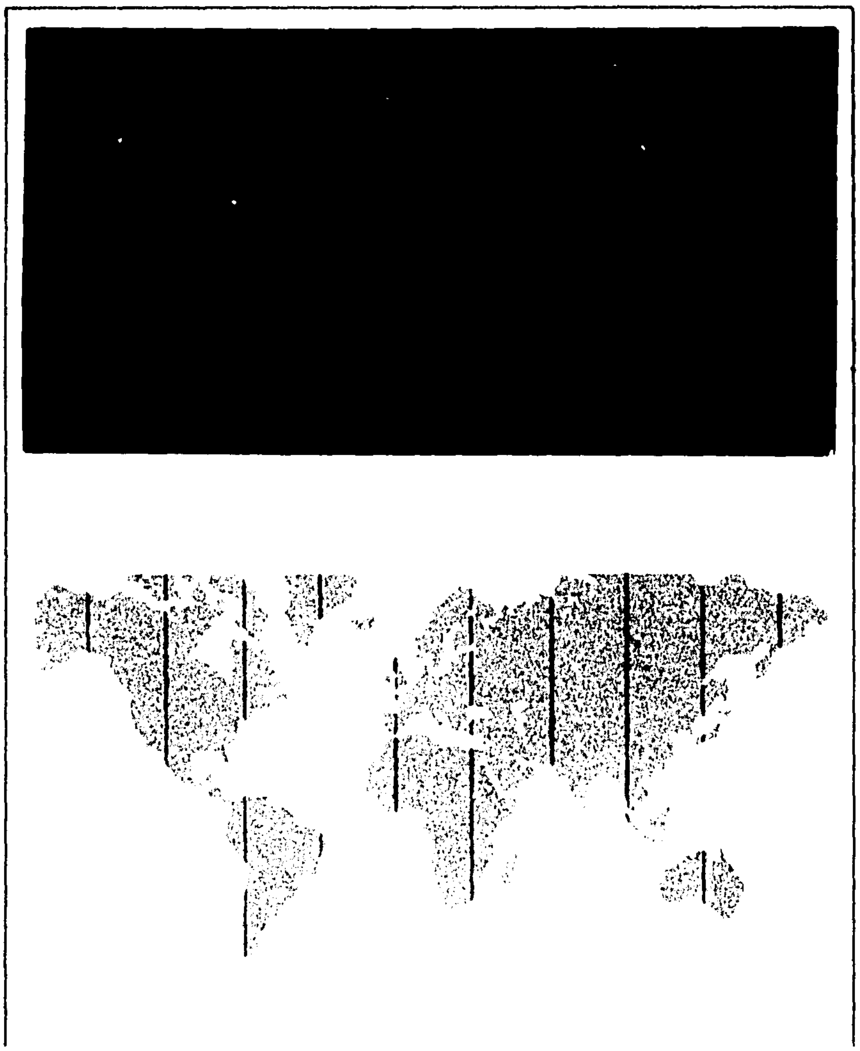
519-0267

THE INSPECTOR GENERAL



Regional Inspector General for Audit

LATIN AMERICA

(Washington, D.C.)

PRIVATE SECTOR SUPPORT PROGRAM

GRANT NO. 519-0267

(LOAN NO. 519-K-030)

USAID/EL SALVADOR

AUDIT REPORT NO. 1-519-82-5

JANUARY 20, 1982

AID provided $44.9 million to assist the Government of El Salvador in its Private Sector Support Program. The program's goals were to provide balance-of-payments support, finance imports of essential commodities and provide credit.

Progress has been made in achieving these goals. Foreign exchange of $44.9 million has been provided, imports from the U.S. of $20 million have been financed, and credits of over $2.2 million equivalent have been provided. Applications for additional credits of $24.4 million equivalent were pending. However, improvements were needed in the management of foreign exchange, the implementation of an import price checking system, and the use and structure of local currency credit funds. The Mission, because of limited staff resources, needs to limit the number and complexity of local currency projects. USAID/El Salvador concurred with our findings and has initiated action to implement the recommendations made.

