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Using Local Currency Generated by U.S. Food Aid for Development Purposes

Statement of
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Subcommittee on International Economic
Policy and Trade

House of Representatives

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Mr. Chairman and Members of the Subcommittee:

We are pleased to be here today to discuss issues related to local currencies generated from U.S. foreign assistance programs. As you requested, we will be providing information on (1) whether local currencies are used to achieve development goals in recipient countries, (2) who owns the local currencies generated under titles I and II of Public Law 480, and (3) how to improve accountability for these local currencies.

SUMMARY OF STATEMENT

To summarize our overall findings, let me first say that both AID and recipient countries view local currencies generated through Public Law 480 and other programs as valued resources in furthering development efforts of these countries. Our reviews of how Public Law 480, title I, local currencies have been used in numerous countries revealed that the currencies generally were programmed in support of U.S. development objectives for those countries. In other words, AID and host governments together planned for, and intended that the local currencies be used for development. However, we also found that monitoring and oversight of the use of local currencies has not been sufficient to ensure that the currencies were, in fact, used for the agreed upon purposes.

The local currencies generated from title I and title II government-to-government food aid belong to the host governments. However, the question of who owns the local currency does not dictate whether it is properly and effectively used. Instead, there are two critical elements of this question that must be addressed irrespective of ownership. First, joint AID/host country programming decisions on the use of U.S.-generated local currency will determine whether the funds will be used for appropriate development purposes. And second, there must be adequate systems of financial management and accountability in place to assure that the funds are indeed used for agreed upon purposes. The first, (i.e. joint programming of local currency) clearly does not depend on ownership of the local currency. Nor does adequate financial control of the funds necessarily depend on ownership, although some argue that more attention would be paid to accountability if the United States retained ownership.

While we recognize the attractiveness of this accountability argument, we do not support making these local currencies U.S. owned. By continuing the present practice of host country ownership, we see significant opportunities to increase the level of developmental assistance in the area of host country financial management capabilities. We believe that AID can and should strengthen its oversight of the use of local currencies in ways that will help to improve the financial management capabilities of the host governments.

BACKGROUND

Last July the AID missions around the world reported that there were a total of 250 local currency accounts with a total balance of over $1.2 billion. Generally, just under half of the local currencies are generated through food aid programs. Most of the rest are generated by Economic Support Fund (ESF) activities (both cash grants and the Commodity Import Program), with a small amount generated by the Development Fund for Africa.

Because host countries vary in their development needs and management capabilities, AID missions have a great deal of flexibility in designing and negotiating local currency uses with host governments, as long as the uses are consistent with the intent and purpose of the authorizing legislation. For example, local currencies generated under title I of Public Law 480 are to be used for economic development purposes. The projects should emphasize directly improving the lives of the poorest in the countries. Similarly, 50 percent of the local currencies generated under ESF programs must be used for development purposes. AID guidance states that, to achieve this goal, currencies can be used to directly support host country or AID development projects or programs, or to support the development budget of a particular sector or ministry. In some cases, local currency use is contingent upon the host country making policy reforms, such as reducing government subsidies or greater privatization of their economies.

PROGRAMMING AND SPENDING LOCAL CURRENCIES

Your recent letter to us raised the question of whether Public Law 480, title I-generated local currencies are used in a way that helps achieve development goals in recipient countries. To address this issue, we considered two related questions. First, are the local currencies programmed for uses that support the development goals for individual countries? And second, do we have reasonable assurance that those local currencies are actually used for the agreed upon purposes?

Are These Funds Programmed For Development Purposes?

Our reviews generally confirm that AID mission officials and the recipient government jointly program and mutually agree on how U.S.-generated local currencies are to be used. Both AID and the host countries view these local currencies as valuable in furthering development. The joint programming aspect of this process fosters dialogue and allows AID to have input into how the host country allocates its scarce development resources.

To determine whether local currency programming supports development goals, evaluations at the country level are necessary.

Over the last few years we have evaluated and reported on how local currencies were programmed relative to development goals in several countries. In general, we found that the currencies were programmed for purposes consistent with development goals. There were some exceptions, such as when the host government and AID could not agree on uses for the currencies, which happened in Kenya and Egypt.

