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INSPECTION REPORT

AID Loan and Related Grants for Tourism Development in Central America

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AID Loan and Related Grants for Tourism Development in Central America

SUMMARY

Under the authority provided by Subsection 624(d) of the Foreign Assistance Act (FAA) of 1961, as amended, we reviewed (1) a $15 million AID loan made to the Central American Bank for Economic Integration (CABEI) to finance tourism in Central America and (2) certain grants made by AID for developing tourism in Central America. The purpose of the inspection was to determine whether the objectives for which the loan and grant funds were made available were being attained.

We concluded that the loan made to finance most of the estimated costs of constructing certain infrastructure facilities (such as airports and highways near existing or potential tourist attractions) was made prematurely in that adequate technical and financial feasibility studies had not been made.

Section 611(a) of the FAA and AID regulations require such studies before large scale capital assistance funds are obligated by AID. Although an AID General Counsel ruling indicated that the FAA proviso need not apply to loans of this kind (through intermediate credit institutions) we do not believe this particular loan should have been made until feasibility studies had been completed because of the circumstances we cite in the report.

We found that the loan was made without a clear understanding by the Central American countries of the loan's aims and purposes. A recent AID evaluation report validates that finding. No AID infrastructure facilities had been started more than two years after the loan was signed and the amount of the loan will not be sufficient to cover the costs of the infrastructure the loan was intended to finance. The original estimate of $18.6 million for the cost of the infrastructure facilities which was the basis for the loan is currently estimated at $32.7 million.

Some of the designated sites on which the loan was based are not suited for the intended projects nor will some of the facilities for which funding was provided be needed.

Furthermore, there is no assurance that the substantial public and private investment funds needed to utilize the infrastructure facilities funded by the AID loan will be available.

We recommend that AID, when making loans to intermediate credit institutions (ICI's), apply the requirements of Section 611(a) of the FAA to such subprojects as are known at the time a loan is made; and that AID otherwise apply prudent management techniques, such as preloan feasibility studies, to such projects.

AID's response implies that because technically ICI loans are not subject to Section 611(a) it need not apply prudent management procedures thereto. AID states that "Congress appears to be satisfied with AID's interpretation of 611(a) as it applies to ICI loans." IGA suggests close review of this point by appropriate committees of the Congress.

We also recommended several corrective actions in connection with the subject loan, and a re-examination of AID's coordination with donors in view of our finding of overlapping studies by three users of U.S. funds.

A special effort was made in this case to affect a meeting of the minds as to the issues involved. As the Bureau comments (reproduced verbatim as an appendix to this report) indicate, IGA analyzed the Bureau's draft response to our draft report in detail. We also met with Bureau officials to attempt to further delineate the issues. The Bureau's revised comments were even longer than its draft and still are not, in our opinion, fully responsive. We have requested review of the issues by the Office of the Administrator of AID.

BACKGROUND

For several years CABEI has made loans for the financing of facilities for tourists, primarily hotels and hotel related facilities. A significant part of the funds used by CABEI for this purpose was derived from funds loaned to CABEI by AID. To further develop the tourism industry in Central America, AID made a loan of $15 million to CABEI (loan No. 596-L-013) on ~~February 28, 1973.~~ CABEI was to sublend the AID funds to CABEI's five member countries (Guatemala, Honduras, El Salvador, Nicaragua, and Costa Rica) for the purpose of constructing a number of tourist infrastructure projects in those countries (hereafter referred to as subprojects) and for related technical assistance in support of tourism. The term tourist infrastructure refers to such items as airports, highways or utility systems to serve tourist areas. The five Central Ameriacan countries and CABEI were also to provide a total of $5 million towards the total project cost of $20 million.

The loan was designed to integrate tourist activity in all of Central America by providing "poles," or prime tourist attractions in each country along with secondary attractions which tourists could visit in connection with their trips to the primary poles. The expectation was that tourists would include visits to several countries in their itineraries and thus a Central American tourist circuit would be developed. The infrastructure was considered necessary to encourage private investment in tourism industries having high foreign exchange earning potential.

The loan agreement tentatively selected for financing 12 subprojects at which tourist attractions either existed or would be constructed (see page 4). The amount of AID funding provided by the loan was based on cost estimates for the infrastructure facilities at these 12 sites. All sites were selected because they conformed to the regional concept of the project.

Some of the sites of possible tourist attractions were suggested by a general study of tourist potential in Central America made for CABEI by a Spanish firm, Techniberia. The loan agreement included sites suggested by Techniberia, which were largely seaside locations where potential tourist accommodations might be built. Other sites included in the loan agreement were those already of interest to tourists, such as Mayan ruins in Guatemala and volcanoes in Costa Rica. The sites suggested by the Techniberia report were not selected as the result of detailed feasibility studies but were suggested as sites having possible tourist potential.

Following is a list of the subprojects tentatively selected for financing by the loan agreement and the infrastructure which the loan was planned to finance at each location:

Country	Tourist Attraction	Location	Infrastructure Facilities Planned for Financing by AID Loan
Guatemala	Mayan ruins	Tikal	Airport, road, ruins restoration
El Salvador	Beach resort	Icacal	Airport, road, utilities
Honduras	Beach resort	Tela	Airport, road, utilities
	Beach resort	Islas de la Bahia	Airport, road
	Mayan ruins	Copan	Airport, road
Nicaragua	Beach resort	San Juan del Sur	Road, utilities
	Beach resort	Masachapa	Road, utilities
	Beach resort	Corn Island	Airport
	Lake facilities	Lake Nicaragua	Docking facilities, navigation aids
Costa Rica	Beach resort	Bahia de Culebra	Airport, road
	Volcanoes	Poas and Irazu Volcanoes	Roads

The Capital Assistance Paper estimated that the construction cost of these facilities would be $18.6 million.

In addition to financing infrastructure subprojects, the loan also provided AID funds which CABEI was to relend to its member countries for the following purposes:

To finance the establishment of training schools for hotel executives and for hotel employees	$ 375,000
To finance tourist promotion activities	375,000
To finance feasibility studies of sub-projects	300,000
	$1,050,000

CABEI was to provide an additional $350,000 towards these activities.

The loan is administered for AID by its Regional Office for Central American Programs (ROCAP) located in Guatemala City.

SCOPE OF INSPECTION

We reviewed AID loan 596-L-013 and certain related AID grants to determine whether the objectives for which the loan and grant funds were made available were being attained.

Our review included an examination of records and documents at AID/Washington and at ROCAP in Guatemala City; and discussions with AID officials in Washington and Guatemala City, CABEI officials in its headquarters in Honduras and at its office in Costa Rica, and consultants employed by certain Central American governments and organizations in connection with tourism development activities.

The findings resulting from our review were discussed with responsible officials at both ROCAP and AID/Washington. After AID's Bureau for Latin America submitted draft comments to our draft report, we met with Bureau officials to attempt to further delineate the issues.

RESULTS OF INSPECTION

A. <u>AID Loan for Tourism Infrastructure</u> - We concluded that the AID loan of $15 million to CABEI to finance most of the estimated costs of constructing certain infrastructure facilities (such as airports and highways near existing or potential tourist attractions) was made prematurely in that adequate technical and financial feasibility studies had not been made.