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EXECUTIVE SUMMARY

Introduction

Since 1980, AID has provided the Government of El Salvador (GOES) with $44.9 million in economic support funds -- a $20 million grant in December 1980, and a $24.9 million loan in July 1981. The purpose of this assistance was to provide balance-of-payments support to the GOES and to strengthen the El Salvador private sector by assuring access to foreign exchange for imports of essential raw materials and intermediate goods.

Cash transfers of project funds from AID to the GOES took place within 10 days after project agreements were signed. In the grant (Private Sector Support I), the GOES agreed to establish two 50-million Colon (local currency) funds -- a fund for private business working capital and a fund to help meet credit needs of the Agrarian Reform Program. The loan (Private Sector Support II) generated 62.25 million Colones which were to be used to meet institutional support needs and Medium-Term Structural Capital requirements of the private sector.

Purpose and Scope

This is the first audit of the project and covers activities from December 17, 1980 through September 30, 1981. The purpose of the audit was to determine if the $44.9 million in grant and loan funds and the corresponding local currency generations were being used efficiently, effectively, and in compliance with AID regulations. Because of the terrorism and violence in El Salvador, we contracted with a local CPA firm to perform end-use checks on goods imported under the grant. Our review of the loan funds in PSS II was limited because the program had been initiated recently.

Conclusions

The transfer of dollar funds to the GOES had gone smoothly and the purposes of both the loan and the grant were being achieved. We did note a few areas in the handling of dollar funds and local currency funds which required changes in order to improve the economy and efficiency of the program. A synopsis of the problem areas follows:

- A large share of dollar funds were required by AID to be deposited as guaranties for lines of credit and could not be used to provide immediate balance-of-payments support to the GOES. By requiring that all or most of the economic support funds be used to establish lines of credit, AID was not giving the GOES maximum flexibility in managing its foreign exchange (Page 5).

- No concrete action had been taken to meet the loan requirement to develop a system for price checking of import transactions (Page 7).

- A substantial part of the 50-million Colon Agrarian Reform Credit Fund had been targeted by the Central Bank to cover old delinquent agricultural loans instead of financing loans for new agricultural production (Page 8).

- Only 1.9 million Colones had been used from the 50-million Colon Short-Term Working Capital Fund since December 24, 1980. However, the demand exceeded the supply for the 52.25-million Colon Medium-Term Structural Capital Fund and 3.6 million Colones had already been disbursed from this fund. A total of 5.5 million Colones ($2.2 million) had been loaned to private businesses under both funds as of September 30, 1981 (Page 9).

- The use of local currency funds generated from the dollar loan and grant encountered a number of problems and required excessive attention by the Mission's limited staff. The way in which the local currency usage is monitored needs to be changed so that the Mission's resources will not be overburdened, while at the same time providing satisfactory accountability (Page 12).

Recommendations

The five recommendations in this report were discussed with USAID/El Salvador officials and a draft copy of this report was submitted to the Mission for review and comment. Mission comments were considered in preparing the final version of this report.

BACKGROUND AND SCOPE

Background

Beginning in 1979, El Salvador experienced a sharp decline in economic activity because of political instability caused by kidnappings, factory takeovers, bombings, and terrorism. Similar incidents have continued to cause significant drops in employment and economic activity. This has led to a general deterioration in the country's domestic resources and foreign exchange positions as evidenced by a 9 percent decline in 1980 Gross Domestic Product and a 490 million Colon reduction in Net International Reserves.

On December 17, 1980, AID signed a $20 million grant agreement with the Government of El Salvador (GOES). The purpose was threefold: (1) to ameliorate El Salvador's balance of payments crisis; (2) to strengthen the private sector by providing foreign exchange resources which will permit the importation of raw materials and intermediate goods needed by manufacturing, industrial, and business communities; and (3) to help restore economic stability.

After the GOES had satisfied several conditions precedent, the entire $20 million was transferred to the GOES on December 19, 1980. The only restriction on the dollar funds was that the GOES import from the United States at least $20 million worth of raw materials and intermediate goods for the private sector.