In 1988, we reported on the integration of fiscal years 1984-86 food aid with development assistance and Economic Support Fund assistance in four African countries--Madagascar, Ghana, Senegal, and Kenya.[1] Although integration of the overall food aid program with the other assistance programs varied by country, we found that in Madagascar, Ghana and Senegal, title I local currencies were programmed to support AID's major development objectives for those countries. For example, in Madagascar, AID's primary objective was to assist the government to achieve higher rice production, and title I local currencies were programmed to fund rice research efforts. In Ghana, where a major goal was to achieve food self-sufficiency by increasing food crop production, local currencies provided credit to small farmers to improve production. In Senegal, title I local currency uses were integrated with other donor efforts, for example, to speed a commercial banking debt

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[1]Food Aid: Integration With Economic Assistance Programs in Four African Countries (GAO/NSIAD-88-96FS, February 25, 1988).

repayment required under an agreement between the International Monetary Fund and Senegal.

However, Kenya provides an example where host government officials resisted U.S. efforts to influence how local currencies would be used. AID and Kenyan officials were unable to agree on the use of title I local currencies for fiscal years 1984-86 until 1987. Consequently the local currencies were not used for economic development until that time. AID officials said that negotiations with Kenyan officials were difficult because the government believed that the food aid program served important U.S. foreign policy and agricultural export objectives, that local currency proceeds belonged to Kenya and were sovereign funds, and that other donors were willing to provide food assistance on a grant basis with fewer strings attached.

We found a similar situation in Egypt involving local currencies generated under a Commodity Import Program[2], where a large portion of the local currencies generated in fiscal years 1986-87 were not programmed until 1988. AID officials said that Egypt prefers to finance development activities with project dollars rather than with local currencies generated from Commodity Import Programs or Public Law 480. AID officials have said that because of the nature of the U.S. assistance program in Egypt, they have less leverage

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[2]Foreign Aid: Better Management of Commodity Import Programs Could Improve Development Impact (GAO/NSIAD-88-209, September 26, 1988).

than in other countries to get Egyptian officials to agree with AID's proposals for using local currencies.

We will soon report on our evaluation of how local currencies were used in Tunisia and Zaire during fiscal year 1988. We found that local currencies were programmed to support development goals for those countries. In Tunisia, AID's goals were to promote economic reform and support Tunisia's structural adjustment program. Title I local currencies were programmed to support high priority Tunisian government rural public works programs that provide the double benefit of funding rural development activities and providing employment to the rural poor adversely effected by structural adjustment and a recent drought. In Zaire, AID's goals included increased agricultural productivity, strengthening the primary health care system, and managing population growth rates. Title I local currencies were programmed to support the local costs of dollar-funded AID development projects, with the majority used for agriculture and rural development, and health projects focusing on child survival strategies and family planning activities.

Local Currencies Used for Budget Support

You questioned how Congress can be assured that local currencies are being used for development projects rather than being absorbed as general budget support. We found that only a small percentage of title I local currency was used for non-development budget support. According to data provided by AID missions, only 3.5 percent of local currencies generated through food aid were used for public sector recurrent costs during fiscal year 1988. However, over 26 percent of local currencies generated through ESF are used for public sector recurrent costs. Since only 50 percent of the local currencies generated from the Economic Support Fund must be used for development, this does not appear excessive.

As you know, the Administration's 1990 food aid legislative proposal dated March 1990 recommends that authority be granted so that "designated uses of local currencies are not required when nonprogramming would best support economic growth through compliance with major economic restructuring." While the use of U.S.-generated local currency for sector or budgetary support would significantly complicate assuring proper accountability for such funds, our reviews indicate that there are occasions when such uses, if legislatively authorized, would not be inappropriate.

Can AID Be Reasonably Sure That Currencies Are Used for Agreed Upon Purposes?

According to AID missions' fiscal year 1991 annual budget submissions, in fiscal year 1988, 84 percent of local currencies generated from food aid programs worldwide were spent for public development activities, 12 percent for private sector programs, 4 percent for budget support and other purposes. While our reviews of Public Law 480 and other programs that generate local currencies concluded that the local currency was generally being programmed appropriately, AID's monitoring was insufficient to provide reasonable assurance that the funds were actually used as intended. While it is true that some AID missions have made progress in monitoring local currency use, in general, inadequate accounting, monitoring, and reporting systems have prevented AID from determining whether withdrawals and disbursements were made for the agreed upon purposes. AID has also been unable to consistently verify that required local currency deposits were actually made by the host country.