Section 611(a) of the FAA and AID regulations require such studies before large scale capital assistance funds are obligated in the case of direct loans. The loan was made without a clear understanding by the Central American countries of the loan's aims and purposes. No AID infrastructure facilities had been started more than two years after the loan was signed, and the amount of the loan will not be sufficient to cover the costs of the infrastructure the loan was intended to finance. Some of the designated sites on which the loan was based are not suited for the intended projects, nor will some of the facilities for which the funding was provided be needed. Finally, there is no assurance that the substantial public and private investment funds needed to utilize the infrastructure facilities funded by the AID loan will be available.

1. Feasibility Study Requirements - Section 611(a) of the FAA requires that funds in excess of $100,000 cannot be committed by AID for any project requiring substantive, technical and financial feasibility studies unless such studies have been made. In the case of AID loans to intermediate credit institutions (ICI's), such as CABEI, which relend AID funds, the sub-borrower (i.e., the person borrowing from the ICI) is often not known when AID enters into the obligation with the ICI. Therefore, in such instances it would be difficult to make technical and financial feasibility studies of the subprojects, which are the ultimate users of the AID funds, before the funds are obligated. Accordingly, in the case of ICI's, on September 29, 1971 the AID General Counsel's Office (GC) has determined that only the AID loan agreement with an ICI requires compliance with Section 611(a) and that the planning for the subprojects to be financed with AID funds made available to the ICI need not necessarily comply with the statute. The GC's ruling, however, pointed out that it was primarily a matter of judgment as to how Section 611(a) should be applied to activities funded by ICI's with AID funds.

In the case of loan L-013, however, the subprojects to be financed by CABEI's relending of the AID funds were known before the funds were committed. We believe that whenever the subprojects to be financed by the relending of AID funds by ICI's are known, AID should apply the requirements of Section 611(a) to the sub-projects to be funded before AID obligates funds for a loan to an ICI.

AID's comments on our draft report may or may not apply to a typical ICI loan but do not fit the special circumstances surrounding the tourism loan. In a typical ICI loan, the AID funds are provided to an ICI which uses the AID funds for loans to sub-borrowers--generally private entrepreneurs needing the funds to finance plant expansion or working capital requirements; these sub-borrowers are not generally known to AID at the time the loan is made and whether or not sub-loans are made to one potential borrower or another does not make a signific nt difference to the success of the overall project.

In the instant case, the subprojects were not only known to AID before the loan was made, but the subprojects designated in the AID loan agreement were, according to the Techniberia report cited by AID as a principal basis for the loan, the major tourism attractions in Central America. Accordingly, the amount of the AID loan was calculated as the estimated cost of infrastructure facilities or the locations designated by the loan.

The subprojects listed in the loan agreement were not tentative in the illustrative sense that AID implies but were tentatively designated as the subprojects for which the loan was made. Such a designation of the sub-projects covered by the loan as the major tourist centers of the area is quite different than a situation in which there is an unlimited number of potential projects, since there is not an unlimited universe of major tourist attractions in Central America.

If the sites on which the amount of the AID loan was based were potentially the principal tourist attractions of the area, the fact that these tourism sites did not live up to their potential does not mean, ipso facto, that there is an unlimited number of other tourist attractions waiting to take their place. For example, the restoration of Mayan ruins in Guatemala was one of the elements of cost included in the AID loan. To say that if this restoration proved infeasible, there were other acceptable Mayan ruins in Central America which could be substituted therefor would be at odds with archeological realities.

As another example, the AID loan contained $225,000 for repairs to a road leading to the crater of the Irazu volcano in Costa Rica. Subsequently, the Costa Rican Government repaired the road without using AID funds; accordingly this subproject is no longer contemplated for AID financing. According to AID's reasoning, there should be other volcanoes or other tourist attractions in Costa Rica which would be substituted for the Irazu subproject; this is not the case because the supply of tourism centers in Costa Rica and throughout Central America is limited.

The same reasoning applies to the beach resorts contemplated for AID loan financing. Those designated by the loan agreement were also selected by the Techniberia study as leading areas for development. Should these areas prove infeasible for tourism development, the number of beaches to replace them is limited.

In the instant case, AID did not claim that Section 611(a) did not apply to the need for technical and financial feasibility studies as the GC had ruled; rather the Capital Assistance Paper (CAP) stated that all Section 611(a) requirements had been met.

2. <u>General Study of Tourist Potential</u> - The CAP, which is the basis for the AID loan, stated that the tourist potential in Central America had been pointed out in several studies, of which the Techniberia study was the latest and most complete attempt to estimate the impact of tourism on the Central American economy. The CAP stated that the Techniberia study was one of the studies providing the focus of the program and the selection of priority tourist locations on which the loan was based.

The Techniberia report, a general study of tourist potential in Central America, was not a feasibility study which would provide an adequate basis for determining the infrastructure facilities needed, the costs thereof, or in some cases, the locations for the facilities. In fact, the loan agreement itself provided that feasibility studies would have to be completed before any subproject was funded by the loan, and provided that $300,000 of the loan funds could be used to pay for such studies.

Several years after completion of the Techniberia study, IDB stated that the operation of a regional tourism circuit had not yet been evaluated and that therefore the necessary projects for the interconnection of the primary poles had not been identified. In a November 1973 appraisal of tourism in Central America, ROCAP reported that the Techniberia study was an attempt to force Central American regional tourism development into a "sun, sea, and sex" pattern and that this was a costly and difficult experiment which had been rejected or not quite understood by the majority of the Central American countries.

3. Feasibility Studies - After the loan agreement was signed, there was uncertainty over the status of feasibility studies and who was to pay for them. In October 1973, the Acting Director of ROCAP said that all five Central American countries were making progress in preparing feasibility studies for each subproject and were using their own or CABEI funds (not derived from AID) to pay for these studies. He also said that while AID funds could be used to pay for feasibility studies, AID did not expect any of its loan funds to be used for this purpose. The Acting Director stated that Honduras, Costa Rica and Nicaragua were using IDB funds supplied to CABEI to finance the studies. However, at the time of our inspection in June 1975, two of the countries had not even started the studies. Furthermore, AID funds rather than IDB funds were loaned directly by CABEI to Nicaragua to finance the feasibility study in that country.

Shortly after our inspection, AID completed an evaluation of the subject loan. Page 12 of the evaluation report stated:

> ". . . for a variety of reasons our initial planning for the loan may have been unrealistic; and, the loan itself appears to have been premature. Problems unforeseen at the outset, in addition to an unrealistic time frame in the preliminary stages, contributed to the long delays. The Central American countries have been very slow in contracting and completing feasibility studies and final design. Factors contributing to this inactivity include: (a) a basic unfamiliarity, on the part of all the C.A. (Central American) countries with the project and its purpose, and (b) a lack of authority on the part of the Tourism Institutes to develop and execute tourism policies and projects on their own." (Underscoring supplied.)

In our inspection we noted data which supported this AID judgment. For example, as cited above, one country's legislature would not approve of its executive borrowing funds for a tourism feasibility study. Also, as AID has stated, the Central American governments were unwilling to borrow AID loan funds provided for technical assistance. These instances, along with others cited by the AID evaluation report, support the statement made by the evaluation report and our conclusion that the Central American countries did not have a clear understanding of the loan's aims and purposes. For example, the AID evaluation report noted that after the loan was made the Government of Nicaragua (GON) was unwilling to accept the locations designated by the loan agreement for that country. After pressure from CABEI, the GON subsequently agreed to study the sites listed in the loan agreement.

