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REPORT TO

THE CONGRESS OF THE UNITED STATES

REVIEW OF THE ADMINISTRATION OF ASSISTANCE FOR FINANCING COMMERCIAL IMPORTS UNDER THE ECONOMIC AND TECHNICAL ASSISTANCE PROGRAM FOR VIET NAM 1958–1962

BEST AVAILABLE

AGENCY FOR INTERNATIONAL DEVELOPMENT
DEPARTMENT OF STATE

BY

THE COMPTROLLER GENERAL
OF THE UNITED STATES

JULY 1964

BEST AVAILABLE

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

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To the Speaker of the House of Representatives
and the President pro tempore of the Senate

This report is concerned with certain policies and practices followed by the Agency for International Development and its predecessor agency, International Cooperation Administration, in the financing of commercial imports and in the administration of other financial elements of the economic and technical assistance program for Viet Nam. These policies and practices substantially increased the cost of United States assistance, were not consistent with sound program management, and were of questionable or disproportionate benefit.

We found that aid levels for nonproject assistance for the years from 1955 through 1961 were substantially in excess of Viet Nam's requirements for foreign exchange. Also, a $10 million cash grant, negotiated in fiscal year 1962 and consummated in fiscal year 1963, was not justified on economic grounds. The costs of pharmaceuticals and fertilizer--two of the major commodities financed from aid funds--were higher than necessary because of ineligible charges included in billings for pharmaceuticals and the failure to purchase fertilizer in the off-season. In addition, aid funds were used to finance significant amounts of nonessential commodities, such as plastic raw materials and high-quality nylon and worsted yarns. During fiscal years 1960 and 1961, the Agency expended $2.7 million of appropriated funds to purchase piasters (local currency) for local support costs of its overseas Mission instead of having the Government of Viet Nam provide the necessary funds as the Agency had a right to do and as was done for the United States Military Assistance Advisory Group which is the military counterpart of the Mission. These and other policies and practices, which were disclosed by our review, are summarized in the forepart of our report.

The Agency signified qualified concurrence in most of our findings and proposed remedies and advised us of actions taken or to be taken in accordance with our proposals.

Copies of this report are being sent to the President of the United States; the Secretary of State; and the Administrator, Agency for International Development.

Comptroller General
of the United States

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INTRODUCTION

The General Accounting Office has reviewed selected activities of the economic and technical assistance program for Viet Nam for the fiscal years 1958 through 1962 as administered by the Agency for International Development (AID)[1] and its predecessor agency, the International Cooperation Administration, of the Department of State under the authority of foreign assistance and mutual security legislation. Our review was made as part of a continuing audit of the foreign assistance and mutual security program, pursuant to the Budget and Accounting Act, 1921 (31 U.S.C. 53), and the Accounting and Auditing Act of 1950 (31 U.S.C. 67), and was a follow-up on an earlier review of the aid program in Viet Nam for fiscal years 1955 through 1957. (See report to the Congress, B-133001, dated May 22, 1958.)

This report deals with the administration of selected activities in the commercial import program (CIP), a cash grant, and

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[1] Aid is used throughout this report to identify the present and predecessor agency which administered the program during the period covered by our review.

local currency. Our review was made at the Agency's operations mission in Viet Nam (referred to in this report as the Mission) and at the Agency's Washington office. The scope of this examination is further described on page 56. We are concurrently issuing a separate report to the Congress on certain problems relating to administration of the economic and technical assistance program for Viet Nam during the fiscal years 1958-62.

The General Accounting Office also issued a separate report on the responsibilities of the Department of Defense for the military assistance program for Viet Nam. (See report dated Nov. 26, 1958, B-133096 (Secret).)

The officials primarily responsible for the administration of economic and technical assistance for Viet Nam, starting with fiscal year 1958, are shown in the appendix to this report. (See p. 58.)

Because of the critical situation in Viet Nam, the United States assistance programs (military and economic) were major elements of two comprehensive reviews ordered by the President of the United States. In the summer of 1961, a joint United States-Vietnamese Special Financial Group (under the co-chairmanship of Eugene Staley for the United States and Vu Quoc Thuc for Viet Nam) reviewed the situation in Viet Nam placing particular emphasis on economic and social conditions. In October 1961, a review was made by General Maxwell Taylor acting as the personal representative of the President. The comments and recommendations resulting from these reviews, where pertinent, are discussed in the related sections of this report.

DESCRIPTION OF AID PROGRAM

The United States provided financial assistance to Viet Nam under a variety of programs prior to the start of the current program which began in fiscal year 1955. The prior programs and the manner in which they were administered were described in our report issued in May 1958.

Beginning in fiscal year 1955, after termination of the Indo-China war between France and the Communist-led Viet Minh, which resulted in the partition of Viet Nam, the subsequent flight of refugees from Communist-controlled North Viet Nam, and complete political independence of the former associated states of Indo-China, the United States undertook to provide under the administration of the International Cooperation Administration and its successor, the Agency for International Development (AID), individual programs of economic assistance directly to each of the former associated states of Viet Nam, Cambodia, and Laos, rather than one program of assistance for all three states, as had been the case theretofore.

The assistance program in Viet Nam during fiscal years 1955 through 1957 (covered by our prior report) was designed to serve three principal purposes: (1) to support the defense budget of Viet Nam, (2) to finance the evacuation and resettlement of refugees from the northern areas of the country coming under communist control, and (3) to promote economic and technical development. The evacuation and resettlement of the refugees was substantially completed by the end of fiscal year 1957.

For the 1958-62 period, the program's objectives continued to include the maintenance of economic stability while strengthening Viet Nam's defense posture, and the promotion of economic and technical development and political stability by helping to improve

basic public facilities and by expanding essential public services. Beginning about 1960, the increasing tempo of insurrection by the Communist Viet Cong against the Republic of Viet Nam gave added urgency to several facets of the assistance program. This urgency led to an increasing need for piasters (local currency) to support the augmented military effort and other counterinsurgency activities and caused a reorientation of the project (or public) sector of the aid program so that emphasis was placed on those activities designed to win the loyalty of the rural population, which was the special target of the Viet Cong. Aid during the 1958-62 period consisted of financing commercial import of commodities for the Vietnamese economy and commodities and technical services for development projects which after 1960 were directed primarily to counterinsurgency. Piasters derived from the commercial import program continued to be used for support of the military budget and of the local costs of development projects and counterinsurgency activities.

During fiscal years 1955 through 1962, AID obligated more than $1-1/2 billion for the economic and technical assistance program. In addition, sales and donations of surplus agricultural commodities under Public Law 480, totaling about $120 million, were authorized. Piaster proceeds from the sales were used for further support of Viet Nam's military budget and to pay certain United States expenses in Viet Nam. The Development Loan Fund (now a part of AID) made loans to Viet Nam, totaling $39.9 million, primarily for expansion of the water and electric systems of the city of Saigon and for railroad rolling stock and facilities.

A summary of aid by principal components for the period 1955-62 is shown below. The amounts shown for program components are estimates developed by us since AID financial reporting of the

Viet Nam program for that period did not furnish a meaningful breakdown by types of program activity. As can be seen from this summary, the nonproject commercial import program constituted about three fourths of the total economic and technical assistance program during the 1955-62 period.

		Amount (million)
Nonproject Assistance:		
Commercial import program:		
Financing of imports into Viet Nam		$1,033.5
Triangular trade--surplus agricultural commodities to France, French franc proceeds used to finance commodity shipments from France to Viet Nam		127.5
Cash grants and loans		151.4
(Of the total of dollar funds given in this form, $119.4 million was used to finance commodity imports, $3.4 million was used to pay Viet Nam's subscription to International Bank for Reconstruction and Development and International Monetary Fund, and the end use of the balance of $28.6 million was not specifically identifiable)		
Project assistance and counterinsurgency action plan:		
Dollar costs of projects (per project agreement, commodities, and contract services)	$159.7	
United States Government technicians and support personnel	16.0	
Training of Vietnamese nationals	8.6	
Total project assistance		184.3
Commodities for counterinsurgency activities		10.0
Refugee programs:		
Evacuation from North Viet Nam and reception in South Viet Nam	16.0	
Relief and resettlement	5.9	
Total refugee program		21.9
Common use commodities for military forces		14.5
Overseas administration		6.7
Total		$1,549.8

For the 1958-62 period covered by this review, commercial import financing provided by AID totaled about $639 million. The principal commodities financed were dairy products, fertilizer, medicines and pharmaceuticals, petroleum fuels, iron and steel mill products, textile fibers and fabrics, motor vehicles, and industrial machinery. The title I, Public Law 480, program during this period totaled $53.4 million and consisted mainly of cotton, tobacco, wheat flour, rice, and dairy products. Commercial imports, including those financed by the United States, are handled through commercial trade channels under the authority of import licenses issued by the Directorate General of Commerce (DGC) of the Government of Viet Nam (GVN). Suppliers of commodities imported under licenses issued by the DGC against United States aid funds are paid by the United States. For United States-financed imports other than surplus agricultural commodities financed under section 402 of the Mutual Security Act of 1954, as amended, Vietnamese importers pay to the GVN the equivalent of the United States cost in local currency (piasters) which the GVN deposits in a special counterpart account in the name of the GVN.[1] For surplus agricultural commodities imported under title I, Public Law 480, and section 402, the piasters paid by importers are deposited in United States Treasury accounts. Funds deposited in the counterpart account were used primarily for support of the GVN military budget, local costs of development projects, and local costs of activities designed to counter the Viet Cong insurrection. Piasters accruing from Public Law 480 and section 402 transactions were used for additional

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[1]The piaster/dollar exchange rate used in these transactions is discussed in our report, referred to on page 2.

support of the GVN military budget and to pay certain expenses of the United States in Viet Nam.

