implemented, whether they afford AID adequate assurance that funds are being used for the intended purposes. Although we identified only one recent possible diversion of ESF funds, there is potential for such diversions. The following factors contribute to the program's potential vulnerability.

- Many cash transfers have been commingled with other recipient government revenues, which has made a specific accounting for some of these resources impossible.
- Provision of dollar assistance frees up resources which can be used for other purposes. A variety of factors influence whether a country could and/or would use such resources for military purposes.
- The environments in which AID operates make diversion without detection possible.
- Weaknesses exist in AID's control systems over economic assistance programs, including ESF, and in the recipients' compliance with agreed upon controls.

Lack of Accounting for Past Cash Transfers

As previously mentioned, about 65 percent of the fiscal year 1986 ESF program was provided as cash transfers. Because many cash transfers have been commingled with other recipient government resources, tracking these dollars to their specific use has not been possible. Although AID has not provided controls over the use of U.S. dollars for some programs, it has tried to maintain accountability over these programs by requiring that the recipient governments use equal amounts of foreign exchange for specified purposes; requiring equal amounts of local currency to be spent for development activities and then monitoring these activities; and/or conditioning assistance on policy reforms essential to longer term development. Although some AID officials believe this system of accountability compensates somewhat for the lack of controls over the dollars, these officials also concede that the agency continues to be concerned with how to manage local currency accounts as well as how to enforce conditionality. Our audit work over the past 3 years has noted continuing difficulties in these two areas.

The new legislative requirement for separate accounts for cash transfers over $5 million is intended to address this issue. At the time of our review AID was developing the procedures to implement this requirement. Some AID officials are concerned as to how much control the agency can or should place over programs for some recipients, especially those receiving cash transfers where no such accounting has previously been required.

ESF Assistance Frees Up Recipient Resources for Other Purposes

Providing dollar assistance frees up an equivalent amount of foreign exchange which can then be used as the recipient chooses. Requiring a detailed accounting of U.S. assistance dollars can ensure that these dollars have not been misused; however, this cannot provide assurances about the way the recipient uses its "freed-up" foreign exchange.

The degree to which a country is in a position to use "freed-up" resources for other purposes, including military uses, varies from country to country and is influenced by a variety of factors. These include the country's political stability, extent of its economic well-being, and level of military assistance it receives in relation to its defense requirements. As previously mentioned, AID officials in some countries believe that they can deduce that funds are not diverted by analyzing these factors.

AID officials pointed out that section 620(s) of the Foreign Assistance Act of 1961, as amended, requires the President to take a country's defense expenditures into account before furnishing foreign assistance to ensure that resources intended for economic development are not diverted to military purposes. In implementing this requirement, AID annually prepares a report to the Congress on defense expenditures of ESF recipients.[5] Although these reports have shown that some ESF recipients have relatively high defense expenditures, an AID official said that no country's ESF allotment had been reduced based on the findings of this process.

[5]For example, see Implementation of Section 620(s) of the Foreign Assistance Act of 1961, as Amended, A Report to the Congress, Dec. 1985.

Vulnerability of Foreign AID to Diversion

AID operates in an environment which makes the funds it administers quite vulnerable to misuse without detection. Often, AID must rely on recipient government institutions beset by weaknesses especially in the administrative and financial management areas. With limited staff and resources, AID often is not able to devote as much technical assistance as is needed to overcome these weaknesses. Project monitoring and end-use checking is often complicated by remote project locations, logistical problems, and, for commodity programs, large numbers of distribution sites. These well-recognized constraints emphasize the vulnerability of most types of U.S. assistance, including ESF, and underscore the need for controls which provide as high a level of accountability as possible commensurate with an acceptable cost.

Weaknesses in AID Control Systems Noted in Past Audits

Audits which we and the Inspector General have conducted have identified weaknesses in AID's implementation of the control systems it has placed over foreign assistance programs. These weaknesses do not relate solely to the ESF program; however, we believe they raise questions about whether AID officials have adequate assurance that economic assistance funds, including ESF, are used for intended purposes.

Although AID officials say they depend on grant provisions agreed on by the recipient government, past audit work shows varying degrees of compliance with the provisions as well as weaknesses in AID's ability to monitor compliance. Further, although AID officials advised us that they review host government reports on ESF activities, past audits have shown that such reports have sometimes not been submitted, have been submitted late, have been inadequately documented, or have not been verified. Reliance on audit coverage which AID itself has reported as a material internal control weakness would also appear to offer inadequate assurance that resources are used as intended.