Eventually, after prolonged delays, the various governments either contracted for feasibility studies to be conducted by specialized firms or planned to contract for such studies. At the time of our inspection in June 1975, the status of the feasibility studies was that in Honduras and El Salvador the studies were underway and near completion; in Nicaragua it appeared that selection of a contractor to make the study was near; in Costa Rica while the government had agreed to borrow money from CABEI to fund such a study, the country's legislature had not ratified the loan; and in Guatemala, that government had conducted its own feasibility study for the Tikal project but CABEI found the study inadequate. The Government of Guatemala then planned to engage engineering firms to do the necessary work.

4. Funding Requirements - Feasibility studies serve as a basis for determining the amount of funds needed to carry out the undertaking for which the loan is made. Because these studies were not made, the funding estimates used as a basis for the AID loan were inaccurate and accordingly the funds provided by the loan are insufficient to finance the subprojects designated by the loan.

The AID estimate of the cost of the infrastructure subprojects designated in the loan agreement totaled $18.6 million, and this is the sum provided for these subprojects by the AID loan agreement and by the contributions of CABEI and the member countries. The estimate of costs of the subprojects at the time of our inspection totaled $32.7 million, but there was no assurance that even this higher figure was the final one. The Chief of Infrastructure of CABEI told us that the cost estimates used as a basis for the loan were, in many instances, not factually based.

Because the need for funds will very likely exceed the fund availabilities, AID and CABEI have agreed to provide these funds on a first-come, first-served basis, which may well exclude some of the countries from participating in the project at all, even though the loan contemplated including all of the Central American countries as a single tourism unit. ROCAP records show that funds will probably be adequate for only two of the five countries originally expected to participate in the project unless CABEI is able to obtain financing from other sources to carry out the original plan.

AID states that, subsequent to our inspection, "CABEI has expressed its commitment to meet the shortfalls in overall project costs from its own resources" and that if the terminal date of the loan is extended, "the Mission will implement the loan in a way which will allow the funding of projects in several countries ...."

5. Site Selection - The following discussion of some of the sites designated by the loan agreement as the locale of tourist attractions, illustrates the inadequacy of the data used as a basis for the AID loan.

The site in El Salvador designated by the loan agreement as the tourist attraction which would tie El Salvador in to the Central American tourist circuit was a proposed beach resort at Icacal. AID proposed to provide a significant amount of funds to build an airport near this site so the tourists could readily get to the resort. The loan agreement stated that this and the other subprojects designated by the loan reflected the priority of the member country for development.

While the loan agreement stated that Icacal along with the other sites listed in the loan agreement were only tentative subproject selections, the Acting Director of ROCAP stated in October 1973, more than seven months after the loan had been signed, that when the feasibility study of the Icacal project was completed, an application for financing that project would be sent to CABEI by the Government of El Salvador. However, the contractor employed by the Government of El Salvador to make a feasibility study for a beach resort told us in

July 1975 that the Icacal location was one of the least desirable for that purpose in the country, in part because it was the farthest from the country's principal tourist attractions. He said that the site he thought was most desirable for a beach resort was close enough to the capital city that the existing airport could be used to accommodate tourists.

In the case of Nicaragua, we were advised by the ROCAP co-manager of the project that the sites designated by the loan agreement were not suitable for international tourism and were likely to be used only by the local population. If that were true Nicaragua would not be able to earn the large amounts of foreign exchange from international tourism the loan contemplated.

In its comments on our draft report AID contends that the subprojects designated in the loan agreement were tentative and that it was recognized that changes in subprojects or subproject sites could occur and alternatives would be identified and evaluated. Accordingly, AID does not find it surpri ing that after subsequent study some sites will be found less desirable than others.

The amount of funding provided by the AID loan was to pay the estimated costs of constructing facilities at the sites designated by the loan agreement. For example, the AID loan included $1.4 million to build an airport and $800,000 to build a road at Icacal, El Salvador. After completion of a feasibility study, should this subproject not prove feasible (as now seems certain), this airport and road would not be needed. If an alternative site is subsequently substituted for Icacal, the amount needed for infrastructure at some other site might be more or less than the amount provided for Icacal; consequently, the loan would then either provide too much or too little funding.

Had adequate feasibility studies been completed prior to making a loan for a number of infrastructure subprojects, changes in the subprojects to be financed and in funding requirements might not occur. As it is, because feasibility studies were not made before making the loan, AID did not have a sound basis for the amount of funds it controlled. Consequently, the amount provided by the loan has proven grossly insufficient to carry out the regional pole concept which was the objective of the loan. We believe that when AID provides large scale funding for a group of subprojects, the amount so provided should have some reasonable relationship to the costs. If such subprojects are not determined to be feasible, and different subprojects substituted therefor, the cost estimates will very likely be grossly inaccurate as is the case with the subject loan.

What AID is saying in effect is "We want to commit funds to finance those capital infrastructure projects which will integrate tourism facilities in five countries. We do not know which projects are needed, nor where they are to be located, nor how much they will cost, but we will commit a specific amount of funds for this purpose anyway. Then we will find out later what capital facilities are needed, where they will be located and how much they will cost"

We do not believe that such a position represents prudent management of public funds, and is precisely what Section 611(a) of the FAA is intended to prohibit (we address the application of Section 611(a) elsewhere). The AID Manual also prescribes sounder planning than is set forth in AID's comment. We believe that before funding is committed for capital facilities for such a complex undertaking as is represented by this loan, prudent management would require a determination of the location and approximate cost of these facilities and we believe preloan feasibility studies would have enabled these decisions to be made. For AID to espouse the position that it need not have feasibility studies of this complex undertaking is not prudent management.

6. Technical Assistance - The loan agreement contemplated that $375,000 in AID funds could be used towards the estimated $500,000 cost of establishing a regional training school for hotel executives, and for national schools for lower level hotel employees. The CAP, dated February 1973, said that plans were then being finalized for the hotel executive training school. However, at the time of our visit 2-1/2 years later, plans had not been finalized and there was considerable doubt that the executive school was needed. As for the schools for hotel employees, the ROCAP co-manager of the project told us that such schools were not considered necessary because hotels generally train their own personnel without recourse to public sector training schools.

As to the $375,000 of AID funds authorized by the loan for tourist promotion activities, we were told by the ROCAP project co-manager that tourist promotion is usually conducted by the tourist offices of each country using funds allocated to these offices from their country's operating budget; accordingly, it is unlikely that those offices would borrow AID funds from CABEI for this purpose. Records of meetings held between AID and CABEI officials show that consideration was being given to using the funds authorized for training and tourist promotion for other purposes, such as meeting cost overruns on the infrastructure subprojects. By using these funds for this purpose it was expected that CABEI would be able to disburse the AID funds at a faster pace and thus avoid the possibility of deobligation of unexpended funds by AID.

7. <u>Public and Private Investments for the Construction of Facilities</u> - Even when the AID infrastructure subprojects are completed, in some instances they will not serve any purpose unless both public and private investment materializes to erect facilities to attract tourists at locations served by the infrastructure. The principal exceptions to this would be for already established Central American tourist attractions, such as Mayan ruins and volcanoes. In these only infrastructure, such as airports or roads, need be completed to facilitate the travel of tourists to these attractions. However, most of the infrastructure to be financed by the AID loan is to serve beach resorts which do not now have facilities of an international tourist standard at the locations to be served. Accordingly, public and private investment to erect such facilities at these locales is essential if the infrastructure expenditures are to serve any purpose.