At the close of fiscal year 1962, AID approved a piaster purchase program in which $10 million of AID funds were to be used to purchase an equivalent amount of piasters from the National Bank of Viet Nam. The piasters thus acquired were for funding certain activities related to the struggle against the Viet Cong insurrection. The purchase was consummated during fiscal year 1963.

SUMMARY

Our examination disclosed that certain policies and practices applied by AID in the administration of nonproject assistance and of local currency at various times since 1955 increased the cost of United States aid substantially, were not consistent with sound program management, and were of questionable or disproportionate benefit. AID expressed qualified agreement with most of our findings and reported that it had taken or planned to take measures to rectify certain conditions along the lines that we proposed. The policies and practices which are the subjects of this report, together with the specific comments of the Agency, are summarized below and discussed more extensively at subsequent pages.

Excessive aid levels (p. 20)

From 1955 through the fiscal year 1961, aid funds made available to the GVN for nonproject assistance were substantially in excess of Viet Nam's requirements for foreign exchange. As a consequence, GVN foreign exchange reserves increased considerably and unused commodity allocations reached sizable proportions, higher levels of consumption were encouraged than were warranted by the state of the Viet Nam economy, and positive incentive for the GVN to mobilize its own resources was weakened. The excessive aid levels during these years occurred because (1) the basis on which aid levels were calculated during the fiscal years 1955-59 was unsound, (2) actual imports and exports by Viet Nam for the fiscal years 1960 and 1961 varied substantially from the estimated imports and exports on which the nonproject aid levels for those years were primarily based and the amounts of these variances were not taken into account in determining the aid levels for the succeeding

years, and (3) additional aid of $4.5 million given in fiscal year 1961 for political reasons was not justified on economic grounds.

From 1955 through fiscal year 1959, the annual nonproject aid level was based primarily on the need for generating a predetermined amount of piasters to be used mainly for the support of the Vietnamese military budget. AID provided annual dollar amounts equivalent to the required budget support, principally by financing commodity imports and by cash grants, both of which generated local currency at the official exchange rate. However, the dollars provided exceeded the essential import requirements of Viet Nam over and above those requirements financed from Viet Nam's foreign exchange earnings, with the consequences noted above. United States agencies recognized that the excessive levels of aid lessened the incentive for the GVN to mobilize its resources for military requirements and economic growth and, further, that this method of determining the aid level was unsound, in that such a level was designed to meet the recipient country's internal budget requirements whereas the assistance program was intended to finance external necessities beyond the country's own capability to finance. In March 1959, AID notified the GVN that calculation of the nonproject aid level on the piaster deficit basis would be discontinued and that, beginning in fiscal year 1960, the aid level would be determined on the balance-of-payments basis which in the light of past experience was contemplated to produce a lower level of nonproject aid and, consequently, reduced generation of local currency. The GVN never fully accepted the changeover from the piaster deficit to the balance-of-payments basis, and the controversy over the new basis which continued for several years thereafter impeded the

program, since the GVN would not agree to raise the additional piaster revenues required to cover the reduction in local currency generation.

AID required Viet Nam to use in fiscal year 1962 a portion of its increased foreign exchange reserves and unused commodity allocations from prior years, and these resources were drawn down by $62.3 million at June 30, 1962.

We proposed that, to avoid or at least minimize excess levels of aid, the AID Administrator take steps to apply the balance-of-payments formula in determining the annual level of the CIP for Viet Nam, subject to adjustment each year for variances in the previous year between actual imports and exports and the estimates thereof on which the aid level for the previous year was determined and that within the boundaries of the most realistic foreign policy considerations AID avoid supplementing aid such as that given in 1961 unless justified on economic grounds. AID has informed us that it has been operating within the framework of our proposals since fiscal year 1963.

Commodity costs higher than necessary (p. 30)

Pharmaceuticals

The cost of pharmaceutical imports financed by AID as part of the CIP was higher than necessary because of commissions and promotional allowances paid to Vietnamese importers by pharmaceutical suppliers. These emoluments, which were generally handled as a separate transaction between the supplier and the importer, were deposited in dollars by the supplier in a bank in the United States or Switzerland to the credit of the importer, and the amount was included by the supplier in the billing to AID for shipment of the pharmaceutical items. AID/Washington stated that these ineligible

payments may have indicated overprograming and subsequent illegal exports to neighboring countries.

We were informed by AID that claims filed to September 1963 against 21 suppliers aggregated $806,000, of which $414,000 had been collected and $240,000 had been referred to the Department of Justice, and that other cases were being investigated. It appears, however, that many excess payments have not been identified and that these losses are attributable at least in part to the failure of the Agency for approximately 4 years to be reasonably alert to the potential abuses in the procurement of pharmaceuticals and to exercise the degree of management control necessary to counteract such abuses.

AID has taken certain measures to overcome these abuses, but we are not certain that these measures can be fully effective. We urged AID, and it agreed, to continued concentration on other control means including those applicable to the authorization of pharmaceutical procurements by the Agency and the GVN.

Fertilizer

Procurement authorizations issued by AID for fertilizer imports into Viet Nam permitted delivery during the demand season when prices are highest, and according to estimates of AID-financed fertilizer arrivals in Viet Nam during 1962 nearly half the imports were scheduled to be received during the period of greatest demand (February through July). If the bulk of the fertilizer were delivered during the off-season and stored until needed, substantial savings in United States dollar aid funds could be realized. In the case of nitrogenous fertilizer which accounted for 54,000 metric tons of the 1962 fertilizer program, the net saving on the off-season price over the storage cost would have totaled more than $240,000.

When we pointed out the advantage of off-season purchasing, the Mission promised to give full consideration to the matter. Subsequently AID/Washington requested data on fertilizer use and purchasing from all its overseas missions for the purpose of making a centralized review of aid-financed fertilizer programs. We proposed that AID develop with the GVN the necessary procedures which will encourage and, if possible, require the procurement of fertilizer during the off-season and the storage thereof until needed. AID expressed agreement with our proposal and stated that it had been working toward that end.

Importation of nonessential commodities (p. 36)

During the fiscal years 1958-62, AID made $9.9 million available for the importation of plastic raw materials which were used to produce a variety of end products, some of which are essential to the Vietnamese economy, such as electrical fixtures, and others are nonessential, such as cigarette boxes, soap containers, plastic bags, perfume bottles, and toys. At the time of our examination the Mission was conducting a survey to determine whether the total demand (essential and nonessential) would justify building a plastic-raw-materials factory in Viet Nam. To the extent that United States financing would be needed to construct and equip such a factory or needed for the ingredient material required for production, it seems that it would be necessary to determine the quantities to be used for essential and for nonessential purposes in order for the Mission to be in a position to judge whether such a factory would be justified.

In recent years AID-financed nylon yarn imported into Viet Nam has been used largely for the manufacture of men's socks although it was reported that in earlier years socks were made from cotton.

Nylon yarn financed by AID cost nearly $3 a pound against a cost of only about 46 cents a pound for rayon and cotton yarn. In fiscal year 1962, AID financing of textile products was discontinued and the GVN assumed funding for textile imports. AID funds were used to finance the importation of unnecessarily high quality worsted yarn which was used to produce sweaters, underclothing, and products of a similar type. The use of this high-cost yarn, which was produced from high-quality wool (64/70 count), resulted in a higher import level than would have resulted if less expensive yarns had been purchased. In April 1961, AID transferred responsibility for financing worsted yarns and other textile products to the GVN.

It seems to us that, so long as outside assistance on a large scale is required by Viet Nam, the import beyond token amounts of commodities not required or of marginal necessity to that country's economic survival or development adds an unjustified burden on the United States. Such is so regardless of whether the imports are financed by aid funds or by Viet Nam's own foreign exchange since both sources of financing are interrelated, and the manner in which either is used governs the size of United States aid and the measure of progress toward achievement of the foreign aid goals. Thus no benefit accrues to the aid program when AID transfers the import financing of commodities it deems of doubtful propriety to the GVN, and in fact it may be said that the program suffers since admittedly AID has less control over GVN foreign exchange than over aid funds.

Accordingly, we urged AID to take steps to curtail the use of aid funds for imported commodities of a nonessential character and endeavor in a positive way to persuade the GVN to do likewise with its foreign exchange. AID agreed that such steps should be taken

and advised that the present GVN recently imposed heavy austerity taxes on certain luxury imports.