In 1983 GAO summarized the findings of 118 AID-related reports which had been issued over the previous 10 years and identified 21 recurring problems. Those most closely related to control issues included

- Inadequate monitoring of compliance with grant, contract, or program requirements, use of assistance funds, or project progress in meeting objectives.
- Recipient government institutional weaknesses especially in administrative management matters.
- A variety of project implementation weaknesses including inadequate coordination, monitoring, evaluation, and host government support.

- Inadequate management information feedback including failure to routinely receive project reports.
- Poorly defined roles and responsibilities which created uncertainty over who was responsible for specific tasks.
- Inadequate program evaluations which left questions over whether U.S. assistance was reaching the intended recipients.
- Failure by AID to systematically identify, record, and use its past experience.

AID has reported agency-wide internal control weaknesses in some of these areas in its annual statements to the President and Congress on the status of internal controls under the Federal Managers' Financial Integrity Act. In its 1983 through 1985 statements, AID reported weaknesses related to staffing, audit coverage, procurement, host country contracting, local currency funds, non-expendable property, administrative support services, and policies and/or procedures. Although AID is working to correct these weaknesses, we believe that they demonstrate the potential vulnerability of economic assistance funds to misuse or diversion.

AID Controls Over Economic Support Fund Programs

This appendix describes the major control features of the three types of ESF programs. In identifying these features, we reviewed AID handbook and policy guidance, program documents and grant agreements for fiscal year 1986 ESF programs. We found that ESF projects and CIPS are controlled in a fairly standard manner, but the degree of U.S. control over the specific use of cash transfers varies widely from country to country.

ESF and Development Assistance Projects Similarly Controlled

For fiscal year 1986, AID used about $916 million in ESF to finance development projects in 25 countries and several regionally or centrally funded programs. Fourteen countries received their ESF project assistance in combination with either a cash transfer or CIP. Egypt received all three types of ESF assistance in 1986. (See app. III.)

Although ESF may be used for a wider range of projects than those funded under development assistance, the two types of projects are planned, approved, implemented, and monitored in a similar manner; the control mechanisms in AID's Project Assistance Handbook apply equally to projects funded by ESF and development assistance. According to the handbook, project grant agreements should contain provisions defining the project costs which may be financed; specify conditions which must be met prior to disbursement; outline how the project will be evaluated; specify applicable procurement, shipping, and insurance requirements; and state requirements for reporting and recordkeeping as well as AID inspection rights.

Standard AID project management procedures provide for project monitoring, including onsite visits by AID project officers; AID approval of vouchers for payment of project expenses; requirements for reporting, evaluation, and audit; and periodic consultation with project implementors on project progress.

The AID project handbook does not require that project grant agreements expressly prohibit using ESF for military activities. However, a standard clause states that, unless AID agrees otherwise, the grant is to be used only for project expenses and, after project completion, only to further the project's objectives. This presumes that any development project approved by AID would have no relationship to military activities.

Commodity Import Programs Controlled by Detailed Procedures and Documentation

AID provided about $357 million, or about 10 percent of the fiscal year 1986 ESF resources, to 12 countries in the form of CIPs or special procurement activities; these countries included Egypt, Fiji, Jordan, Tunisia, Pakistan, and 7 African countries. There were no CIPs in Latin America or the Caribbean. The largest CIP was in Egypt, whose $200 million program was legislatively mandated. (See app. III.)

Like ESF project assistance, controls over CIPs are fairly standardized; AID's nonproject assistance handbook includes model agreements for loans and grants which can be used as guides. Standard control features of all CIP grants include what commodities are eligible to be financed; applicable procurement regulations; requirements regarding source and origin of commodities; shipping and marine insurance; requirements to ensure effective use of the commodities, including prompt customs clearance, maintenance of records on arrival and disposition of the commodities, and time limits on putting the commodities into use; prohibitions against re-export and acceptance of bribes; specified disbursement procedures; and standardized provisions regarding reports, records, and inspection rights. The agreement also describes circumstances which would trigger suspension and/or cancellation of the grant and AID's right to request a refund.