The project agreement provided for two local currency funds:

- The $20 million transfer generated 50 million Colones (2.50 Colones = $1.00) in local currency for use in establishing a special account to meet the credit needs of the Agrarian Reform Program. The interest earned was first to be used to establish two separate funds: (1) a 500,000 Colon fund with the Small Business Finance and Guarantee Fund to provide technical assistance and support for the establishment of small, worker-owned businesses; and (2) a 4.0-million Colon fund to establish a private, non-profit, technical vocational school to provide training in various types of skilled labor techniques. After the funds are established, the interest earned reverts back to the principal account.

- The GOES agreed to provide an additional local currency contribution of 50 million Colones. This contribution was to provide working capital credit to the private industrial sector over a 12-month period following the signature of the agreement.

On July 21, 1981, AID signed another agreement loaning $24.9 million to the GOES for Private Sector Support II. The purpose of the loan was: (1) to provide immediate balance-of-payments support to the Government of El Salvador; and (2) to strengthen the private sector by assuring access to foreign exchange for imports of essential raw materials and intermediate goods and access to medium-term credit to cover local operating costs.

There were basically three requirements attached to the use of the $24.9 million: (1) that the GOES make its best efforts to use the full $24.9 million as a guarantee for U.S. bank lines of credit for imports of raw materials and intermediate goods from the U.S.; (2) that the GOES seek to maintain these lines of credit for at least 12 months; and (3) that within six months of the disbursement date of AID funds, the GOES undertake to develop a system for price checking of import transactions to identify violations of capital flight regulations.

The U.S. Dollar cash transfer took place on July 31, 1981. The local currency generated by these funds was to be used for:

- a 10-million Colon fund to meet the institutional support needs of private and public sector entities; and

- a 52.25-million Colon fund to meet medium-term structural capital requirements of the private sector.

Scope

We reviewed program activities through September 30, 1981, in both Private Sector Support I and II, including the use of dollar funds and local currency. Because of the terrorism and violence in El Salvador, we contracted with a local CPA firm -- Castellanos, Cea, Campos & Compania -- to perform end-use checks on goods imported under the grant. Our review of the loan funds in PSS II was limited because the program had just started to get underway. We examined program documents and records and discussed program progress and activities with officials at the Banco Central de Reserva -- the implementing agent for the GOES -- and the AID Mission.

AUDIT FINDINGS, CONCLUSIONS AND RECOMMENDATIONS

Dollar Funds

Private Sector Support I (PSS I)

On December 19, 1980, AID transferred $20 million in grant funds to the Government of El Salvador (GOES). The purpose of the grant was to enable the Banco Central de Reserva (BCR) to make available badly needed foreign exchange for the importation of raw materials and intermediate goods for the private sector.

The BCR decided to use part of the $20 million as a lever to finance additional imports, so a series of agreements were signed with U.S. commercial banks to establish lines of credit. Using $11.4 million of the grant funds as guarantee deposits, the BCR obtained a $21 million line of credit for importing raw materials and intermediate goods into El Salvador. These lines of credit were used to import goods from both U.S. and non-U.S. sources. As of September 30, 1981, 69 percent of all goods financed with lines of credit at Manufacturers Hanover Trust and Capital Bank were from U.S. suppliers. The remaining $8.6 million was released by the BCR for the direct importation of raw materials and intermediate goods. More details are shown in the following table:

Lines of Credit (in $ millions)				$11.4
Bank	Expiration Date	Deposit	Credit Line	
Manufacturers Hanover Trust	11/30/81	$10.0	$15.0	
Capital Bank	1/28/82	1.0	2.0	
First National Bank of Chicago	1/31/82	0.4	4.0	
Total Line of Credit		$11.4	$21.0	
Cash Imports				$ 8.6
				$20.0

The grant agreement required that the GOES import from the United States at least $20 million in raw materials and intermediate goods for use by the private sector. This requirement has been met. The BCR submitted invoices totalling $20,605,721. In line with the Section 7(a) of the special covenant of the agreement, the Mission reviewed and approved them on October 1, 1981. Presented here is a summary of the types of products imported and their value as shown by the invoices:

Import Classification	Value
Wood & wood products	$ $265,850
Nutrition products	1,320,213
Paper products	6,334,786
Chemicals	5,172,148
Textiles	3,872,409
Metal products	583,133
Footwear	1,476,929
Other	1,580,253
Total	$20,605,721

We made a desk review of these invoices and found them to be in compliance with the project requirements. As a final check, we selected invoices with a total value of $1.15 million for site visits by the local public accounting firm. We instructed the accountants to verify that the imported goods were:

- raw materials and/or intermediate goods;
- from the United States; and
- used by the private sector.