For example, in Honduras, AID expects to spend about $3 million to build a road leading to a proposed beach resort where no development now exists. The consultant hired by the Government of Honduras (GOH) to prepare a feasibility study for the project contemplates that phase one of the resort will require an investment of about $80 million (which is equal to about one-half of the total investment made for all purposes in Honduras during 1973). The contemplated investment includes approximately $25 million by the GOH for additional infrastructure facilities, such as streets and utility systems within the development, and a private investment of about $55 million for construction of hotels, condominiums, etc. There is no assurance that the GOH will be able to finance its share of the investment (which is equal to about ten percent of its annual revenues) nor that private investors would be willing to invest this sum in a country which (we were told by the ROCAP project co-manager) has no tourist investment laws to safeguard the private investment.

AID has recognized that there is not now any definite commitment for such an investment either on the part of the GOH or the private sector. Accordingly, it made a grant of $100,000 to the Secretariat for Central American Tourist Integration (SITCA), an agency to which all the Central American countries and Panama belong. SITCA was to employ a contractor to identify investors and hotel operators involved with international hotel chains, and try to interest these groups in investing in tourist facilities in rural areas outside the Central American capital cities.

We discussed the probability of getting the investment to make the AID infrastructure expenditures worthwhile with the contractor selected by SITCA to carry out this task. He told us that he has found little interest on the part of the large hotel chains in investing in Central American facilities. In particular, the chains were wary about Honduras because of political instability, and about Central America in general because the Eastern Caribbean area, which is a competitor of Central American tourism, has a surplus of hotel accommodations. The matter of excess hotel accommodations in the Caribbean region was also brought out in a recent report prepared for the World Bank.

The contractor told us that he thought it would be well over a year before it would be reasonable to expect a potential investor to make a commitment to build a hotel in Honduras. He did not expect that investments of the size contemplated by the consultant who was preparing the feasibility study for the project in Honduras would materialize from traditional investment sources.

Finally, the contractor told us that tourist hotels in Central America probably should be located near the capital cities rather than in the rural areas contemplated in the AID loan. The consultant employed by the Government of El Salvador to make a tourism feasibility study in that country gave us similar advice.

Both the CAP and the loan agreement recognize the necessity for providing investment to assure utilization of the infrastructure facilities. The loan agreement requires CABEI to obtain a feasibility study from the member countries prior to the signing of any subproject loan. The study is to include the private investment anticipated as a result of the infrastructure development, as evidenced by the firm commitments for the construction of hotels in the area served by subprojects financed by the AID loan.

We believe that unless the term "firm commitments" means a signed, enforceable contract between the respective governments and private investors (with suitable requirements for performance by all parties), there will be no assurance that the investment to utilize the AID-financed infrastructure subprojects will in fact be made. In order to receive such guarantees, potential investors will have to receive some assurances from the governments of the countries involved regarding the safety of their investments. Furthermore, there would have to be assurances that the country itself could provide the necessary public sector investment that a private investor would require.

Because of the prolonged delay in implementing this loan, more than half of the term of the loan has elapsed without any of the subprojects which the loan was to finance being started. The loan's terminal commitment date (TCD) is December 31, 1976. With the additional time required before a potential investor would be in a position to make a guaranteed commitment, the TCD could arrive without the loan being fully committed. We hope that pressure to commit funds will not cause AID to construe the term "firm commitment" as other than an enforceable investment contract because if AID approves infrastructure subprojects without guarantees that the other necessary investment will materialize, some of the AID expenditures for infrastructure may serve no immediately useful purpose.

Changes in the foreign assistance act since this loan was made would generally preclude such a loan in the future. However, other international lending agencies have expressed interest in financing some of the infrastructure included in the AID loan or for providing financing for projects of this type.

Recommendations

1. That AID, when making loans to intermediate credit institutions, apply the requirements of Section 611(a) of

FAA to such subprojects as are known at the time a loan is made; and that AID otherwise apply prudent management techniques, such as preloan feasibility studies, to such subprojects.

<u>Agency Comments</u> - AID acknowledges that the loan has been subject to delays which were unforeseen in the CAP, and that the CAP did not take into account a number of problems which prevented the subprojects from being implemented as expected. However, AID disagrees with our conclusion that technical and financial feasibility studies should have been made of the proposed subprojects prior to AID's approving this loan. Its disagreement is based on the fact that it believes that, while such feasibility studies are made for construction of a road when financed by a direct bilateral loan, such studies need not be made when a road is to be constructed by a loan made for that purpose through an ICI. AID cites a 1967 legal memorandum written by its General Counsel's office stating that Section 611(a) of the FAA which generally requires technical and financial feasibility studies, does not apply to AID loans to ICI's.

<u>IGA Response</u>

Section 611(a) provides in effect that a prudent management procedure should be applied to the act of providing assistance. This procedure is to determine, in advance of making aid available, if the project for which the aid is advanced, is technically and economically feasible. Section 611(a) was enacted by the Congress because it felt that such procedures were not always applied before aid was made available. In the case of assistance to the ICI's AID's GC has ruled that technically this provision may not be applicable. However, recent GC rulings point out that whether AID should avail itself of this escape clause is a matter of judgment, and as a matter of fact, the most recent GC rulings state that AID should apply this procedure even though technically AID may not be required to do so. Though the more recent rulings apply to CIP loans and grants, the GC argument applies equally to ICI's and, in our opinion, reflects a maturing of GC's viewpoint.

In the case of the subject loan, because AID knew of the subprojects that would be financed through the ICI in advance of making the loan, it could have applied the prudent *management procedure of determining in advance whether the subprojects to be financed were feasible. Not to have done so seems to us to be a lack of prudent management which is the essence of our findings. AID's comment implies that because technically this loan is not subject to Section 611(a) it need not apply prudent management procedures thereto. We do not agree.*

The most significant comment by AID in this regard appears to us to be "AID has continued to apply its interpretation consistently, and Congress appears to be satisfied with AID's interpretation of 611(a) as it applies to ICI loans." (Underlining added.) Apparently AID is inviting the appropriate Congressional Committees (who receive IGA reports) to determine whether the intent of Congress was that AID apply prudent management practices narrowly, as AID contends, or whenever prudent management can be effectively exercised, as IGA contends. IGA concurs and suggests close review of this point by appropriate committees of the Congress.

2. We recommend that AID not approve CABEI sub-loans of AID funds for infrastructure subprojects for those tourism locations which require further investment by the public and private sectors unless there is an enforceable agreement which guarantees that such investments will materialize.

Agency Comments - AID acknowledges the importance of reasonably assuring private investment follow-on to the public sector infrastructure investments undertaken under loan 013 before subproject approvals are made by CABEI. AID believes, however, that the loan requirement that CABEI include in each subproject proposal the amount of private investment anticipated as a result of the infrastructure provides the best indication of reliability of overall investment. AID does not agree with one proposal that a legally enforceable private investment contract is necessary to assure utilization of AID-financed public sector infrastructure subprojects. AID believes such a requirement would make the chances for successful loan implementation extremely improbable, and that an undefined loan commitment is the best method of operation.

IGA Response

The history of this loan to date does not offer much assurance that it will be successfully implemented if left to *continue without more effective supervision by CABEI than it has already received.*

Our discussions with the AID-financed contractor selected to ascertain the likelihood of private investment for this project did not indicate that the needed private investment would be readily forthcoming. Consequently, we believe that, with the pressures to commit the loan funds before the TCD, CABEI's statement as to anticipated private investment resulting from the infrastructure projects may well be more evanescent than real. Our comments on what we consider an unrealistic level of expectation in the case of Honduras, cited on page 14 reinforce this belief. This would then raise the possibility that the AID-financed infrastructure project would not serve any immediately useful purpose.