Financing of industrial development as nonproject aid resulted in inaccurate and incomplete program presentation (p. 40)

In Viet Nam, the establishment or major expansion of various industries was largely financed under the CIP, whereas in most other country-aid programs this type of industrial development has usually been financed as project assistance. We identified $14.7 million of CIP financing for the purchase of machinery for the establishment of new industries and $4.2 million for major expansion of existing plants.

The principal objection to this form of financing is that it results in an incorrect and incomplete presentation of the annual program to the Congress and makes more difficult the task of the responsible congressional committees in analyzing and evaluating proposed aid programs.

We suggested that, to the extent that the Agency continues to finance new enterprises or the major expansion of existing enterprises on an entire-package basis as nonproject aid under the CIP, the Agency devise some practical means of disclosing, in its annual program presentations, data as to each major enterprise similar to the data that is disclosed for projects under the project assistance program. AID advised us that it accepted and would carry out our suggestion.

Unnecessary aid costs and windfall profits to outside investors under the CIP (p. 41)

Industrial machinery for several new enterprises organized by American and Vietnamese interests was financed by AID under the CIP whereas the American investors converted their dollar capital to

piasters at the limited access market rate of about 73 piasters to the dollar and transferred the piasters to the enterprises as their capital contribution. The enterprises then applied part of their piaster capital to pay the local currency equivalent (counterpart) at the official rate of 35 piasters (plus taxes and duties) for the imported machinery financed by AID.

The effects of these types of transactions were that (1) aid funds financed commodity imports for which dollar exchange was already available and (2) the American investors and the enterprises realized windfall profits through the difference between the rate at which the investors' dollars were converted to piasters and the rate at which they paid in piasters for the imported machinery. We identified three such transactions in which the dollar investments totaled $775,000.

Although the Mission defended these types of transactions, we noted that subsequently among the criteria adopted by AID for eligibility for piaster loans under section 104(e) of Public Law 480 (loans to private enterprise) American investors were encouraged to use their dollar investments to finance their import requirements.

The situation described above is a direct consequence of the multiple exchange rate system in Viet Nam, which was one of the subjects of our report referred to on page 2. It seems to us that the dollar investments in the instant cases should have been used to purchase part of the required machinery and aid funds or GVN foreign exchange called upon to finance only the balance of the machinery import requirements and, further, that aid financing which allows windfall profits such as occurred in these cases is not a proper utilization of aid funds nor was such financing contemplated by the Congress.

We proposed that AID institute procedures which will require that the hard currency capital invested in Vietnamese enterprises by foreign investors be used to pay for the foreign exchange costs of required imports as a condition to AID financing of the balance of such requirements and, also, that AID seek the cooperation of the GVN in adopting similar procedures for requests made to obtain GVN foreign exchange to finance required imports. The Agency has advised us that the Mission is currently carrying out our proposal.

Cash grant in fiscal year 1963--
lack of economic justification (p. 46)

Despite the acknowledged defects of cash grants, AID in fiscal year 1963 agreed to purchase up to $10 million of piasters from the National Bank of Viet Nam. These piasters were to be used for financing expanded counterinsurgency activities for which the Agency stated that no provisions had been made in the GVN 1962 budget. AID officials acknowledged that no additional assistance beyond the amount then programed could be justified on balance-of-payment grounds but stated that there was a problem of meeting the piaster costs of the expanded counterinsurgency effort. Of greater importance, according to AID officials, was that the purchase afforded leverage to the United States to obtain, as a condition of the purchase, concurrence by the GVN in direct procurement, distribution, and control of domestic supplies and services vitally needed for counterinsurgency operations. These officials considered that the piaster purchase offered a substantial inducement to the GVN to accept the direct procurement plan because the purchase went a long way toward meeting the GVN preoccupation with the need for additional foreign exchange reserves.

Thus it appears that the United States had to buy the right to institute a method of operation which presumably was advantageous to the counterinsurgency effort and therefore should have been considered solely on its merits. Such action is incompatible with basic standards of sound administration and contrary to the concept of mutual cooperation between the two governments. The Agency advised us that it has a strong policy in opposition to cash grants but that the instant case was a carefully considered exception made at the highest levels of the executive branch. The reasons advanced by the Agency in our view are not related to the fact that the GVN could have obtained the required piasters by various means other than purchase by the United States.

At the time of the above purchase the United States Treasury had on deposit 138.9 million piasters (equivalent to $1.9 million at an exchange rate of 73.5 piasters per dollar) representing repayments on dollar loans aggregating $53 million made to the GVN during fiscal years 1956-58. Repayments on these loans were due every 6 months.

AID informed us that these piasters were not purchased from the Treasury in lieu of an equivalent amount purchased from the National Bank of Viet Nam because the exchange rate at which the piasters had been received from the GVN was in dispute and the piasters had been blocked by the Treasury pending resolution of the exchange rate issue. The loan agreements provide that if the exchange rate is not agreed upon within 60 days after the letter of nonacceptance the funds shall be returned to the GVN with a request for repayment in dollars, and although repayments had been unacceptable for more than 3 years the funds had not been returned nor had a representation been made to the GVN that the United States

intended to return the funds. Since the continued retention of these funds in a blocked status prevents their utilization for any purpose and thus is a significant disadvantage to the United States, we proposed that if it is not feasible to reach agreement now with the GVN on an acceptable exchange rate the piaster repayments be returned and request be made for repayment in dollars as provided in the loan agreements. The Agency agreed that a settlement of the local currency loan repayments is overdue and stated that it would seek negotiations with the GVN for an early resolution of the matter.

Purchase of piasters for Mission support costs resulted in unnecessary costs to the United States (p. 53)

From February 1957 to February 1962, the Mission used its dollar appropriations to purchase from the GVN, at the limited access market exchange rate, the piasters required to meet the local support costs applicable to its technical personnel instead of requiring the GVN to pay these costs as had been done in previous years. This action was based on the theory that counterpart funds were generated at the rate of 35 piasters to $1 whereas the limited access market rate was 72.8 to 1; consequently, the Mission believed that it was more advantageous to buy the piasters from the GVN than to request an allocation of counterpart funds. During fiscal years 1960 and 1961, the Mission expended $2.7 million of appropriated funds for the purchase of piasters needed for support costs, all of which could have been saved if the Mission had reexamined its policy in respect of local support costs at the time the basis for the level of aid was changed (see p. 23).

Although both the Mission and the United States Military Assistance Advisory Group (MAAG) were authorized to buy piasters for

support costs, the MAAG continued to require the GVN to provide piaster counterpart funds to pay for MAAG support costs.

There does not seem to be any logical basis on which this inconsistency between the Mission and the MAAG can be rationalized. Moreover, if, as the Mission claimed, the shortage of counterpart funds because of military commitments justified the purchase of piasters for local support costs, there appears to have been no ground for discontinuing such purchases in February 1962 since the military requirements for local currency did not diminish but rather increased before and after that time. The Agency agreed that it might have been more consistent to have reverted to the use of counterpart funds in 1960 for Mission support costs but stated that it was not in the political interest of the United States to press the GVN on this point when a reduction in aid was being made.

FINDINGS AND CONCLUSIONS

EXCESSIVE AID LEVELS

From 1955 through the fiscal year 1961, aid funds made available to the GVN for nonproject assistance were substantially in excess of Viet Nam's requirements for foreign exchange. As a consequence, GVN foreign exchange reserves increased considerably and unused commodity allocations reached sizable proportions, levels of consumption were encouraged beyond the capability of the Viet Nam economy to sustain, and positive incentive for the GVN to mobilize its own resources was weakened. The excessive aid levels during these years occurred because (1) the basis on which aid levels were calculated during the fiscal years 1955-59 was unsound, (2) actual imports and exports by Viet Nam for the fiscal years 1960 and 1961 varied substantially from the estimated imports and exports on which the nonproject aid levels for those years were primarily based and the amounts of these variances were not taken into account in determining the aid levels for the succeeding years, and (3) additional aid given in fiscal year 1961 for political reasons was not justified on economic grounds.

AID required Viet Nam to use in fiscal year 1962 a portion of its increased foreign exchange reserves and unused commodity allocations from prior years, and there was a drawdown of these resources totaling $62.3 million.

Fiscal years 1955-59

From the start of the expanded aid program in 1955 through fiscal year 1959, the annual nonproject aid level was based primarily on the need for generating a predetermined amount of piasters to be used mainly for the support of the Vietnamese military budget. AID provided annual dollar amounts equivalent to the required budget support, principally by financing commodity imports

and by cash grants, both of which generated local currency at the official exchange rate. However, the dollars provided exceeded the essential import requirements of Viet Nam over and above those requirements financed from Viet Nam's foreign exchange earnings with the result that Viet Nam's foreign exchange reserves increased substantially and large unused balances of commodity procurement authorizations accumulated; also, a higher level of internal consumption was fostered than was warranted by the state of the Viet Nam economy.