All of the imported goods inspected consisted of raw material or intermediate goods from the United States. The majority of imported goods were being used by the private sector. However, we found one case where the goods were not used by the private sector.

Part of an ammonium sulphate shipment was transferred to the GOES Agricultural Development Bank. The importing fertilizer manufacturer purchased 4.0 million kilos of ammonium sulphate valued at $504,000. The Agricultural Development Bank purchased 2.5 million kilos (62-1/2 percent of the total shipment) from the importer at a cost of $315,000. Although the chemical was a prime material imported from the United States, part of the shipment was used by the GOES -- not the private sector. Therefore, $315,000 worth of merchandise invoices, accepted by the Mission as meeting the import requirements, were ineligible. This still does not adversely affect the import requirements because the Mission accepted a larger amount of invoices than actually required. In addition, during the first ten months of 1981, El Salvador averaged monthly imports of $48 million from the U.S. Therefore, if invoices for other ineligible goods were included among the invoices furnished by BCR, they could be replaced with invoices for eligible goods.

Private Sector Support II (PSS II)

On July 31, 1981, AID transferred $24.9 million in loan funds to the GOES. The purpose of the loan was the same as for the grant -- to enable the BCR to make available badly needed foreign exchange for the importation of raw materials and intermediate goods for the private sector in El Salvador.

This time, however, AID required the GOES to use as much of the loan as possible to open negotiated lines of credit with U.S. banks. As of September 30, 1981, the BCR had signed an agreement with one U.S. bank establishing a line of credit and was planning to sign another agreement shortly. These lines of credit will provide about $30 million and will require from the GOES a deposit of $15.0 million. The amount not committed ($9.9 million) to establishing lines of credit was used to pay for imported goods already in El Salvador. These were mostly supplier-financed goods which had not been paid for. A summary follows:

Lines of Credit			$15,000,000
Bank	Deposit	Credit Line	
Bank of America	$5,000,000	$10,000,000	
Lloyds International	10,000,000	20,000,000	
	$15,000,000	$30,000,000	
Payment for Goods in-Country			9,900,000
Total			$24,900,000

On October 9, 1981, the Mission received foreign exchange documents of $11.3 million worth of goods in country. These documents will be reviewed and serve as a basis for approving $9.9 million worth of transactions to satisfy the loan requirement in Section A.3,(a) in Annex I of the agreement: "The GOES will apply at least $24.9 million to finance imports of raw materials and intermediate goods from the United States to the private sector in El Salvador either by direct purchase or through lines of credit ...".

A brief review of these foreign exchange documents shows that most of the transactions were approved around June 1981, and had a value of about $10,000 to $20,000 each. This meets the needs of small importers. We noted that the value of most transactions financed by the lines of credit in PSS I were for over $100,000.

Unlike PSS I, project documents for PSS II restrict the use of the lines of credit to imports from the United States. Also, more detailed reporting and record-keeping requirements have been included in the loan agreement. The first series of reports were not due until after our departure from El Salvador and therefore, we were not able to review them.

Lines of Credit

The principal purpose of the program was " ... to provide immediate balance of payments support to the Government of El Salvador ...". Our review showed that a large share of AID funds (57 to 60 percent) were serving as guaranties for lines of credit and could not be used for immediate importations; thus, they run somewhat counter to the principal purpose of the agreement. The use of AID funds to guarantee lines of credit was a provision of the PSS II agreement. For the future, the GOES should be given more latitude on the mechanism to be used for the importation of goods.

The use of AID funds to guarantee negotiated lines of credit was not envisioned when the first project paper was written. Nevertheless, the GOES used $11.4 million of the $20.0 million grant and negotiated lines of credit totalling $21.0 million with three U.S. banks. Based on this voluntary action of the GOES, AID/Washington decided to formalize the procedure in the follow-on $24.9 million PSS II project. The Mission was opposed to this action because such a requirement would reduce the flexibility of the GOES to manage its foreign exchange. However, the final version of the PSS II agreements did include a requirement that most of the dollar funds be used to establish such lines of credit.