AID is troubled by our recommendation that enforceable agreements, guarantying that private investments will materialize, be required. AID says that, instead, "The best one can anticipate and demand is a firm 'commitment' . . . ." Since our finding as developed suggests the lack of availability of such investment commitment, we assume AID is concurring with the spirit of our recommendation.

3. We recommend that AID not extend the present terminal commitment date of this loan and that AID deobligate any funds remaining uncommitted at that date, in view of expressed interest by other international lending agencies and changes in the FAA.

<u>Agency Comments</u> - AID will review the ROCAP Mission's evaluation (page 9) by the end of December and advise IGA of the results of that review.

B. <u>Coordination of Tourism Studies</u> - For a number of years AID has been providing grant funds to SITCA. Some of these funds have been used for budgetary support of SITCA. This was required because some member countries were unwilling to pay the assessments levied on them for the maintenance of the agency. However, the greater part of the AID funds have been used to hire contractors to make studies of various aspects of Central American tourism or to otherwise promote tourism in that area.

1. In FY 1974, AID provided grant funds to SITCA to hire a contractor to update a marketing action plan for the development of tourism in Central America. The contractor was selected to carry out this work in FY 1975. An earlier

AID grant had funded the preparation of the original tourism marketing action plan. Subsequent to making the grant, AID learned that IDB was planning to make a $250,000 grant to the Regional Tourism Commission of the Americans (RTCA), a regional office of the International Union of Official Tourist Organizations, a group consisting of the heads of official tourist organizations of 109 countries.

When AID learned of the proposal, it was concerned that this study might duplicate the work it was funding for the updating of the marketing action plan. After some difficulty, AID was subsequently able to learn the details of IDB's proposed study. ROCAP reported that SITCA had concluded that there was no relationship between the proposed IDB study and the ROCAP financed contract for the updating of the marketing action plan. However, ROCAP stated that the proposed IDB study did duplicate an earlier AID-financed study made for SITCA. Furthermore, ROCAP believed that by making its proposed grant to the RTCA, IDB was undermining SITCA, to which agency AID had made grants of several hundred thousand dollars in budgetary support. As a result, representations were made to the IDB about their proposed financing and IDB subsequently agreed to make a grant of $235,000 to SITCA rather than to the RTCA.

While ROCAP reported that SITCA had concluded that there was no relationship between the proposed IDB study and ROCAP's plan to finance the updating of the marketing action plan, we noted a number of related points in the two plans. For example:

(a) The scope of work for the contractor selected to update the ROCAP financed marketing action plan is to include preparation of statistics on tourism expenditures in Central America and to report on trends of Central American tourism. One of the tasks for the IDB-funded contractor is to evaluate the present and potential tourist demand for the Central American tourist attractions.

(b) The scope of work for the AID-funded marketing action plan updating calls for a report by the contractor on Central America's lodging and other facilities available for tourists in the area, air transport and airport facilities, and other tourist related matters such as the state of the highways in the area and the availability of cruise ships.

IDB proposes that its contractor report on such matters as highway facilities, tourist lodgings, construction or improvement of airports and water ports, and on the infrastructure facilities needed to connect the main tourist points of interest.

IBD also proposed that its contractor examine those projects that the Central American countries were proposing to carry out to determine existing limitations to the operations of the tourism circuit. Most of these projects which IDB stated should be examined have already been designated by AID loan L-013 as sites for the tourism infrastructure facilities financed by the AID loan.

2. On April 9, 1975, in justifying its grant to SITCA (discussed above), IDB stated in regard to the integrated tourism development strategy through the operation of a regional circuit (the basis of AID loan L-013) that such a

> "proposal has not yet been evaluated, the (tourism) circuit had not yet been defined, and therefore the necessary projects for the interconnection of the national primary areas have neither been identified."

IDB further stated that although the AID loan for tourism infrastructure was justified by the theory that joint regional development is the alternative for developing the tourism sector, the AID loan consisted only of the selection of priority areas in each country and a general agreement on the adoption of a joint strategy. Accordingly, IDB said that to date efforts under the AID loan had been limited to carrying out studies without analyzing the definition of the tourism circuit and the strategy for integrated regional development.

The IDB paper says, in effect, that its grant to SITCA to study the Central American tourism circuit was necessitated, at least in part, because the development of an integrated tourism circuit for Central America (which was the purpose of the AID loan) had not been adequately analyzed. In fact, part of the work to be financed by the IDB grant was to examine the projects which the Central American countries proposed to carry out with AID funds to determine their existing deficiencies and limitations for the operation of a tourism circuit.

3. In addition to tourism development studies financed by AID and IDB, the OAS has also provided funds for studies of tourism. OAS funds have been provided bilaterally to each of the Central American countries for studies of various aspects of tourism in Central America. However, the assistance provided by OAS covered much of the ground which has been or will be covered by both AID and IDB financed studies. For example, OAS has provided funds to the Guatemalan Government's tourism office to study various aspects of tourism in that country, including studies of the Tikal project. That project had also been studied or will be studied with funds provided by AID and IDB.

Also, OAS is providing funds in the Guatemalan tourist office to fund technical assistance for evaluating and promoting tourism projects in that country while IDB is funding a study of tourist possibilities in the Lake Izabal region of Guatemala. The Central America-wide studies financed by AID and IDB referred to in this report will probably include tourism prospects in Guatemala. OAS is also providing funding for technical assistance follow-up on the implementation of tourist areas in Nicaragua identified in the Techniberia report, although IDB plans to cover this same ground and AID is providing direct funding for these projects.

From our review we learned that in the past the coordination between ROCAP and IDB had not been satisfactory. We learned that in the latter part of 1972, IDB and CABEI tried to reach agreement on the delineation of areas of tourism development studies but were unsuccessful. The ROCAP Director told us that more recently he had achieved a much better degree of coordination of tourism development activities at the local level. We noted that the ROCAP Director meets with IDB representatives in Guatemala to discuss these matters.

While coordination may be improving at the local level, we believe a greater degree of understanding is needed between AID, IDB, and the OAS at the Washington level to avoid overlapping in tourism or other areas, particularly since the United States provides funding for all of these agencies. Economies might be achieved by providing for one contractual arrangement rather than several to study various aspects of tourism. We believe that studies discussed in items 1 and 2 above clearly illustrate the need for better coordination, since several of the duties of the contractors described in AID and IDB documents appear to be overlapping. It is possible that one contractor could do at a lower cost what two contractors plan to do under present proposals.

While AID Washington personnel told us that they meet with IDB in Washington about twice a year to discuss matters of mutual interest, we were also told that when IDB decides to provide funding for activities at times between these semiannual meetings, there is no procedure for mutual discussions regarding these activities.

Recommendations

1. That AID revoke the funding for the AID-financed contract for updating of the market action plan for the development of tourism in Central America because the work to be conducted thereunder is similar if not identical to that to be conducted under the larger IDB financed contract for a study of tourism in Central America.