United States agencies recognized that the excessive levels of aid lessened the incentive for the GVN to mobilize its resources for military requirements and economic growth and, further, that this method of determining the aid level was unsound, in that such a level was designed to meet the recipient country's internal budget requirements whereas the assistance program was intended to finance external necessities beyond the country's own capability to finance. In March 1959, AID notified the GVN that calculation of the nonproject aid level on the piaster deficit basis would be discontinued and that, beginning in fiscal year 1960, the aid level would be determined on the balance-of-payments basis (see next section) which in the light of past experience as described above was contemplated to produce a lower level of nonproject aid and, consequently, reduced generation of local currency. The GVN never fully accepted the changeover from the piaster deficit to the balance-of-payments basis, and the controversy over the new basis which continued for several years thereafter impeded the program, since the GVN would not agree to raise the additional piaster revenues required to cover the reduction in local currency generation.

At June 30, 1959, Viet Nam foreign exchange reserves, which were practically nonexistent at the start of the expanded aid

program in 1955, had increased to $158.2 million, and commodity financing authorizations issued by AID but not licensed by GVN for import totaled $77.8 million at the same date. The following summary shows the dimensions of these import financing resources during the fiscal years 1956 through 1959.

June 30	Unlicensed CIP authorizations	Viet Nam foreign exchange reserves (note a)	Total import financing resources
	millions		
1956	$95.9	$137.0	$231.9
1957	59.4	135.2	194.6
1958	83.8	166.2	250.0
1959	77.8	158.2	246.0

[a]Estimated by AID Mission

The Mission attributed the failure of Viet Nam to mobilize its resources partly to United States aid and partly to insecure conditions brought about by the intensive Viet Cong insurgent activities. It emphasized the political problems which confronted the GVN and affirmed that tax collections should be higher; as to the latter, it reported that some progress was being made.

According to the Mission, the high level of consumption was true in the Saigon-Cholon area but not generally true for the largest percentage of the people in Viet Nam, and was not the consequence of the aid program but rather of the history of the French colonial period. The Mission further stated that although the struggle for national survival calls for sacrifices and general austerity the internal character of the war is such that winning and holding the support of the rural as well as the urban populace

depend upon the capacity of the GVN to meet the economic aspirations of its people. The Mission's argument here seems to imply that despite the critical stature of the civil war and the necessity for advancing the economic standards of the rural populace the relatively high living standards in the Saigon area should be allowed to continue undisturbed.

Fiscal years 1960-61

Under the balance-of-payments method of determining the nonproject aid level which AID initiated in fiscal year 1960, the total annual import requirements and foreign exchange earnings were estimated and the excess of the former over the latter, representing the additional foreign exchange necessary to finance the total import requirements, was fixed as the aid level. During the years that this method of computing the aid level was in effect, there should have been no significant variation in foreign exchange reserves or unlicensed import financing authorizations. Yet, during the fiscal years 1960 and 1961 Viet Nam foreign exchange reserves increased by more than $50 million while unlicensed import financing authorizations decreased by $28.9 million.

The increase was attributable in part to substantial variances in the actual imports and exports by Viet Nam from the estimates thereof on which the aid levels were determined. For example Viet Nam exports for calendar year 1960 were estimated at the equivalent of $70 million; according to the Mission actual exports totaled the equivalent of $85.6 million and imports financed from GVN resources amounted to only $45 million, thus more than $40 million was added to Viet Nam foreign exchange reserves. This increase in reserves was not considered in developing the nonproject aid level for the succeeding year.

A further factor contributing to the increase in foreign exchange reserves was a supplementary grant of $4.5 million by AID one day before the close of fiscal year 1961, to finance commercial imports. This grant was acknowledged by AID as not economically justified but was made to demonstrate United States support for Viet Nam during the Laos crisis.

United States aid officials were considerably disturbed by the increase in foreign exchange reserves since these resources were about twice as high on a per capita basis as the average for all aid recipient countries in the Far East. GVN foreign exchange reserves reached $223 million at the end of calendar year 1960. In July 1961 the Special Financial Group recommended that these reserves should be held in the region of $200 million. By March 1962, the GVN reported that its reserves had dropped to a level equal to $162 million.[1] This reduction in reserves became a matter of concern to GVN authorities, who stated that the $200 million set by the Special Financial Group was not a ceiling, but an amount below which Viet Nam's reserves should not be reduced. Accordingly, GVN requested a cash grant to help build up its reserves to the $200 million level. Preoccupation of the GVN with this and other fiscal matters became so dominant that American officials feared that the whole counterinsurgency effort would be seriously affected, and overcoming this concern of the GVN was one of the principal factors which led AID to approve a cash grant. (See p. 46.)

The Mission claimed that the higher-than-estimated exports in 1960 were due to the happy circumstance of firm rubber prices and a

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[1] The reliability of foreign exchange information given to the Mission by the GVN is discussed in our report referred to on page 2.

higher-than-anticipated rice crop and cited this circumstance as indicative of the inherent difficulty of estimating Viet Nam exports. The Mission agreed that there was no economic justification for the $4.5 million grant at the close of fiscal year 1961 but stressed that the political considerations warranted it and asserted that such funds would have been available within a matter of days from fiscal year 1962 funds and that the net amount of the combined 1961 and 1962 funds would have been the same regardless of whether the grant was made from 1961 or 1962 funds. We do not disagree with the Mission regarding the difficulty of estimating exports. Our point is that significant variances between estimated and actual imports and exports should have been taken into account in formulating the level of aid for the succeeding years; that, because they were not, the aid levels were excessive; and that this excess aid was reflected in progressively increasing and higher-than-reasonable foreign exchange reserves. On the same premise the Mission's rationale of the $4.5 million is specious since the 1962 aid level was determined independently of the $4.5 million on the basis of bridging the gap in the balance of payments as calculated on estimates of Viet Nam imports and exports for 1962.

Fiscal year 1962

In fiscal year 1962, AID again became seriously concerned about the high level of unused import financing resources. In negotiations with the GVN on the fiscal year 1962 program, agreement was reached by the United States and the GVN on certain economic reforms which provided, among other things, for:

1. An increase in the effective piaster-dollar exchange rate so that more piasters could be generated without increasing dollar aid levels.

2. A reduction in the unused (unlicensed) level of CIP authorizations to $25 million. (This would mean a reduction of about $15 million from the level of about $40 million at the close of the previous year.)

3. No further increases in Vietnamese foreign exchange reserves.

In return for these concessions, AID informed GVN that it would make available $135 million of supporting assistance for the CIP and $25 million of Public Law 480 title I commodities. In approving this level of aid for 1962, AID recognized that Viet Nam did not require such a high aid level. A memorandum prepared for the Administrator of AID in November 1961 stated:

> "*** not more than $145 million at the outside could be economically justified. However, in consideration of the political justification for the increased aid, you approved the full $160 million subject to criteria designed to assure optimum utilization of resources.
>
> * * * * *
>
> "*** The excess aid over that economically required is designed to create a climate in which the GVN will accept reforms the U.S. considers essential to the survival of the country."

Subsequently, the Mission reduced the target for supporting assistance to $115 million and again reduced it to $97.5 million and the Public Law 480 allocation was increased to $30 million. At the reduced level of $127.5 million, the unlicensed CIP authorizations at June 30, 1962, amounted to $33.9 million, although the United States-GVN agreement envisaged a reduction of these authorizations to $25 million, and Viet Nam foreign exchange reserves were reported by the GVN at $161.7 million, a decline of $47.3 million from the reserves reported for the previous year.

The Mission ascribed the high amount of unlicensed CIP authorizations at the close of fiscal year 1962 to the effect of the exchange rate adjustment on imports, the limited worldwide procurement policy of the United States, and internal insecurity in Viet Nam. The Mission further claimed that because the United States was prepared to extend more aid than private importers were prepared to utilize was no indication that the United States was profligate with its resources since a higher level of resource import would have resulted in a higher level of governmental activity in the rural areas, which was necessary to the defeat of the communists. This theory is contrary to the basic concept of commodity import assistance which is predicated on the financing by the United States of essential commodity import requirements beyond those which Viet Nam can finance from its own resources and on the financing by the GVN of the internal activities beyond the amounts generated by the CIP.

Summary conclusions and Agency comments

The Mission informed us that Viet Nam import financing resources further declined subsequent to June 30, 1962, and that at September 30, 1962, unlicensed CIP authorizations had been reduced to $23.3 million and foreign exchange reserves were $153 million. However, in the light of our discussion on the reliability of financial data reported to the Mission by the GVN (see footnote on p. 24), there remains some question as to what the Viet Nam foreign exchange reserves actually were. Apart from this factor we believe that on the basis of our findings the dimensions of CIP over the years exceeded the essential import requirements of Viet Nam by relatively substantial margins and that, although reported recent drawdowns may be considered as having retrieved some of the excess, much of this excess has been expended in high consumption of

nonessentials made possible and given impetus by the availability of more import financing than was needed or could be beneficially absorbed. The consequences of this situation have been twofold. First, the cost of United States aid was unnecessarily and significantly increased not only with no compensating economic benefit but with detriment to the achievement of aid objectives through the effect of excessive aid levels on the economic, social, and political structure of Viet Nam. Second, the abundance of aid funds readily at hand enabled the GVN to avoid taking the hard measures of economic discipline and reform that would lay the foundation for solid economic development, national unity and stability, and ultimate economic self-sufficiency. The failure to take these measures, particularly in the late 1950's when conditions for their success were more favorable than in later years, together with the cultivated habit of high consumption and a disordered economic structure advantageous to certain segments of the population, has made it considerably more difficult to institute these measures in later years when their rewards have become so critically needed. This state of affairs has been a severe deterrent to the aid program and to the overall economic, social, and political advancement of Viet Nam.