The issue of accountability for local currencies is a contentious one. AID management and AID's Inspector General disagree on the extent to which AID should be held accountable for local currency use. AID management argues that, although it must be satisfied that local currencies are used for appropriate economic development, host countries, and not AID, ultimately should be accountable for the proper use of the currencies because they own them. AID officials maintain that increasing demands for accountability create friction with the host government because government officials view the currencies as their own. On the other hand, the Inspector General contends that AID missions must maintain full financial accountability for the local currencies because they are generated from U.S. assistance. Our work has shown that improvements in local currency accountability are needed.

OWNERSHIP, CONTROL, AND ACCOUNTABILITY

You asked us who owns the local currencies generated from the resale of title I commodities and those generated from the resale of title II donated commodities. Local currencies generated through title I are owned by the host government. Local currencies generated from title II government-to-government food aid are also owned by the host government. We believe that because the United States structures the assistance as a grant or a sale on a concessional loan basis, the United States manifests its intent that the host country will own the local currencies generated form the assistance. There are no disagreements between AID and the recipient countries in this regard. However, regardless of who owns the currencies, the host country and the United States decide jointly how they will be used.

The Senate proposed amendment to the 1985 farm bill gives the AID Administrator the option to determine whether local currencies generated from a sale of commodities are owned by the United States or the host country. We do not support changing the ownership of local currencies because we believe that such a change would run counter to the general development strategy of assisting sovereign countries to manage their own resources through providing technical assistance and helping them build the financial management institutions that are necessary for all aspects of government. Furthermore, we do not believe that taking ownership of the local currency is necessary to resolve the accountability problem. Also, AID officials have said that changing ownership could create foreign policy problems, since recipient governments may see this as infringing on their national sovereignty.

AID officials also told us that assuming ownership of local currencies would increase accountability requirements and would require additional resources at AID missions. We did not analyze overall mission staffing requirements, but some AID officials have said they do not have enough staff to provide the oversight of local currencies that they are currently required to provide.

Finally, U.S. ownership of large volumes of local currencies may lead to problems similar to those experienced in the late 1960s and early 1970s, when the United States owned vast quantities of local currencies in several countries (known as excess currency countries). The most notable of these was India. At the time, the United States had accumulated Indian rupees equal to $687 million, or about 9.6 percent, of India's money supply. Due to numerous constraints, the currencies were not being spent as fast as they were generated, and the fact that the United States controlled such a large portion of the Indian money supply became a major political problem. Currently, local currency generations, expenditures, or year end accumulations are near or exceed 9 percent of the money supply in several countries. For example, as of the end of 1988, local currency accumulations in Costa Rica amounted to 12 percent of the country's money supply. If these currencies were U.S.-owned, the United States would control 12 percent of Costa Rica's money supply.

AID ACTIONS AND POSSIBLE SOLUTIONS

The problem as we see it is one of maintaining proper control and accountability over the local currencies. We believe this can be accomplished without U.S. ownership of the currency. Although the currencies are owned by the host government, agreements place conditions on the currency use and AID is responsible for reasonable assurances that the currencies are being spent for their intended purpose. AID recognizes that the local currencies are vulnerable to fraud, waste, and abuse. In its December 1989 report on compliance with the Federal Managers' Financial Integrity Act, AID identified inadequate procedures to track host country owned local currencies as a material weakness.

A June 1989 AID survey identified three key weaknesses in local currency monitoring. Subsequently, AID's Office of Financial Management proposed steps to help ensure that the currencies are used for the agreed upon purposes. First, AID would require formal and standard financial assessments of host country agencies using local currencies. Second, AID would strengthen host country reporting requirements and mission verification procedures for local currencies held in special accounts. Finally, AID would require audits of host country agencies managing the local currency accounts and receiving funds.

We support this approach because we believe the proper focus for local currency accountability should be on assessing and improving the financial management systems of host country agencies. The proposed steps reiterate the internal control and financial management responsibilities of the host country, while AID remains responsible for providing reasonable assurance that the currencies are used as intended. Also, assessments of host country financial management systems and audits of local currency activities could be funded with local currencies without additional strain on existing mission resources. We urge AID management to adopt the Office of Financial Management proposal as soon as possible.

Mr. Chairman, this concludes my prepared remarks. We would be happy to respond to any questions you or the members may have.