Usage of these lines of credit has been reasonably successful, although not as much as originally thought. The project paper for PSS II assumed a 180-day average line of credit resulting in a complete credit turnover twice a year. This assumption means that by the end of a year the $21-million lines of credit in PSS I should have had about $42 million in cumulative credits channeled through the system. As of August 31, 1981 - approximately eight months after creating the lines of credit -- cumulative flow-through was $21,947,077. The basic reason given for the shortfall was the limited amount of foreign exchange the GOES had to pay for imports. In other words, the usage of these lines of credit was directly related to the availability of the GOES to repay the usage of the foreign exchange.

The GOES tied up 57 percent of the PSS I grant in the negotiated lines of credit for a period of a year. In PSS II, the amount of funds being tied up in lines of credit will increase to $15.0 million or 60 percent of the loan. Although the GOES negotiated the lines of credit on its own initiative in PSS I, AID/Washington required the GOES to negotiate new lines of credit in PSS II. Since one of the major stated purposes of the program is " ... to provide immediate balance of payments support to the Government of El Salvador ...", the required usage of lines of credit runs somewhat counter to this purpose. The funds will not be immediately available for meeting foreign exchange needs, but rather to guarantee lines of credit which may only be used to the extent that foreign exchange is available to the GOES.

This is not to say that a line of credit is bad. In fact, at times, it can be very useful. The line of credit is a cash management tool which the GOES can use to temporarily extend its import capabilities for 60 to 90 days. By using a line of credit, the BCR has a 60 to 90-day period to plan the use of foreign exchange before payment is due. In addition, they: (1) help rebuild the credit reputation of the GOES in the international banking community; (2) provide a mechanism for facilitating import transactions; and (3) generate an amount of good will and confidence in the GOES.

However, by requiring that all or most of the economic support funds be used to establish lines of credit, AID tied the hands of the GOES. We do not see much use in maintaining large lines of credit unless they meet the GOES exchange management needs.

When considering additional funding for this project, we believe that more attention should be given to the GOES's ability to effectively use the lines of credit which AID may require be established. The use of lines of credit as a cash management tool and confidence builder should be balanced against the project purpose of immediate balance-of-payments support.

In response to a draft of this report, the Mission stated that it would strive to establish more flexible foreign exchange management mechanisms when designing future programs related to the private sector.

Recommendation No. 1

The Assistant Administrator, Bureau for Latin America and the Caribbean, AID/Washington, and USAID/El Salvador, in consultation with the Government of El Salvador, should agree on the most effective means of providing the GOES the maximum flexibility in managing its foreign exchange while maintaining adequate safeguards over the use of AID funds.

Price Checking

The BCR is required under the loan agreement for PSS II to " ... undertake within six months of the date of disbursement of AID funds to develop a system for price checking of import transactions ...". This requirement was designed to help identify violations of GOES capital flight regulations. As of October 15, 1981, no concrete actions had been taken to meet this requirement.

A price-checking system is only one of several means the GOES will be using to prevent capital flight. The GOES already has strict foreign exchange controls in place. All purchases of foreign exchange must be made through the BCR. The BCR reviews foreign exchange applications and follows established evaluation criteria for approval.

Recently, the Mission outlined fairly detailed requirements for BCR progress reports on the development of a price-checking system. But actions at the time of our reviews had only taken the form of general discussions between the project manager and BCR officials. Reasons for the slow progress were:

- The BCR would first like to study the price-checking systems operating in Mexico, Peru, and Nicaragua; and

- No funds had been allocated for either establishing the price-checking unit in BCR, or traveling costs to study systems in other countries.

We are aware that the loan agreement only requires the GOES to undertake development of a system within six months, and is mute on implementation. In our view, prevention is the best defense. Thus, we believe the system should be in operation before all of the project funds are spent. If the price-checking system is not in operation by early 1982, much of the $24.9 million may be used to pay for imports without any price checks.