The extraordinary financing demands for combating the intensified Viet Cong insurrection undoubtedly have complicated the task of fixing realistic requirements for United States aid. Nevertheless it should be considered that even the reportedly reduced Viet Nam foreign exchange reserves at September 30, 1962, were approximately double the average annual Viet Nam exports and that since fiscal year 1960 it has been the intent to have the CIP finance the excess of essential imports on an annual basis, thereby avoiding any diminution of foreign exchange holdings. This situation,

together with the substantial United States assistance for counter-insurgency activities[1] and military hardware, training, and other support furnished under the military assistance program, constitutes a solid bedrock of fiscal safety which should enable the GVN to extract from its own resources the further means with which to meet its regular and extraordinary financing demands.

Accordingly, we believe that it is practical to apply the balance-of-payments formula in determining the annual level of the CIP and that this formula should contemplate adjustment of the aid level each year for variances in the previous year between actual imports and exports and the estimates thereof on which the aid level for that year was determined. This more careful attention to a proper level of aid would eliminate the excesses which have marked the CIP since 1960 and may reasonably be expected to induce a sharper consciousness of essentials in the utilization of both aid and Viet Nam funds. We proposed that the AID Administrator take appropriate steps to see that the formula as outlined above is adopted and applied in the determination of the annual CIP and, also, that insofar as may be compatible with the most realistic foreign policy considerations AID avoid supplementary aid, such as the $4.5 million at the close of fiscal year 1961, unless justified on economic grounds.

AID informed us in March 1964 that it has been operating within the framework of our proposals since fiscal year 1963.

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[1] See report referred to on page 2.

COMMODITY COSTS HIGHER THAN NECESSARY

Pharmaceuticals

The cost of pharmaceutical imports financed by AID as part of the CIP was higher than necessary because of commissions and promotional allowances paid to Vietnamese importers by pharmaceutical suppliers. These emoluments, which were generally handled as a separate transaction between the supplier and the importer, were deposited in dollars by the supplier in a bank in the United States or Switzerland to the credit of the importer, and the amount was included by the supplier in the billing to AID for shipment of the pharmaceutical items. Although such payments, which are prohibited by AID regulations, had been made to the importers since 1956, it was not until March 1961 that AID/Washington filed its first claim for refund and the Mission did not take action until requested to do so by AID/Washington in late 1961. AID internal auditors indicated that if the Mission had closely examined pharmaceutical import licenses issued by the GVN these illegal payments would not have gone undetected for such a long time. The auditors believed that a review by the Mission of the prices shown in the license applications would have revealed that the prices paid were well in excess of worldwide competitive prices. AID stated that it is not solely the responsibility of the Mission to review prices to be paid by importers and that postaudit by a commodity specialist at the Agency's Washington office is the most effective check on prices because of the proprietary nature of many pharmaceutical products.

In November 1961, AID/Washington requested the Mission to review this situation and stated that (1) ineligible payments could amount to several million dollars and (2) this situation may be indicative of overprograming by the Mission of pharmaceutical imports

and subsequent illegal exports to neighboring countries. The subsequent Mission audit disclosed ineligible payments totaling more than $400,000. It was acknowledged that this amount was incomplete since three of the most important pharmaceutical importers were unwilling to furnish requested information to the Mission auditors and certain other importers were not covered in the audit. A Washington review indicated a total of about $675,000 of ineligible payments, but this review also did not include all shipments.

In regard to illegal exports, the Mission audit report dated January 1962 stated that since October 1961 there was little incentive for these exports since an increase in the retail price in Viet Nam made it as profitable to sell the goods in Viet Nam as it would be in neighboring countries. However, it seemed to us that the data used by the Mission auditors in reaching this conclusion was unsound[1] and that the incentive for illegal exporting still existed. As to possible overprograming, which would enable the illegal export, although pharmaceuticals were one of the major elements of the United States-financed portion of the CIP (about $9 million annually), it was not until March 1962 that the Mission undertook a market survey to ascertain Viet Nam's actual pharmaceutical requirements. Prior to that time the Mission claimed that it did not

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[1]The auditors reported that the dollar equivalent of the piaster retail selling price of pharmaceuticals within Viet Nam was higher than in the neighboring countries, hence no incentive for illegal exports existed. However, the auditors computed the dollar equivalent retail price using the official exchange rate of 35 piasters per $1, whereas pharmaceutical imports were paid for at substantially higher rates (about 71 piasters per $1) because of the application of various taxes to the official rate. If the dollar equivalent retail price had been computed at the 71:1 rate, the retail price in Viet Nam would have been lower than in neighboring countries and therefore an incentive for illegal exports existed.

need to make market surveys to determine what the annual AID funding for specific imports should be and that, in the case of pharmaceuticals, variations of one million dollars during the course of a year were not significant.

Conclusion and Agency comments

We were informed by AID that between March 1961 and September 1963 claims aggregating $806,000 were filed against 21 suppliers; that on account of ineligible commissions and promotion allowances, lack of certification by the Food and Drug Administration, and other reasons $414,000 of this total had been collected and claims in the amount of $240,000 had been referred to the Department of Justice; and that other cases were being investigated. However, there can be little doubt that many thousands of dollars in excess payments have not been identified and that this loss is attributable at least in part to the failure of the Agency for approximately 4 years to be reasonably alert to the potential abuses in the procurement of pharmaceuticals and to exercise the degree of management control necessary to counteract such abuses.

Agency representatives have further advised us that since February 1962 all shipments of pharmaceuticals are being audited in detail principally by analysis of unit prices of individual items and that, in any instance where prices or other aspects of a shipment appear questionable, an examination is made of the supplier's records. The Agency believes that these measures have been effective and that the suppliers' awareness of these measures exerts a salutary influence in minimizing the incentive to the suppliers to include commissions and promotional allowances in their billings. Although the measures taken by the Agency constitute a positive effort to overcome these abuses, we are not convinced that they can be fully effective since the market spread in unit prices of many

pharmaceutical items is sufficient to permit absorption of charges for commissions and promotional allowances without exceeding the limit of acceptable unit prices. For this reason and because of the particular vulnerability of pharmaceuticals to improper practices by suppliers and importers, we urged the Agency to continued and concentrated vigilance in the application of workable controls in the authorization of pharmaceutical procurements by the Agency and the GVN, in the audit of procurements, and in the search for additional methods of detecting and preventing these improper practices. The Agency advised us that it would continue as urged by us to guard against improper procurement practices and to seek additional means of assuring compliance with procurement regulations.

Fertilizer

World fertilizer prices are governed in part by the date of delivery; if delivery is scheduled during the period of greatest demand, prices are higher than if delivery is scheduled before or after the peak fertilizer demand periods. For fertilizer procured from the United States, higher prices are paid if delivery is requested between February and July. Procurement authorizations issued by AID for fertilizer imports into Viet Nam permitted delivery during the demand season, and according to estimates of AID-financed fertilizer arrivals in Viet Nam during 1962 nearly half the imports were scheduled to be received during the period of greatest demand (February through July). If the bulk of the fertilizer were delivered during the off-season and stored until needed, substantial savings in United States dollar aid funds could be realized.

The Mission estimates that there are adequate storage facilities in the Saigon-Cholon area for 80,000 metric tons of fertilizer and that additional facilities exist in the rural areas where

central distributing points, in the form of storage sheds or cooperative or commercial warehouses, are available. It appears that, with proper planning, the approximately 138,000 metric tons of AID-financed fertilizer scheduled to be imported in 1962 could have been delivered during the off-season at considerable savings.

The Mission reported that storage costs amounted to 34 cents a ton per month and that, since GVN price control regulations prohibited importers from adding storage costs to the final retail price of the commodities, most Vietnamese importers were reluctant to keep large volumes stored for periods longer than 1 or 2 months. In the case of nitrogenous fertilizer, which accounted for 54,000 metric tons of the 1962 fertilizer program, the net saving on the off-season price over the storage cost would have totaled more than $240,000.

It appeared that up to the time of our review the Mission had not given any recognition to the potential economies which could be realized by off-season purchasing. When we pointed out this advantage, the Mission promised to give full consideration to the matter. Subsequently, AID/Washington requested data on fertilizer use and purchasing from all its overseas missions for the purpose of making a centralized review of aid-financed fertilizer programs.

In view of the significant savings attainable through off-season purchase of fertilizer, particularly nitrogenous fertilizer, and the relatively large quantities required in Vietnamese agriculture, we proposed that AID develop with the GVN the necessary procedures which will encourage and, if possible, require the procurement of fertilizer during the off-season and the storage thereof until needed.