> Agency Comments - AID's comments on this recommendation restate elements of our finding in greater detail but do not address our finding as to the similarity in scope of work for the two studies. Instead AID states that after study ROCAP and SITCA are both convinced that the two contracts are complementary.
>
> *IGA Response*
>
> *We remain unconvinced since AID has not addressed the similarities cited. We are especially disturbed by AID's comment that ROCAP negotiated with SITCA "the revised needs of the Marketing Action Plan in order to avoid to the extent possible duplication with the contract activity which the IDB would finance for a Central American Tourism Circuit plan." (Underlining added.) It seems clear that AID is acknowledging the inevitability of duplication in the subject undertakings. We cannot then understand or accept AID's non-concurrence with our recommendation, and suggest review of the Bureau's decision by the Office of the Administrator.*

2. We recommend that AID, IDB and OAS reexamine their coordination procedures to assure that overlapping in other assistance fields cannot recur in the manner that did occur in tourism development.

Agency Comments - AID does not question the facts we presented showing overlapping of assistance provided by three donor agencies, all involving funds provided at least in part by the United States. AID does not, in fact, address that finding which is the basis for our recommendation. Instead, while AID agrees that coordination among donor agencies is essential, it describes in detail its existing coordination process which it believes is adequate. AID considers coordination "to be an evolving process" and "does not consider that a formalized reexamination is necessary."

IGA Response

The facts as we presented them in our draft and in this final report seem to us to clearly represent an overlapping of donor financed studies. Since the United States supplied funds for all of these donors, this condition represents an unnecessary use of U.S. funds, which we believe ought to be corrected as soon as possible. Furthermore, even though AID states that it has formalized procedures for consultation with other donors, the facts presented above indicate that these procedures need revision since the overlapping occurred despite these procedures. While AID may not plan any further assistance for tourism, similar overlapping could occur on any other type of activity financed by AID and other donors. Again, we suggest that the Office of the Administrator review the Bureau's decision in this instance.

AGENCY COMMENTS ON IGA DRAFT REPORT

DEPARTMENT OF STATE
AGENCY FOR INTERNATIONAL DEVELOPMENT
WASHINGTON, D.C. 20523

MEMORANDUM

TO: IGA/RPM, Mr. Thomas Novotny

FROM: AID/AG, Harry C. Cromer HCC

SUBJECT: Draft Inspection Report - AID Loan for Tourism Made to the Central American Bank for Economic Integration (CABEI) and Related Grants for Tourism Development

Attached are comments on the subject draft Inspector General of Foreign Assistance report as prepared by the Bureau for Latin America.

Attachment: a/s

OPTIONAL FORM NO. 10
JULY 1973 EDITION
GSA FPMR (41 CFR) 101-11.6

UNITED STATES GOVERNMENT

Memorandum

NOV 24 1975

889

TO : AG, Mr. Harry C. Cromer

DATE: November 21, 1975

FROM : AA/LA, Herman Kleine

SUBJECT: A.I.D. Tourism Infrastructure Loan to Central American Bank for Economic Integration (CABEI) (596-L-013) - Draft IGA Inspection Report

As agreed with the IGA, on October 24 my staff informally provided comments to the IGA on the report under subject. Based on these comments the IGA, on November 7, gave us what was characterized as a "cut and paste" of our comments with IGA responses at appropriate points and with modifications of some of the recommendations contained in their draft report. This memorandum represents the official Agency coordinated comments keyed to the conclusions and recommendations of the IGA draft report as modified. We understand them to be the following:

Conclusions

1. The Tourism Infrastructure Loan to CABEI was made prematurely in that adequate technical and financial feasibility studies had not been made.

2. The Tourism Infrastructure Loan was made without a clear understanding by the Central American countries of the loan's aims and purposes.

3. Some of the designated sites on which the loan was based are not suited for the intended projects, nor will some of the facilities for which funding was provided be needed.

4. There is no assurance that the substantial public and private investment funds needed to utilize the infrastructure facilities funded by the A.I.D. loan will be available.

Recommendations

1. "That A.I.D., when making loans to intermediate credit institutions, apply the requirements of Section 611(a) of the FAA to such subprojects as are known at the time a loan is made; and that A.I.D. otherwise apply prudent management techniques, such as preloan feasibility studies, to such subprojects."

2. "That A.I.D. not approve CABEI sub-loans of A.I.D. funds for infrastructure subprojects for those tourism locations which require further investment by the public and private sectors, unless there is an enforceable agreement which guarantees such investments will materialize."

3. "That A.I.D. not extend the present terminal commitment date of this loan and A.I.D. deobligate any funds remaining uncommitted at that date in view of expressed interest by other international lending agencies and changes in the FAA."

4. "That A.I.D. revoke the funding for the A.I.D.-financed contract for updating of the market action plan for the development of tourism in Central America because the work to be conducted thereunder is similar if not identical to that to be conducted under the larger IDB-financed contract for a study of tourism in Central America."

5. "That A.I.D., IDB, and OAS reexamine their coordination procedures to assure that overlapping in other assistance fields cannot recur in the manner that did occur in tourism development."

Conclusion 1. Premature authorization in the absence of adequate technical and financial feasibility studies.

We agree that the loan has been subject to delays in starting and completing feasibility studies which were unforeseen in the capital assistance paper (CAP). We believe, however, that this conclusion is misleading inthat it implies that A.I.D. made a loan without adequate planning. It was not possible to foresee, for example the time needed for the subborrowing governments to arrive at a consensus on specific projects and on the manner in which further project development was to be financed and executed.

This is not to say that this factor was ignored in preparing the loan project. The first Regional Tourism Conference was sponsored by CABEI in September 1972 (five months prior to loan authorization). The Tourism Directors from each country discussed and approved the Tourism Development Program supported by the loan and appointed CABEI as financial agent. However, the agreement of the Tourism Directors only proved insufficient. The Tourism Institute of each country, but one agency of the government, was not able to persuade other key executive agencies (e.g. finance ministries) and the respective legislative assemblies to initiate the necessary studies once loan funds became available. In retrospect, it was probably unrealistic to expect rapid action by executive bureaucracies and assemblies even with substantial agreement on proposals. As a result, the last two feasibility studies are only now about to begin and the project has suffered a two-year delay.

The issue here, in our opinion, was the reasonableness of the expectation in the CAP that subborrowing governments would be able to move quickly to initiate studies, rather than whether or not completed feasibility studies for specific subprojects existed, as indicated in the Report. It is entirely possible that CABEI could have had subprojects on hand with good studies and yet not receive government agreement on proceeding with the subproject. On the other hand, if governments had been able to move promptly to approve and initiate the studies upon authorization of the loan, the studies may well have been completed on time and the delay avoided or at least held to a minimum. In short, the CABEI tourism program as a whole appeared further advanced to A.I.D. at the time of loan authorization in terms of subborrower readiness to act than was actually the case.

Recommendation 1. Application of Section 611(a).

We disagree with the Report's recommendation that Section 611(a) should be applied to subloans by ICIs and the suggestion that failure to so apply that section demonstrates that A.I.D. has not exercised prudent management.

This recommendation appears to place the CABEI loan in the same category as all A.I.D. capital project loans, such as those for the construction of a bridge or road. This characterization fails to recognize differences between loans for specific construction projects and loans for support of development programs to be undertaken through an intermediary such as an intermediate credit institution ("ICI").