In its comments to the draft report, the Mission advised us that the BCR has (1) assigned two full-time employees to contact U.S. suppliers to verify prices on invoices and bills of lading; and (2) begun organizing a library of price catalogs and back-up reference material. Until the price checking system is fully developed, the Mission will send copies of BCR import documents to AID/Washington for reveiw. The Mission plans to continue monitoring BCR progress in developing a price checking system.

Recommendation No. 2

USAID/El Salvador should obtain from the GOES a plan for funding the development and implementation of an import price-checking system. The plan should include a timetable for the implementation of the system.

Local Currency Funds

Agrarian Reform Credit

The grant agreement for Private Sector Support I stated that the GOES establish a special 50-million Colon ($20 million) account for the purpose of helping to meet the financial requirements of its Agrarian Reform Program. The BCR established the 50-million Colon Agrarian Reform Credit Fund on December 22, 1980. However, the Central Bank could not extend credit from this fund to commercial banks because there was no demand at the time. The demand for agricultural credit increases around March and remains relatively high through July.

In an attempt to meet the spirit of the loan agreement and to start earning interest to pay for two small projects (which were specified in the grant agreement), the BCR purchased agricultural loans made by commercial banks during the previous planting season. By June 15, 1981, these loans had been repaid and the fund had earned 1,573,406 Colones ($629,362) in interest. By purchasing the agricultural loans from the commercial banks, 50 million Colones (which had previously been committed to agricultural credit) were released into the banking system for use by the general economy.

In July 1981, the BCR announced the availability of this credit for the new agricultural season. But no money was loaned because the program was delayed by a study indicating that there was ample agricultural credit in El Salvador. The 1981 planting season passed with the 50 million Colones unused.

The BCR was planning to refinance old ISTA (El Salvador Institute of Agrarian Transformation) loans with this money. In 1980, the Agricultural Development Bank (BFA) advanced funds to ISTA for loans to agricultural cooperatives for the 1980 planting season. Some of these loans were made without signed agreements between the cooperatives and ISTA. Many cooperatives were unable to pay off the loans.

The BCR had identified 38.2 million Colones worth of these delinquent ISTA loans for refinancing with the AID generated local currency fund. Another 9.6 million Colones was to be used to refinance similar type loans to coffee cooperatives. The BCR was planning to use the remaining 2.2 million Colones to pay administrative expenses for Phase III of the El Salvador Agrarian Reform Program.

We do not believe that the BCR should be using AID generated local currency funds to refinance old delinquent ISTA loans. Rather, the funds should be used to finance new production and investment loans in the agrarian sector.

In respone to the draft report, the Mission advised us that it requested the BFA to work with the BCR to reschedule the delinquent portfolio so that the Agrarian Reform Credit Fund under PSS I would be used to finance viable agrarian reform loans. The rescheduling of these delinquent loans has been made a condition precedent to disbursement of project supplement funds for the Agrarian Reform Credit Project (No. 519-0263) to ensure compliance with our recommendation.

Recommendation No. 3

USAID/El Salvador should require the BCR to restrict its loan activities for the 50-million Colon Agrarian Reform Credit Fund to new loans. No refinancing of old loans of questionable value should be permitted.

Use of Interest

Interest earned on the Agrarian Reform Credit Fund was to be applied to two projects: (1) a 4-million Colon fund to establish a private, non-profit, technical vocational school to provide training in various types of skilled labor techniques; and (2) a 500,000 Colon fund with the Small Business Finance and Guarantee Fund (FIGAPE) to provide technical assistance and support for the establishment of small, worker-owned businesses.

Recently the BCR signed a contract with the Seventh Day Adventist Church in El Salvador to operate an agricultural vocational school. It also plans to give money to FIGAPE once enough interest has been earned by the fund. At the time of our audit, the fund had earned about 1.5 million Colones in interest.

Working Capital Funds

The working capital funds in PSS I and II have encountered mixed results. The first fund in PSS I had only loaned to businesses about 5 percent of the 50 million Colons available. On the other hand, the demand for loans from the fund in PSS II has already exceeded the supply. The Mission and BCR need to reevaluate the terms for the PSS I working-capital fund to better meet credit market demands.