Agency comments

The Agency expressed agreement with our proposal and stated that it had been working toward that end. It stressed, however, that there were some limitations that militate against maximum off-season procurement. Security conditions hinder orderly procurement and distribution, and rural storage facilities are subject to Viet Cong raids thus discouraging dealers from taking the risks of advance procurement. Also, limited credit and high interest costs of borrowed money make dealers reluctant to purchase in advance of needs. In addition, some offers of ammonium sulphate fertilizer in the off-season have been found to be for small quantities.

IMPORTATION OF NONESSENTIAL COMMODITIES

Plastic raw materials

During the fiscal years 1958-62, AID made $9.9 million available for the importation of plastic raw materials which were used to produce a variety of end products, some of which are essential to the Vietnamese economy, such as electrical fixtures, and others are nonessential.

In September 1960, the Mission, recognizing that a large proportion of plastic raw material imports were being used to produce nonessential goods and that such use was not in accord with AID objectives, informed GVN that it proposed to discontinue further financing of plastic raw materials as of January 1, 1961; in October 1960 the cutoff date was extended to June 30, 1961, but in December 1960 the Mission decided to continue the financing of plastic raw materials subject to the President's balance-of-payments directive limiting procurement to United States sources.

We questioned the continued financing of plastic raw material imports in view of the Mission's finding that a large part of these materials were being used to make nonessential items such as cigarette boxes, soap containers, plastic bags, perfume bottles, and toys. The Mission informed us that it did not consider these items questionable consumer goods although the Mission files revealed that the Mission itself had questioned the necessity of many of these items. The Mission also stated to us that one of the reasons for its proposal to discontinue financing plastic raw materials was limited fund availability; however, the Mission decided subsequently, that because these materials were becoming increasingly important to the proper growth of the Vietnamese economy they should continue to be eligible for aid financing. Since plastic

raw materials have both essential and nonessential uses, we inquired if the Mission had made a survey to determine the quantities of plastics needed for essential and for nonessential uses so that financing could be limited to meet the need for only the essential requirements. The Mission stated that it was then conducting such a market survey. However, we ascertained that the study being conducted did not include the end uses made of the plastic raw material imports and was designed to determine whether the total demand (essential and nonessential) would justify building a plastic-raw-material factory in Viet Nam. To the extent that United States financing would be needed to construct and equip such a factory or needed for the ingredient materials required for production, it seems that it would be necessary to determine the quantities to be used for essential and for nonessential purposes in order for the Mission to be in a position to judge whether such a factory would be justified.

Nylon and worsted yarns

In recent years AID-financed nylon yarn imported into Viet Nam has been used largely for the manufacture of men's socks. However, an industrial contractor whose services were financed by AID reported that in earlier years socks were made from cotton, which is much less costly than nylon. Nylon yarn financed by AID cost nearly $3 a pound against a cost of only about 46 cents a pound for rayon and cotton yarn. In April 1961, AID financing of textile products was discontinued and the GVN assumed funding for textile imports.

AID funds were used to finance the importation of unnecessarily high-quality worsted yarn which was used to produce sweaters, underclothing, and products of a similar type. The use

of this high-cost yarn, which was produced from high-quality wool (64/70 count), resulted in a higher import level than would have resulted if less expensive yarn had been purchased, and, consequently, the level of the CIP was higher than necessary. We found no evidence that the Mission or AID/Washington took any specific cognizance of these very high-quality yarn imports to recommend the use of less expensive grades. Nylon and worsted yarns were classified by the Agency in the commodity code for "yarns, threads, and manmade fibers" whereas procurement authorizations were only by commodity codes. Therefore it was not practicable to ascertain the amount of aid financing for nylon and worsted yarns, but other information sources within the Agency indicated that the amount was relatively significant. In April 1961, AID transferred responsibility for financing worsted yarns and other textile products to the GVN.

Conclusions and Agency comments

It seems to us that, so long as outside assistance on a large scale is required by Viet Nam, the import beyond token amounts of commodities not required or of marginal necessity to that country's economic survival or development adds an unjustified burden on the United States. Such is so regardless of whether the imports are financed by aid funds or by Viet Nam's own foreign exchange since these sources of financing are interrelated, and the manner in which either is used governs the size of United States aid and the measure of progress toward achievement of the foreign aid goals. Thus no benefit accrues to the aid program when AID transfers the import financing of commodities it deems of doubtful propriety to the GVN, and in fact it may be said that the program suffers since

dmittedly AID has less control over GVN foreign exchange than over id funds.

Accordingly, we urged that AID take steps to curtail the use f aid funds for imported commodities of a nonessential character nd endeavor in a positive way to persuade the GVN to do likewise ith its foreign exchange. AID agreed that such steps should be aken and advised that the present GVN recently imposed severe austerity taxes on certain luxury imports.

FINANCING OF INDUSTRIAL DEVELOPMENT AS NONPROJECT AID RESULTED IN INACCURATE AND INCOMPLETE PROGRAM PRESENTATION

In Viet Nam, the establishment or major expansion of various industries was largely financed under the CIP, whereas in most other country-aid programs this type of industrial development has usually been financed as project assistance. We identified $14.7 million of CIP financing for the purchase of capital equipment for the establishment of new industries and $4.2 million for major expansion of existing plants. The Mission informed us that the following criteria were applied in approving industrial development under the CIP rather than as project assistance.

1. AID assistance was limited to financial aid and did not include technical assistance.
2. The total financing required was not more than $1 million per recipient.
3. The industry could pay the piaster countervalue of the dollars provided, at the rate of 35 piasters per dollar, without the necessity of a loan.

We noted that for a number of enterprises, both new and those being expanded, the financing considerably exceeded the $1 million ceiling per recipient. We noted also that the Deputy Assistant Secretary of State for Far Eastern Economic Affairs indicated in March 1959 that since the Development Loan Fund (DLF) was considered to have been established as the main instrument for financing development needs it was expected that the level of the CIP would be reduced, but that since the resources of the GVN to meet future amortization and interest on development loans would be limited he favored restricting DLF loans to self-liquidating projects and continuing to finance other development needs under the CIP.

Conclusion and Agency comment

The principal objection to this form of financing stems from the fact that AID classifies country-aid programs as project and nonproject in its annual program presentations to the Congress and for project assistance submits a separate listing of major projects showing various data as to each project. Thus, to the extent that entire-package enterprises are financed as nonproject aid under the CIP, the program breakdown between project and nonproject assistance as shown in the annual program presentation is inaccurate and the enterprises so financed are not included in the listing of major projects. As a consequence the task of the responsible congressional committees in analyzing and evaluating proposed aid programs is made more difficult than it otherwise would be.

We suggested that, to the extent that the Agency continues to finance new enterprises or the major expansion of existing enterprises on an entire-package basis as nonproject aid under the CIP, the Agency devise some practical means of disclosing, in its annual program presentations, data as to each major enterprise similar to the data that is disclosed for projects under the project assistance program. The Agency advised us that it accepted and would carry out our suggestion.

UNNECESSARY AID COSTS AND WINDFALL PROFITS TO OUTSIDE INVESTORS UNDER THE CIP

Industrial machinery for several new enterprises organized by American and Vietnamese interests was financed by AID under the CIP whereas the American investors converted their dollar capital to

piasters at the limited access market rate of about 73 piasters[1] to the dollar and transferred the piasters to the enterprises as their capital contribution. The enterprises then applied part of their piaster capital to pay the local currency equivalent (counterpart) at the official rate of 35 piasters (plus taxes and duties) for the imported machinery financed by AID.

The effects of these types of transactions were that (1) aid funds financed commodity imports for which dollar exchange was already available and (2) the American investors and the enterprises realized windfall profits through the difference between the rate at which the investors' dollars were converted to piasters and the rate at which they paid in piasters for the imported machinery. We identified three such transactions in which the dollar investments totaled $775,000.

The Mission justified these transactions on the following grounds:

1. Establishing the rate at which dollars are converted into piasters is a prerogative of the GVN and beyond the control of the AID Mission.

2. Preventing American investors from purchasing piasters with dollars would be discriminatory since other investors, both Vietnamese and other than American foreign investors, could continue to use the limited free exchange market.

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[1] The limited access market permitted the purchase of piasters for certain types of transactions (including investment in Viet Nam by outside interests) at a more favorable rate (about 73 piasters per 1 United States dollar) than the official rate of 35-1,

3. Since disinvestment and capital repatriation are also accomplished at the limited access free market rate, the initial windfall would be recovered by the GVN at a later date.

4. The provision of an investment incentive in the form of a favorable piaster purchase rate ultimately reduces the cost of the aid program, because the productive facilities established as a result of the incentive ultimately reduce the level of imports and, consequently, the requirements for aid.

5. The foreign exchange increment to the GVN from the sale of piasters on the limited access market can be used to offset the requirements for aid, inasmuch as under the balance-of-payments method of computing the aid level the higher GVN's foreign exchange earnings the less the requirement for aid funds.

The merits of these reasons are considered below in the order in which they are stated.

1. Foreign investment undertakings of the type described above are individually approved by both the Mission and the GVN, and the piaster conversion of investment dollars increases the immediate burden on AID funds. Therefore, it would be well within the province of the Mission to require partial defrayal of foreign exchange costs of the imported machinery with the invested funds as a prerequisite to financing the balance of the import funding requirements of the enterprises.