The standard grant agreement does not expressly prohibit the use of financed commodities for military activities, however, it does specify what commodities are eligible to be imported from AID's eligible commodity list. The list prohibits AID financing of items for military use and commodities supporting police and other law enforcement activities. Several CIPs are for a single commodity group such as fertilizer or agricultural commodities which would be of little use to military activities unless they were resold and the resources used to purchase other items. Diversion would be more difficult to detect for programs which have authorized the import of such commodities as petroleum or vehicles which would be suitable for either civilian or military purposes.

Cash Transfer Programs Tailored to Individual Country Needs and Situations

About $2.4 billion, or about two-thirds of all fiscal year 1986 ESF assistance, was provided to 27 countries and two regional programs in the form of cash transfers. The largest cash transfers were $1.148 billion to Israel; about $220 million to the Philippines; $147 million to El Salvador; about $120 each to Costa Rica and Turkey; and $110 million to Egypt. These six programs taken together accounted for 77 percent of the total cash transfers provided in fiscal year 1986. (See app. III.)

Table II.1: Categorization of Fiscal Year 1986 ESF Cash Transfer Programs

Uses not specifically defined	Uses specified for the grant	Uses specified for local currency equivalent	Uses specified for foreign exchange and local currency equivalent	Special arrangements
Middle East and Europe:				
Egypt Israel Turkey	Portugal			Ireland
Latin America and Caribbean:				
	Panama	Haiti[a] Honduras[a] Jamaica Uruguay	Belize[a] Bolivia Costa Rica[a] Dominican Republic Ecuador Guatemala	El Salvador
Africa:				
		Chad Guinea[a] Senegal[a] Togo[a]	Niger[a] Zambia[b] Somalia[a]	Liberia[a]
Asia:				
	Thailand Philippines			

[a]Denotes programs conditioned on the country's taking specified policy reform actions before funds are released.

[b]For Zambia, AID specified uses for the dollars transferred rather than for a foreign exchange equivalent.

Use Not Specifically Defined

Cash transfer agreements with Egypt, Israel, and Turkey contained the fewest controls. Egypt agreed to "exert its best efforts" to (1) provide local resources equal to the cash transfer to finance development and economic reform items in its national budget and (2) ensure that imports of U.S. nondefense items and bulk commodities would be maintained at about the same levels as during the past 5 years. Israel agreed to (1) maintain U.S. imports of non-military items at a level at least equal to its ESF assistance, (2) maintain import levels for specified U.S. agricultural imports, (3) follow proper procedures in selecting dry bulk carriers, and (4) certify that U.S. exporters would not be harmed by the cash transfer. Turkey agreed to provide information that AID might request concerning economic and financial situations in Turkey. In all three

Unlike the other types of ESF, controls over cash transfer programs are instituted on a case-by-case basis according to individual country needs and U.S. objectives. This has resulted in programs which vary widely as to the extent to which AID specifies uses for the funds. For programs used for the U.S. objectives of furthering the prospects for peace in the Middle East and programs in base-rights countries, AID has generally been less specific as to the use of the funds. For programs providing budget or balance-of-payments support, AID has generally not specified uses for the dollars it provides; however, the grantee has usually agreed to make available equal amounts of recipient-owned foreign exchange and/or local currency for agreed upon purposes. In addition, AID has conditioned ESF assistance on specified policy reforms for some recipients.

As shown in table II.1, we categorized fiscal year 1986 ESF cash transfer programs according to the extent that AID specifies uses for the funds. AID's requirements for the use of ESF grant assistance, and foreign exchange and local currency equivalents, if required, for each category are described in the following sections. The programs in Ireland, El Salvador, and Liberia have unique features and are therefore discussed separately.

cases, the United States agreed to provide the assistance for general balance-of-payments support without requiring an accounting for its use.

Programs Specifying Uses for the Grant

AID specified how grants were to be used in the case of the Philippines, Portugal, Panama, and Thailand. The Philippines' grant was to be used to finance budget expenditures in priority sectors, including agriculture, education, and health. The Philippines agreed to provide quarterly unaudited reports and a final report audited by the Philippines Commission on Audit on its use of grant funds.

Half of Portugal's assistance was to be used for economic and social development in the Azores and to support the Luso-American Development Foundation, by which Portugal gains access to U.S. training, technology, and investment. The remainder was designated for general economic and social development purposes. Panama agreed to use its assistance for budget items in support of designated priority sectors. Thailand agreed to use its assistance to finance relief and development activities for Thai nationals affected by the influx of Indochinese refugees. Each of these countries, except Portugal, is required to provide AID with periodic reports on the use of its grant.