In the case of the direct project construction loan or grant, the requirements of FAA Section 611(a) are applied directly to the construction project involved. The requirement is typically that substantive technical or financial planning be performed before the loan or grant agreement is signed and that any necessary legislative action within the recipient country be reasonably anticipated to be completed in time to permit orderly accomplishment of the project purposes. In the case of a loan or grant to an ICI the emphasis is upon the ICI and its capacity to handle the funds being lent, and the "project specific" requirements of FAA Section 611(a) do not come into operation with respect to the capital projects ultimately to be financed.

The same question of the application of Section 611(a) requirements to ICIs as was raised in the draft IGA report was raised earlier in a GAO draft report dated November 1966 dealing with A.I.D. loans to the International Finance Corporation for capital development projects in India. In a legal memorandum dated January 6, 1967 from John R. Liebman of AID/GC to Theodore H. Lustig of AID/NESA/CDF, the same issue raised here were carefully examined and the conclusion reached that the "project specific" requirements of Section 611(a) do not apply to subloans made by A.I.D.-assisted ICIs. After examining the terms of Section 611(a) and its predecessor legislation, Section 517(a) of the Mutual Security Act of 1954, and the legislative history of both, that memorandum concluded as follows (footnotes omitted):

> "The end product of A.I.D. assistance to development banks is clearly the injection of needed foreign exchange through local banking institutions into the economy of the host country; the loan agreement is with the intermediate credit institution, and it is this financial obligation which demands compliance with the requirements of Section 611(a) for financial planning.
>
> "The financial planning accomplished in regard to development banks is an analysis of the capabilities of the institutions to analyze and screen subloan

applications, applying the criteria set forth in the Manual Order (M.O. 1524.1). A.I.D. approval of subloans, on the other hand, is a matter requiring considerable flexibility, and the levels established for approval will vary from bank to bank according to the experience of the particular institution. In the language of the Manual Orders,

> 'Because A.I.D. looks to the borrowing institution for repayment of its loan rather than to the individual subborrowers of the bank, A.I.D. will review applications referred to it to establish that the Development Bank has made the necessary economic, technical, financial, and management analyses as called for ... above.'

"The end product in this case is clearly the loan to the intermediate credit institution, and not to the subborrower. Therefore, any review required by A.I.D., insofar as Section 611(a) is concerned, related only to the loan to the intermediate credit institution."

It is A.I.D.'s position that where loans are made to ICIs, 611(a) requirements must be satisfied as to the ICI itself, since as noted above it is the loan to the ICI which is the "end product" of the assistance. As stated in the legal memorandum dated September 29, 1971 of Mr. Charles L. Gladson, GC/VN to Mr. E. A. Anderson, SA/VN/PEP

> "In general, the financial planning required by 611(a) in regard to an ICI is an analysis of the capabilities of the institution to analyze and screen applications and a clear understanding of the structure of the institution and the nature of its operations..."

Furthermore, rather than failing to apply 611(a) standards at all in the case of the loan to CABEI, A.I.D. in effect required the application of such standards twice: first in determining whether or not the loan should be made to the ICI, and second by requiring that the ICI meet 611(a)-type standards in its evaluation of projects for sub-loans. The CABEI Tourism loan agreement specifically provides that feasibility studies, engineering plans, and specifications, etc. must be prepared and found adequate before loan funds are disbursed for sub-loans.

A.I.D. believes some comment is necessary on IGA suggestions that AID/GC views on the application of 611(a) have not been entirely consistent. Some GC opinions have stated that prudent management would dictate application of 611(a) standards to individual capital procurements under a large commodity import or supporting assistance program, even when the overall CIP or SA loan had already been subjected to the 611(a) tests and even though such second application of 611(a) might not technically be required. (Carter/Looper memo of February 21, 1974 and Morris/Wedeman letter of June 14, 1971). From such opinions, the IGA concludes that because A.I.D. has acknowledged in some circumstances that 611(a) should be applied even though not technically necessary, that A.I.D. is failing to exercise prudent management if it does not apply 611(a) to ICI sub-loans when sub-projects have been identified in advance of the AID/ICI loan.

A.I.D. believes the foregoing conclusion on the part of the IGA is inaccurate for two reasons. First, in the CIP and SA situations, GC felt there was sufficient evidence to support a conclusion that the "end products" of the assistance were specific capital projects. With the CABEI loan the purpose or "end product" of the assistance is the engagement of the ICI itself in general development activity, not the sub-projects, and the GC opinions are distinguishable on that basis. In ICI loans, if A.I.D. were to complete all 611(a) tests on subprojects <u>in advance</u> of making the umbrella loan to the ICI, then A.I.D. might simply make the subproject loans directly and eliminate the ICI altogether. While the subprojects are important, the primary goal in an ICI loan is to encourage the institution to lend in priority areas and to strengthen the institution so that there will be an experienced financial institution in place when A.I.D. is gone.

Secondly, as pointed out earlier, by applying 611(a) tests to the ICI, A.I.D. satisfies itself that the ICI is in turn capable of ensuring that the proper technical and financial planning for subprojects will be performed, and that the umbrella loan should be made.

A.I.D. believes that the IGA concern as to whether A.I.D. is applying prudent management to ICI loans may be attributable to a misunderstanding of the "end product" of the ICI loans. The IGA focuses on the subproject; A.I.D. focuses on building the capability of the ICIs as institutions.

A.I.D. has followed its application of 611(a) consistently through a large number of loans to ICIs. The GAO examined A.I.D.'s application of the statute to ICI loans in 1966-67 and was satisfied that A.I.D. was exercising prudent manage-eent in its interpretation and application of 611(a) to ICI loans. A.I.D. has continued to apply its interpretation consistently, and Congress appears to be satisfied with A.I.D.'s interpretation of 611(a) as it applies to ICI loans.

Conclusion 2. Lack of understanding by Central American Countries of the loan's aims and purposes.

This conclusion, taken from an A.I.D. evaluation report, is overdrawn as presented and should be placed in the historical context of the genesis of coordinated Central American efforts in tourism development. In July 1968, President Johnson visited the five Central American nations, meeting individually and collectively with their Presidents. At this time, President Johnson, as part of a Joint Declaration issued during the meeting, pledged continued U.S. support for the Central American integration movement and affirmed U.S. recognition of the need for a substantial level of foreign assistance for economic development programs to be undertaken.

The single, most urgent request of the five nations to the U.S. at that time was for assistance in overcoming dependence on their "one-crop" economies. This request resulted in follow-up negotiations by high-level administration officials with the Central American Ministers of Economy, the establishment of the position of a ROCAP Export Promotion adviser, and the subsequent development and authorization of ROCAP Loan L-010 for Export Industries and Tourism, and Loan L-013 for Tourism Infrastructure. The stimulation and development of tourism was recognized early by all of the Central American countries as having a high economic development and financial benefit potential and featured prominently in their identification of assistance needs and requests to A.I.D. for both loans as a means of diversifying their economies' "single crop" dependencies. Therefore, we believe it is inaccurate to state that Loan L-013 was made without a clear understanding by the Central American countries of the loan's aims and purposes. Loan L-013 in fact responded to the Central American countries' expressed needs to improve national and regional potential for tourism. Extensive pre-authorization negotiations between A.I.D. and CABEI, and between

CABEI and the individual countries, provided ample clarification to all parties of the loan's aims and purposes.

Conclusion 3. Shift in subproject sites and subprojects.