2. Any requirement to use foreign investment capital to pay for imported equipment should be applicable to all outside investors, not only to American, and to all hard currency foreign investment as such hard currency (dollars, francs, etc.) is readily convertible. Since Vietnamese investors would not have any hard currency funds the Mission's contention in this respect is not applicable.

3. It is theoretically correct that the windfall can be recovered at the time of profit remittance or capital repatriation, but such recovery will take place only when and if these events occur. Furthermore, it is possible that future changes in conversion rates in the limited access market will negate all or part of this recovery or that exchange control will restrict or prevent profit remittance or capital repatriation.

4. Adequate incentives existed for foreign investment in Viet Nam in the form of guarantees by AID as to convertibility of profits and capital, tax exemption by the GVN for a period of years, and noncompetitive markets in the Viet Nam economy at least in the early years of an enterprise. These incentives precluded the need for the techniques employed in the instant situation; these techniques added to the burden of United States aid while producing monetary gains to the investors.

5. In theory the receipt of foreign exchange by the GVN from operation of the limited access market should reduce the aid level by an exactly equal amount under the balance-of-payments method. However, in actual practice this has not been the case mainly because the varied types of movement in GVN foreign exchange not subject to AID knowledge or control, and the historical pressure by the GVN for reserves as high as possible, permit the increment of foreign exchange from transactions of the kind herein described without corresponding diminution of the level of aid.

Although the Mission defended the aforestated types of transactions, we noted that the criteria subsequently adopted by AID for eligibility for piaster loans under section 104(e) of Public Law 480 (loans to private enterprise) included encouragement to American investors to use their dollar investments to finance their import requirements.

Conclusions and Agency comments

The situation described above is a direct consequence of the multiple exchange rate system in Viet Nam which was one of the subjects of our report, referred to on page 2, on certain economic and financial policies of the GVN. It seems to us that the dollar investments in the instant cases should have been used to purchase part of the required machinery and aid funds or GVN foreign exchange should have been called upon to finance only the balance of the machinery import requirements and, further, that aid financing which allows windfall profits such as occurred in these cases is not a proper utilization of aid funds nor was such financing contemplated by the Congress.

We proposed that AID institute procedures which will require that the hard currency capital invested in Vietnamese enterprises by foreign investors be used to pay for the foreign exchange costs of required imports as a condition to AID financing of the balance of such requirements and, also, that AID seek the cooperation of the GVN in adopting similar procedures for requests made to obtain GVN foreign exchange to finance required imports. AID advised us in March 1964 that the Mission currently was carrying out our proposal. The Agency does not agree, however, that rigid proscription of cash investment would be necessary or desirable in every case and stated that, to the extent that the GVN and Vietnamese partners may offer alternative types of incentives for foreign investment, other than the cash investment practice discussed above, AID would favor such alternatives.

CASH GRANT IN FISCAL YEAR 1963[1] -- LACK OF ECONOMIC JUSTIFICATION

In fiscal years 1955 and 1956, AID made dollar cash grants or loans to Viet Nam, totaling $151 million, for the purpose of quickly generating piasters needed for program purposes. Under this procedure, the GVN, in return for United States Treasury checks, deposited the piaster equivalent of the dollar amounts (computed at the official exchange rate of 35 piasters per 1 United States dollar) into the counterpart fund. In order to obtain the piasters for deposit, the GVN generally borrowed the required sum from the National Bank of Viet Nam; the dollar funds remained in the possession of the bank and were to be used to finance commodity imports by Vietnamese importers through licenses issued by the GVN; the piaster countervalue paid by the importers to the bank for the dollars used was applied by the bank to repay the Government's borrowings. The piasters borrowed by the GVN from the bank were deposited into the counterpart account, from which AID subsequently authorized releases to be used for military budget support, for local costs of the refugee program, and for other purposes. (See p. 44 of our 1958 report.)

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[1] The AID plan for acquiring piasters with a United States dollar check in 1963 is designated as a piaster purchase differing from the earlier cash grants in that under the 1955 and 1956 cash grants the piasters generated were deposited in the GVN-owned counterpart account from which they were released for program purposes. Under the piaster purchase plan, the piasters generated were to be deposited in a United States-owned account from which they were to be released for program purposes. In this report, we refer to the 1963 piaster purchase as a cash grant because of the similarity between the two types of grants.

During those years, the Agency used the cash grant method of generating piasters because it considered its traditional commodity procurement authorization procedure too slow to produce the required piasters and cited the emergency conditions then existing in Viet Nam as a justification for making these grants.

Subsequently, AID recognized that cash grants were economically unsound and discouraged the practice in Viet Nam. Among the reasons for this recognition was that cash itself was not aid; also, in the case of Viet Nam, it was found that to a large extent the dollars were not being used but became a part of the country's foreign exchange reserves which as a result rose to an unnecessarily high level (see p. 25). Responsible officials recognized that only resources other than cash represented aid and that there was no justification for aid merely to provide a country with its own currency.

Despite the acknowledged defects of cash grants, AID in fiscal year 1963 agreed to purchase up to $10 million of piasters from the National Bank of Viet Nam. These piasters were to be used for financing expanded counterinsurgency activities for which the Agency stated that no provision had been made in the GVN 1962 budget. AID officials acknowledged that no additional assistance beyond the amount then programed could be justified on balance-of-payment grounds but stated that there was a problem of meeting the piaster costs of the expanded counterinsurgency effort. Of greater importance, according to AID officials, was that the purchase afforded leverage to the United States to obtain, as a condition of the purchase, concurrence by the GVN in direct procurement, distribution, and control of domestic supplies and services vitally needed for counterinsurgency operations. These officials considered that the piaster purchase offered a substantial inducement to

the GVN to accept the direct procurement plan because the purchase went a long way toward meeting the GVN preoccupation with the need for additional foreign exchange reserves.

The piaster purchase had the following unsatisfactory aspects:

1. There was no real economic reason for this expenditure of United States funds. The GVN had no need for dollar funds since the funds were intended merely to augment Viet Nam foreign exchange reserves, and as pointed out in the preceding section these reserves even at the reduced level of $153 million at September 30, 1962, were more than ample. The piaster funds required for the expanded counterinsurgency effort, if not then available, could have been borrowed from the National Bank of Viet Nam and repaid from subsequent revenues from increased taxation which would have been warranted (1) on the general grounds of Viet Nam's unbalanced tax system and (2) on the specific basis that the planned expansion of counterinsurgency activities necessitated further demands on the country's resources. Moreover, in the congressional presentation for the fiscal year 1962, AID stated that, since the GVN had always pursued a conservative fiscal policy in the past, an increased currency issue or further borrowings would not be fiscally unsound and could result in substantial savings to the United States without harmful effect on the aid program or the Viet Nam economy.

2. The continued provision by the United States of dollar funds for local currency purposes dulls the incentive for the GVN to institute needed economic reforms which would make Viet Nam less dependent on United States aid, particularly for local cost requirements. Although such measures as tax reform and exchange rate adjustment have reportedly produced impressive additional revenues, these measures have been considerably short of realizing the full potential in these fields.

3. The direct payment of dollars to aid-receiving countries without specific provision as to their utilization deprives the United States of the control mechanism for assuring that such funds are used for purposes deemed consistent with United States aid objectives and strengthens the position of the recipient country for employing its foreign exchange for purposes for which aid funds would not be considered eligible. As pointed out in our report on certain economic and financial policies of the GVN, referred to on page 2, the GVN has permitted the import of substantial amounts of luxury goods with its own foreign exchange. Moreover, such dollar funds also enable the recipient country to import commodities from other than United States sources, which is not generally permitted under the CIP, thereby contributing to dollar outflow and losing to the United States business community the financial benefit of such imports.

4. The problem of control to assure proper utilization may also extend in the subject case to the local currency purchased. An audit report issued in March 1964 by the Mission Controller's office covering one release agreement involving the equivalent of about $342,000 (the piasters acquired by the $10 million purchase were distributed under a total of 46 release agreements) disclosed that piasters aggregating the equivalent of about $72,000 of reported expenditures were unaccounted for, used without authorization, or used for unauthorized purposes. The Mission report stated that the funds under this agreement were for specified counterinsurgency activities to be administered in Quang Tin Province by a Provincial Committee, composed principally of the Vietnamese Province Chief, the Mission Rural Affairs Representative, and the MAAG Provincial Advisor, and that this report was the first of a series to be issued on the counterinsurgency program including the use of

the purchased piasters. AID/Washington has expressed its serious concern to the Mission about the audit findings, particularly as to the need of flexibility of local procedures to provide adequate control without impeding counterinsurgency activities, and has advised the Mission that it is anxious to receive further reports on the situation under this and other release agreements and on the action taken.

A further circumstance in regard to the piaster purchase is worthy of note. At June 30, 1962, while the purchase was being negotiated the United States Treasury had on deposit 138.9 million piasters (equivalent to $1.9 million at an exchange rate of 73.5 piasters per dollar) representing repayments on dollar loans aggregating $53 million made to the GVN during fiscal years 1956-58. Repayments on these loans were due every 6 months.