Private Sector Support I

On December 24, 1980, the BCR established a Short-Term Working Capital Fund with a 50 million Colon counterpart contribution. The Fund was to be used to provide short-term loans to businesses for up to one year. The interest rate varied depending on the size of the business -- 13 percent for businesses with assets valued up to 5 million Colones; and 15 percent for businesses with assets valued over 5 million Colones.

As of September 28, 1981, only 1.9 million Colones had been used from this fund. Reasons given for the low usage rate include:

- Demand was related to the volume of imports because the fund was supposed to help finance imports. Consequently, with a low import rate, demand for short-term money was low;

- Commercial banks would rather loan their own funds first because the 2 percent margin on the Working Capital fund was not very attractive;

- The loan terms for large firms were more favorable in the commercial market. The rate for large firms was 15 percent from the Working Capital Fund and 13 percent from commercial markets.

- The loan criteria included a debt to capital ratio of 2.5/1, which was very difficult to achieve, especially for small businesses. This ratio was recently changed to 3.25/1.

Private Sector Support II

In July 1981, the BCR established a 52.25-million Colon Medium-Term Structural Capital Fund with part of the local currency generations from the loan. The money in this fund was to be loaned out from one to four years, with very favorable interest rates -- 7 percent for businesses with assets valued up to 5 million Colones and 9 percent for businesses with assets valued over 5 million Colones. Demand for this money surpassed the amount available. As of September 22, 1981, the BCR had received applications totalling about 61 million Colones. At the time of our review, about 3.5 million Colones had been disbursed to businesses.

In an attempt to increase the use of the money in the Short-Term Fund, the BCR was planning to tie it to the use of the Medium-Term Fund. For example, the BCR may determine that on a 10,000 Colon application, 2,000 Colones would be for short-term needs. Therefore, the BCR would approve a loan of 8,000 Colones from the Medium-Term Fund and 2,000 Colones from the Short-Term Fund. The business would have to take both loans or none at all.

We believe that the use of the 50-million Colon Short-Term Working Capital Fund should be reevaluated. Since demand exceeded the amount of money in the Medium-Term Fund, it may be appropriate to shift all or part of the money in the Short-Term Fund into the Medium-Term Fund.

Since the completion of the audit, the Mission has carried out a comprehensive, in-depth evaluation of the performance of both funds. As a result, the Mission advised us that it plans to propose combining the funds, as well as a number of other changes in fund administration.

Recommendation No. 4

USAID/El Salvador should reevaluate the use of the Short-Term Working Capital Fund in Private Sector Support I to determine if it should be restructured to provide terms similar to those in the Private Sector Support II Medium-Term Structural Capital Fund.

Institutional Support

In addition to establishing the Medium-Term Structural Capital Fund under PSS II, the GOES agreed to establish a 10-million Colon account to be used to meet the institutional support needs of private and public sector entities whose operations were vital to the economic and social development of the country. The GOES has decided to give this money to seven El Salvador institutions. The planned breakdown was:

	(in Colones)
Health Sector Support: Basic health services provided under the Rural Health Aides System; health education classes; budgetary support to the Ministry of Health	3,000,000
Election Committee Support: Operational cost support	600,000
Education Sector Support: Operational cost support	1,500,000
Ministry of Interior: Operational and logistic support and operational support to the Emergency Community Feeding Program	1,500,000
Ministry of Justice; Solicitor General for the Poor; and Integrated Program for Community Developement: Operational support and studies related to the defense of civil liberties, establishment of adoption centers and legal assistance to unions	1,050,000
Ministry of Labor: Operational and logistic support for counterpart contribution to a professional training program (UNDP)	300,000
Ministry of Planning: Operational and logistic support and studies to implement or improve upon the various administrative and political reforms undertaken by the GOES	2,050,000
Total	10,000,000

At the time of our review, no money had been distributed. The Mission had received five of the seven agreements between the Ministry of Planning and the recipient institutions and found them to be basically acceptable. Once the agreements are signed, the distribution of funds should take place.

Management of Local Currency Fund

A way must be found to manage the local currency funds generated from future economic support projects for El Salvador which will not overburden the Mission's resources and still provide some form of accountability. The management of the dollar funds in PSS I went fairly well. The program was very simple -- a cash transfer to the GOES to be used to import badly needed raw materials and intermediate goods. However, the use of the local currency funds generated from this program, as well as the counterpart fund, have encountered a number of problems and required excessive attention from the Mission's limited staff resources.