The subprojects designated in the loan agreement were tentative and it was recognized that changes in subprojects or subproject sites could occur and alternatives would be identified and evaluated by CABEI. Accordingly, we do not find it surprising that governments may change some subprojects or that subsequent studies might demonstrate the need to change the subproject mix. As an ICI loan, this loan was designed to permit this flexibility which is inherent in the ICI concept. As pointed out above, a major purpose of the loan is to stimulate tourism by providing financing to initiate the Regional Tourism Development Program and by strengthening the role of CABEI in promoting tourism; it is not to finance any particular subproject or number of subprojects. In addition, the concern expressed in the Report over the sharp increases in subproject costs should be evaluated in light of the loan purpose.

Unlike a more conventional capital project loan, A.I.D. is not committed to fund a certain number of sub-loans or a specified quantity of construction (miles of road, number of buildings, etc.). Should costs increase, the number of subprojects initially contemplated will not be completed under the loan. This does not mean that one of the major loan purposes will not be accomplished. The basis for determining the funding level of this ICI loan was a combination of the anticipated demand for credit, the impact desired on tourism development, the extent to which the institution must change its normal procedures to accomplish loan objectives, A.I.D.'s funding availabilities, and the borrowers' constributions.

Further to the question of funding inadequacies, CABEI has expressed its commitment to meet the shortfalls in overall project costs from its own resources. ROCAP will make this commitment more explicit if it is decided to extend the terminal dates. In this circumstance, the Mission will implement the loan in a way which will allow the funding of projects in several countries, provided that "reserving" funds for later developing projects can be based on reliable evidence that such projects will in fact be ready for financing at times consistent with a detailed PERT implementation plan.

Conclusion 4 and Recommendation 2. Investment of public and private sector funds.

We agree with the intent of the Draft Report in emphasizing the importance of reasonably assuring private investment follow-on to any public sector infrastructure investments undertaken with support from the Tourism Infrastructure project before subproject financing approvals are made by CABEI. The loan agreement with CABEI which underlines this point specifically defines, as a major element,to be treated in the feasibility study required for each subproject proposal submitted to CABEI for financing, the private investment anticipated as a result of the infrastructure development. As a test of the reliability of projected investment figures, it was assumed that firm commitments from firms intending to construct hotels in the areas served by subprojects financed by the A.I.D. loan, would serve as a reasonable indicator of the reliability of overall investment to be incorporated in the subproject plan.

However, we do not agree with the Draft Report that without "enforceable contracts," (which we assume to mean contracts which will stand the test of legal action) there will be no or inadequate assurance that the investment to utilize A.I.D.-financed infrastructure projects will in fact be made. We doubt that any situation exists where investors sign "enforceable agreements" guarantying investments prior to the construction of necessary infrastructure facilities. Investors are unlikely to commit themselves in such a manner. A requirement such as that advanced would make the chances for successful loan implementation extremely improbable.

We continue to believe that the best approach to this issue is an analysis of all factors bearing on feasibility, especially weighing those of critical long-term importance as investors' interests and market response (i.e., tourists) to the proposed subproject. Fundamentally, all of these decisions are judgmental, but to the extent confidence can be placed in the results of the recommendations of the feasibility studies that conditions for the subprojects are favorable, investors' interest in the activity, from one or more sources, will be probable.

A.I.D. and other international development agencies' experiences in this type of program of "leading edge" public sector investment shows that more stringent investment requirements as proposed are unreasonable and unworkable. The best one can anticipate and demand is a firm "commitment," whose adequacy should be determined by the feasibility analysis and its review. Therefore, we believe the current procedure is adequate in this regard.

Recommendation 3. Extension of TCD and TDD.

We believe that a proper decision on whether to approve or disapprove any extension of TCD or TDD can only be made after analysis of whether or not the purposes of the loan can still be achieved in a reasonable time period. We intend to review the ROCAP Mission's recently completed evaluation of the history of the Tourism Infrastructure Project and future projections. We expect this review to be completed by the end of December and we will advise the IGA of the results at that time.

Recommendation 4. Revoke funding for the contract to update the Marketing Action Plan.

In reviewing the possible similarity between the A.I.D.-financed contract for services to the Secretariat for Central American Tourism (SITCA) in upgrading the 1969 Central American Marketing Action Plan and IDB's grant to SITCA for a contract for a Study of a Central America - Panama Tourism Circuit, the following aspects of this matter should be taken into account. Shortly after ROCAP had signed a Project Agreement with SITCA on August 21, 1974 to finance a contract to update the 1969 Marketing Action Plan for the Development of Tourism in Central America, the Director of SITCA reported that the Panamanian Director of Tourism and four of the five Central America Tourism Commission Directors were being offered a $250,000 grant for their "region" from the IDB to finance a Study of a Central America - Panama Tourism Circuit. This was naturally of some concern to SITCA and to ROCAP for two reasons. First, there was likely to be a duplication of much of A.I.D.'s activity for which $73,000 had just been obligated. Second, the proposal bypassed SITCA, the recognized organization of the Central American countries, empowered to deal with regional tourism matters. As a result of A.I.D.'s coordinating role and many discussions with the IDB, the latter made its grant to SITCA. This action was in keeping with the earlier agreement which had been worked out in principle with the Bank that both A.I.D. and IDB would seek to work through the Central American regional institutions whenever possible. ROCAP then renegotiated with SITCA the revised needs of the Marketing Action Plan in order to avoid to the extent possible duplication with the contract activity which the IDB would finance for a Central American Tourism Circuit plan. The negotiations between A.I.D. and SITCA extended over a year before A.I.D. signed a contract with the Stanford Research Institute to update the Tourism Marketing Plan. Both ROCAP and SITCA are convinced that the two contracts are complementary. As a consequence we believe it would not be appropriate for A.I.D. to revoke the funding of the Marketing Action Plan contract which is an important part of our final grant assistance to the Central American countries in the field of tourism.

Recommendation 5. Reexamination of coordinating procedures.

We agree that coordination among donor agencies is essential. We already have in place a formalized coordination process in addition to informal coordination procedures, which we believe are adequate to minimize problems of competition and duplication among donors in sectors where A.I.D. operates. These include: The OAS-sponsored annual country reviews of Latin American assistance needs and problems; preparatory and follow-up meetings of the country specialists of the donor institutions participating in these country reviews; annual country-by-country program reviews among the lending institutions (A.I.D., IBRD, IDB, occasionally others) and, separately between A.I.D. and UNDP; participation in World Bank-sponsored Consultative Groups for some countries and for the agriculture sector; in-country donor coordination meetings in most of the countries supplemented by constant informal contacts with government planners and with resident and visiting representatives of other donors. In Central America where integration efforts are so complex, quarterly meetings of a Mission Directors Coordinating Committee focus specifically on regional and bilateral donor assistance to the region.

In view of the foregoing, A.I.D. does not consider that a formalized reexamination is necessary. We consider coordination to be an evolving process, which engages its sectoral specialists and country desk officers on a day-to-day basis, assisted by an LA Bureau office specifically responsible for assuring the interchange of documentation and discussions necessary for effective multilateral co-ordination. Overseas, every A.I.D. Mission Director is under instructions to make and maintain frequent contacts with other assistance donors and with the host government officials responsible for planning and implementing economic assistance. Mission technical officers and programmers similarly undertake such coordination efforts so as to carry out their duties as effectively as possible. With the advent of such subregional joint programs as the inter-agency agricultural sector studies in Central American agricultural development by A.I.D./IDB/IBRD, and the new hemispheric agricultural group, the momentum to continue to extend A.I.D.'s interagency coordination seems well in hand.

Drafted:LA/DR:RGomez:af
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