We inquired of AID why these piasters were not purchased from the United States Treasury in lieu of an equivalent amount purchased from the National Bank of Viet Nam as part of the total piaster purchase transaction. In response, AID stated that in 1960 the United States decided as a matter of policy that repayments in local currency at 35 piasters to the dollar would not be acceptable as interest and amortization payments on loans and that, although the GVN adopted new exchange arrangements in 1962, it was unwilling to extend these arrangements to payments under various loans. AID further advised us that the United States policy was officially communicated to the GVN by protests on each payment, that by reason thereof the payments although retained were never accepted, that the United States reserves the right to return the local currencies received and require payment in dollars, and that such currencies

have been blocked by the United States Treasury which ruled out their utilization in the instant piaster purchase.

Our further examination of the above situation brought out that (1) under the provisions of the loan agreements if the exchange rate is not agreed upon within 60 days after the letter of nonacceptance, the funds shall be returned to the GVN with a request that repayment be made in dollars, (2) although repayments had been unacceptable for more than 3 years, the funds had not been returned nor had a representation been made to the GVN that the United States intended to return the funds, and (3) the first repayment was officially accepted by AID and on at least four other repayments the agency did not file protests.

Conclusions and Agency comments

The essence of the piaster purchase seems to be that the United States paid $10 million to obtain the right of direct procurement and related supply management in order that counterinsurgency could be more effectively prosecuted. That the United States had to buy the right to institute a method of operation which presumably was advantageous to the counterinsurgency effort, and therefore should have been considered solely on its merits, is incompatible with basic standards of sound administration and is totally contrary to the concept of mutual cooperation between the two Governments.

With regard to the local currency repayments on loans, the continued retention of these funds in a blocked status prevents their utilization for any purpose and thus is a significant disadvantage to the United States. Accordingly, we proposed that, if it is not feasible to negotiate or reach agreement now with the GVN on an acceptable exchange rate, the United States should exercise

its right under the loan agreements to return the piaster repayments and require repayment in dollars.

The Agency agreed that the United States should not have to provide assistance as the price of agreement to a course beneficial to the aid-receiving country. It claimed, however, that this principle had to be bent in the instant case in order to establish and support an intensified and decentralized counterinsurgency program. The Agency further stated that it has a strong policy in opposition to cash grants but that this case was a carefully considered exception made at the highest levels of the executive branch and, also, that it was a one-time emergency measure which enabled the quick initiation of an unprecedented program and circumvented the cumbersome controls and budgetary release delays that characterized the GVN. These exigencies cited by AID, however meritorious, do not explain why the required piasters could not have been obtained by the GVN as explained in item 1 on page 48, particularly since the full amount was not required immediately but could have been provided over a period of months as was done by AID.

The Agency stated that negotiations on the local currency loan repayments had been deferred for several years because of the press of higher priority matters but agreed that a settlement of the matter was overdue and that it would seek to renew negotiations with the GVN for an early resolution.

PURCHASE OF PIASTERS FOR MISSION SUPPORT COSTS RESULTED IN UNNECESSARY COSTS TO THE UNITED STATES

From February 1957 to February 1962, the Mission used its dollar appropriations to purchase from the GVN the piasters required to meet the local support costs applicable to its technical personnel instead of requiring the GVN to pay these costs as had been done in previous years. Prior to February 1957, the GVN had made available to the Mission piasters from the counterpart account for certain local costs of the AID program in Viet Nam. This practice was in accordance with the 1951 bilateral agreement between the United States and Viet Nam, which provided that either counterpart funds or the GVN's own resources could be used to meet local costs of the assistance program. A further agreement provided for the GVN to deposit the required funds in a special trust fund account under control of the United States Treasury, from which the Mission could obtain funds to pay certain of its piaster costs.

In July 1957, the Mission rescinded the requirement that GVN make piaster funds available for local costs and instead purchased its local currency requirements from the GVN with appropriated dollar funds at the limited access market exchange rate. This action was based on the theory that counterpart funds were generated at the rate of 35 piasters to $1 whereas the limited access market rate was 72.8 to 1; consequently, the Mission believed that it was more advantageous to buy the piasters from the GVN than to request an allocation of counterpart funds. This method of purchasing local currency continued in use until February 1962 because (1) the exchange rate situation was not alleviated until January 1962 and (2) there was a shortage of counterpart funds due to large military commitments and a further use of counterpart funds for Mission support would have required an increase in the commercial import

program to generate the additional piasters needed for support costs.

Although this reasoning may have had some validity when the size of the commercial import program was based on the piaster deficit (see p. 20), it appears to have had little merit after AID changed the basis for computing the level of aid in 1960 to the balance-of-payments basis (see p. 23). Under this latter method, shortages of local currency funds are not made up by increasing the United States-financed commodity aid program, and one of the reasons for the change in computing the aid level was to stimulate the GVN to a more productive mobilization of its internal resources to meet local currency requirements. During fiscal years 1960 and 1961, the Mission expended $2.7 million of appropriated funds for the purchase of piasters needed for support costs, all of which could have been saved if the Mission had reexamined its policy in respect of local support costs at the time the basis for the level of aid was changed.

At the time the Mission was granted permission by AID/Washington to buy piasters for support costs, the United States Military Assistance Advisory Group (MAAG) also received the same authority in respect of its local support costs. Whereas the Mission chose to use appropriated funds to purchase piasters, the MAAG continued to require the GVN to provide piaster counterpart funds to pay for MAAG support costs.

There does not seem to be any logical basis on which this inconsistency between the Mission and the MAAG can be rationalized. Moreover, if the shortage of counterpart funds because of military commitments justified the Mission's purchase of piasters for local support costs, there appears to have been no ground for discontinuing such purchases in February 1962 since the military requirements

for local currency did not diminish but rather increased before and after that time.

Agency comments

AID agreed that it might have been more consistent to have reverted to the use of counterpart funds for Mission support costs in 1960 to coincide with the change in the basis of calculating the annual level of the CIP. However, the Agency asserted that the policy objective of the United States was to bring about a reduction in aid without excessive political risk and that it was not in the political interest of the United States to press the GVN to pay Mission support costs when a reduction in aid was being made. With regard to the inconsistency between the Mission and the MAAG, the Agency agreed that United States agencies in Viet Nam had varying policies over the years in the funding of local support costs and stated that, although the GVN continued to press from time to time for dollar purchases for both Mission and MAAG support costs, AID expected to be able to obtain adequate funding for Mission support costs from the GVN without further dollar purchases for such costs.

SCOPE OF REVIEW

Our review of the subjects covered in this report was made as part of our review of the economic and technical assistance program for Viet Nam for the fiscal years 1958 through 1962.

With respect to the subjects covered in this report, we reviewed program documents, reports, correspondence, and other pertinent material at the Washington office of AID and the Agency's overseas Mission, which we visited during fiscal year 1962 and the early months of fiscal year 1963, and also records of certain agencies of the GVN on a limited basis. In addition, we discussed relevant matters with responsible representatives of AID at the Washington office and the Mission and of the GVN.

APPENDIX

OFFICIALS RESPONSIBLE FOR ADMINISTRATION OF THE ECONOMIC AND TECHNICAL ASSISTANCE PROGRAM FOR VIET NAM STARTING WITH FISCAL YEAR 1958

	Appointed or commissioned (note a)	
SECRETARY OF STATE:		
John Foster Dulles	January	1953
Christian A. Herter	April	1959
Dean Rusk	January	1961
UNDER SECRETARY OF STATE (note b):		
C. Douglas Dillon	February	1959
George W. Ball	February	1961
ADMINISTRATOR, AGENCY FOR INTERNATIONAL DEVELOPMENT (formerly International Cooperation Administration):		
John B. Hollister	July	1955
James H. Smith, Jr.	October	1957
James W. Riddleberger	March	1959
Henry R. Labouisse	February	1961
Fowler Hamilton	September	1961
David E. Bell	December	1962
AMBASSADOR TO VIET NAM:		
Elbridge Durbrow	March	1957
Frederick E. Nolting, Jr.	March	1961
Henry Cabot Lodge	August	1963
DIRECTOR, UNITED STATES AID MISSION TO VIET NAM:		
Arthur Z. Gardiner	November	1958
Joseph L. Brent	July	1962

[a]In the case of Ambassadors, date of presentation of credentials.

OFFICIALS RESPONSIBLE FOR ADMINISTRATION

OF THE ECONOMIC AND TECHNICAL ASSISTANCE PROGRAM

FOR VIET NAM

STARTING WITH FISCAL YEAR 1958 (continued)

[b]On February 3, 1959, the Secretary of State placed the International Cooperation Administration under the direction and control of the Under Secretary of State for Economic Affairs, Mr. C. Douglas Dillon. On June 12, 1959, this responsibility, together with the overall direction and coordination of the mutual security program, was reassigned to Mr. Dillon as Under Secretary of State. On February 2, 1961, Mr. George W. Ball was confirmed as Under Secretary of State for Economic Affairs and assumed the responsibilities for the mutual security program formerly carried out by Mr. Dillon.