Although the purpose of these local currency projects may look good on paper, the Mission has had to spend a significant amount of time following these projects and reviewing documentation to assure proper use of the funds. The Agrarian Reform Credit Fund has been the subject of much correspondence between the Mission and BCR in an attempt to determine how the money was being used. Interest from this fund was to be used to pay for two more subprojects .... thus creating more review and accountability problems for the Mission. In PSS II, no less than seven projects will be funded with $4 million in local currency funds; again, requiring lengthy reviews of agreements and plans.

USAID was planning a third tranche to the Private Sector Support Project which would provide another $99 million in economic support at the time of our review. The local currency generated from the project will be about 250 million Colones.

The local currency portions of both PSS I and PSS II have required much more Mission time to monitor than the dollar portions. Yet the dollar transfers were the primary purpose of the projects. We do not believe that the Mission will be able to adequately monitor the use of 250 million Colones unless the number of local currency projects are kept to a minimum and are simple to implement.

As the number and complexity of projects increases, monitoring becomes more difficult. Numerous, complex local currency projects would only serve to exacerbate an already difficult task in El Salvador where the Mission's limited staff resources are restricted because of civil strife and terrorist activity.

In response to the draft report, the Mission advised us that it was working with the GOES to program all local currencies generated by fiscal year 1982 economic support fund and P.L. 480, Title I programs directly into the GOES 1982 budget. The local currency generation will provide counterpart funding to AID-financed assistance activities or GOES activities which are supportive to AID's program interests in El Salvador.

Recommendation No. 5

USAID/El Salvador, should establish guidelines for the programming and use of local currency generations that will reduce monitoring requirements and provide adequate oversight.

LIST OF RECOMMENDATIONS

Recommendation No. 1

The Assistant Administrator, Bureau for Latin America and the Caribbean, AID/Washington, and USAID/El Salvador, in consultation with the Government of El Salvador, should agree on the most effective means of providing the GOES the maximum flexibility in managing its foreign exchange while maintaining adequate safeguards over the use of AID funds. (Page 7)

Recommendation No. 2

USAID/El Salvador should obtain from the GOES a plan for funding the development and implementation of an import price-checking system. The plan should include a timetable for the implementation of the system. (Page 8)

Recommendation No. 3

USAID/El Salvador should require the BCR to restrict its loan activities for the 50-million Colon Agrarian Reform Credit Fund to new loans. No refinancing of old loans of questionable value should be permitted. (Page 9)

Recommendation No. 4

USAID/El Salvador should reevaluate the use of the Short-Term Working Capital Fund in Private Sector Support I to determine if it should be restructured to provide terms similar to those in the Private Sector Support II Medium-Term Structural Capital Fund. (Page 10)

Recommendation No. 5

USAID/El Salvador, should establish guidelines for the programming and use of local currency generations that will reduce monitoring requirements and provide adequate oversight. (Page 12)

LIST OF REPORT RECIPIENTS

	No. of Copies
Deputy Administrator, AID/W	1
Assistant Administrator - Bureau for Latin America and the Caribbean (LAC/CAR), AID/W	1
Mission Director, USAID/El Salvador	5
Assistant Administrator - Bureau for Development Support	1
Assistant Administrator, Office of Legislative Affairs (LEG)	1
Office of Financial Management (FM), AID/W	1
General Counsel (GC), AID/W	1
Audit Liaison Office, LAC/DP, AID/W	3
Director, OPA, AID/W	1
DS/DIU/DI, AID/W	4
PPC/E, AID/W	4
Inspector General, AID/W	1
IG/PPP, AID/W	1
IG/EMS, AID/W	12
AIG/II, AID/W	1
RIG/A/W	1
RIG/A/Abidjan	1
RIG/A/Cairo	1
RIG/A/Manila	1
RIG/A/Karachi	1
RIG/A/Nairobi	1
RIG/A/NE, New Delhi Residency	1
RIG/A/LA, Panama Residency	1
RIG/A/LA, La Paz Residency	1
GAO, Latin America Branch, Panama	1