Programs Specifying Uses for Local Currency Equivalent

AID provided general budget or balance-of-payments support to Chad, Guinea, Senegal and Togo. AID did not specify the use for the dollars,[1] but required each country to set aside an equal amount of its local currency for agreed upon development purposes. In addition, Guinea was required to provide its Central Bank with foreign exchange equal to the dollar grant to be sold to private sector importers at its weekly foreign exchange auctions. It was also required to report weekly to AID on the results of the auction. The others did not have to report on the use of the dollars but were required to maintain records and reports on the use of the local currency. Each country, except Chad, was required to undertake certain policy reforms as a condition of receiving the dollar assistance.

[1]Chad was provided local currency for budget support; the others received their grants in U.S. dollars.

Programs Specifying Uses for Equal Amounts of Foreign Exchange and Local Currency

For Latin American and Caribbean countries, AID typically provided dollars for general balance-of-payments support without specifying exactly how the assistance was to be used or requiring an accounting for its use. Instead, these programs require that the governments make equal amounts of foreign exchange available to finance imports for private sector use within a specified time period, usually 12 months. Eligible imports were then to be attributed to these equal amounts of foreign exchange and reported quarterly to AID. Additionally, AID required each recipient to deposit an equal amount of local currency into a special account to be used for agreed-upon development purposes. Conditionality was a feature of most of these programs. As mentioned above, Panama is the exception to this regional model because it does not have a local currency program associated with the dollar grant.

AID also specified the uses for both dollars and local currencies for three African countries. In Zambia, the cash transfer dollars were to go directly into its weekly foreign exchange auction and be sold to private sector importers. Somalia was to receive half of its grant as general balance-of-payments support, however, AID designated the rest to support an acceptable foreign exchange auction which had not yet been set up. Niger agreed to spend part of its cash transfer to finance certain foreign exchange and local currency costs; the rest was a straight transfer of resources. Each country agreed to establish a local currency account to be used for development purposes and to submit reports to AID on the use of both the dollars and local currencies.

Programs Conditioned on Policy Reforms

Table II.1 shows those recipients which were required to take policy reform measures before AID would disburse the funds. For example, Honduras was required to take actions to limit credit expansion, improve net international reserves, enhance the competitiveness of its exports, and promote private investment. Several other recipients agreed to take specified policy reform measures, but could receive funds before taking these actions. In addition to these two types of arrangements, AID officials said that some countries were required to take certain actions before AID would even consider entering into an agreement.

Although AID views the conditions it places on some programs as an important element of accountability, past audits[2] have found that AID

[2]See GAO reports FOREIGN ASSISTANCE: U.S. Use of Conditions to Achieve Economic Reforms (GAO/NSIAD-86-157), August 1986 and Providing Effective Economic Assistance to El Salvador and Honduras: A Formidable Task (GAO/NSIAD-85-82), July 3, 1985.

sometimes disburses funds even though the conditions are not fully met. According to AID officials, political considerations sometimes enter into decisions to waive or modify the conditions.

Special Arrangements

AID instituted special arrangements for cash transfers to Ireland, El Salvador, and Liberia.

Ireland Cash Transfer to International Fund

Ireland's cash transfer was to be deposited into an International Fund for Ireland, which will be administered by a board of representatives from both Ireland and the United Kingdom. It will be used to promote the economic and social development of both Northern Ireland and Ireland.

El Salvador Separate Accounts

Since fiscal year 1985, Congress has required that El Salvador's cash transfer be placed in a separate account(s) and not commingled with other government revenues. These funds have been used to finance eligible imports, including raw materials, intermediate and capital goods, spare parts, agricultural items, and petroleum. AID officials review Central Bank documentation on transactions financed from the separate accounts and request reimbursement or substitute transactions for any found to be ineligible or inappropriately priced. AID conditions the assistance on policy reforms and makes provisions for monitoring the required local currency account as it does for other Latin American countries.

Liberian Debt Repayment

Under an arrangement unique to Liberia, AID will deposit the cash transfer into Liberia's account at the Federal Reserve Bank of New York. Based on instructions from the National Bank of Liberia, the Federal Reserve Bank will pay specified international debts agreed upon by AID and Liberia. AID has conditioned the assistance on agreed upon policy reforms. No local currency program is associated with this program.

Economic Support Fund Programs Financed From Fiscal Year 1986 Appropriations

Dollars in milions

Country	Cash transfer	Commodity import program	Projects	Total
Asia:				
Afghanistan	$ •	$ •	$14.758	**$14.758**
Cambodia	•	•	3.350	**3.350**
Fiji	•	.957	•	**.957**
Pakistan	•	91.500	147.750	**239.250**
Philippines	219.625	•	•	**219.625[a]**
Thailand	5.000	•	•	**5.000**
South Pacific regional	•	•	.957	**.975**
Regional programs	7.000	•	.284	**7.284**
Subtotal	**231.625**	**92.457**	**167.099**	**491.181**
Middle East, Near East and North Africa:				
Egypt	110.055	199.730	469.384	**779.169**
Israel	1,148.400	•	•	**1,148.400**
Jordan	•	5.549	9.323	**14.872**
Lebanon	•	•	1.380	**1.380**
Morocco	•	•	16.484	**16.484**
Oman	•	•	19.556	**19.556**
Tunisia	•	4.774	17.200	**21.974**
Regional program	•	•	13.951	**13.951**
Subtotal	**1,258.455**	**210.053**	**547.278**	**2,015.786**
Europe:				
Cyprus	•	•	14.355	**14.355**
Ireland	50.000	•	•	**50.000**
Portugal	76.487	•	•	**76.487**
Spain	•	•	11.484	**11.484**
Turkey	119.625	•	•	**119.625**
Regional programs	•	•	0.073	**0.073**
Subtotal	**$246.112**	**$ •**	**$25.912**	**$272.024**

Country	Cash transfer	Commodity import program	Projects	Total
Africa:				
Botswana	$ •	$ •	$7.623	**$7.623**
Chad	7.000	•	2.519	**9.519**
Djibouti	•	•	2.950	**2.950**
Guinea	10.000	•	•	**10.000**
Kenya	•	14.355	•	**14.355**
Liberia	28.203	•	•	**28.203**
Madagascar	•	2.000	.844	**2.844**
Mauritius	•	1.914	•	**1.914**
Mozambique	•	9.570	•	**9.570**
Niger	4.373	•	•	**4.373**
Senegal	26.484	•	1.000	**27.484**
Seychelles	•	1.914	•	**1.914**
Somalia	21.011	•	1.000	**22.011**
Sudan	•	10.000	•	**10.000**
Togo	7.850	•	•	**7.850**
Zaire	•	14.800	9.727	**24.527**
Zambia	17.000	•	•	**17.000**
Zimbabwe	•	•	5.000	**5.000**
Africa regional	•	•	.976	**.976**
Sahel regional	•	•	.678	**.678**
South Africa regional	•	•	28.442	**28.442**
South Africa Republic regional	•	•	4.972	**4.972**
Subtotal	**$121.921**	**$54.553**	**$65.731**	**$242.205**
Latin America and Caribbean:				
Belize	1.500	•	0.414	**1.914**
Bolivia	7.177	•	•	**7.177**
Costa Rica	120.582	•	•	**120.582**
Dominican Republic	40.000	•	•	**40.000**
Ecuador	20.110	•	•	**20.110**
El Salvador	147.000	•	30.045	**177.045**
Guatemala	47.350	•	0.500	**47.850**
Haiti	18.000	•	3.321	**21.321**
Honduras	61.248	•	•	**61.248**
Jamaica	58.000	•	•	**58.000**
Panama	5.742	•	•	**5.742**
Peru	•	•	7.000	**7.000**
Uruguay	14.000	•	0.355	**14.355**

Country	Cash transfer	Commodity import program	Projects	Total
Caribbean regional	9.500	•	15.672	**25.172**
Latin America and Caribbean regional	•	•	7.983	**7.983**
Regional Office for Central America and Panama	•	•	43.434	**43.434**
Subtotal	**550.209**	•	**108.724**	**658.933**
Other:				
Science and Technology Bureau	•	•	1.435	**1.435**
Grand Total	**$2,408.322**	**$357.063**	**$916.179**	**$3,681.564**
Percent of Total	65.4	9.7	24.9	**100.0**

[a]Includes $100 million supplemental appropriation.

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