214 Massachusetts Avenue N.E.
Washington, D.C. 20002-4999
(202) 546-4400

The Heritage Foundation

F.Y.I.

FYI 49
January 11, 1995

INSPECTOR GENERAL FINDS FRAUD AND WASTE AT AID

By Bryan T. Johnson

With the new political climate in Washington forcing Congress to consider reduced domestic spending, one program certain to undergo intense scrutiny is U.S. foreign aid. Senator Jesse Helms (R-NC), Chairman of the Senate Foreign Relations Committee, characterizes the U.S. foreign aid program as one which throws U.S. tax dollars down foreign "rat holes." Senator Mitch McConnell (R-KY), Chairman of the Senate Appropriations subcommittee that deals with foreign aid, says that allowing foreign aid to go untouched while domestic spending is slashed "isn't going to fly" in this Congress.[1]

This message does not appear to have sunk in at the agency responsible for doling out the $13 billion in U.S. foreign aid annually. Brian Atwood, Administrator of the U.S. Agency for International Development (AID), claims that "We have reorganized, reformed, reinvented and reengineered. It is in fact a new AID whose mission is relevant and whose commitment is to produce results."[2] Nevertheless, recent reports by Atwood's own Inspector General find that agency programs remain fraught with "fraud and waste." As Atwood tries to make his case that foreign aid benefits both the U.S. and recipient countries and that AID no longer wastes American tax dollars overseas, he will have to contend with his own Inspector General's findings to the contrary.

A New Focus Needed. Atwood will have to contend as well with outside critics who believe that foreign aid needs a new focus. Such an approach has been provided by The Heritage Foundation's *Index of Economic Freedom*, a study published last December.[3] Ranking the relative economic freedom of 101 countries, the *Index* demonstrates that those with the highest levels of economic freedom are among the world's wealthiest. Conversely, those with the lowest level of economic freedom are also the poorest. Thus, economic freedom plays an important role in helping a country create the conditions necessary for economic growth and prosperity.

FYI#49/95

1 Jonathan S. Landay, "Foreign Aid on the Chopping Block," *The Christian Science Monitor*, December 20, 1994, p. 2.

2 Remarks of J. Brian Atwood, Administrator, Agency for International Development, to the Center for National Policy, Washington, D.C., December 14, 1994.

3 Bryan T. Johnson and Thomas P. Sheehy, *The Index of Economic Freedom* (Washington, D.C: The Heritage Foundation, 1995).

Nothing written here is to be construed as necessarily reflecting the views of The Heritage Foundation or as an attempt to aid or hinder the passage of any bill before Congress.

The Heritage study reveals a dilemma for the foreign aid community: Of the 15 countries examined that received the largest amounts of U.S. development assistance last year, 12 rate as "mostly unfree," one has a "repressed" economy, and just two earn "mostly free" ratings. Overall, of the 58 economies that are classified as "mostly unfree" or "repressed," more than 40 received U.S. development aid.

Moreover, there is a connection between the findings of the Inspector General's recent reports on AID projects and those in the *Index of Economic Freedom*. Some of the countries that continue to receive U.S. foreign aid squander it on projects and programs that have little impact on economic growth; those countries also scored poorly on the *Index*. In many cases, their own restrictions on economic freedom are the cause of their poor economic status.

The findings of the Inspector General offer significant evidence that much of the U.S. foreign aid budget—particularly development assistance—is squandered and wasted by recipient countries. Moreover, as the *Index* has determined, much of this aid is going to countries with notably low levels of economic freedom. Indeed, some of it is directly supporting the very government policies which are the root cause of poverty in less developed countries. Congress would do well to scrutinize these and other AID projects when establishing funding levels for foreign aid projects.

FINDINGS OF THE AID INSPECTOR GENERAL

INDONESIA

Indonesia receives some $50 million a year in U.S. foreign aid. It has accepted almost $5 billion in U.S. economic assistance since 1946. Yet, much of this money continues to be wasted on projects that have little if any impact on economic growth.

IG Finding: According to the AID Inspector General's March 31, 1994, report to Congress, U.S. aid to Indonesia is being squandered. Of one $55 million road maintenance project that began in 1987 and was still going on at the time of the audit, for example, the IG states: "After six years and $19.5 million only 260 of the anticipated 1,600 kilometers of roads have been rehabilitated."[4]

This finding conflicts with a recent statement by AID Administrator Brian Atwood, who noted in his December 1994 criticism of Heritage's *Index of Economic Freedom* that

> Indonesia is one of the most dynamic economies in the world today, and has been for quite some time....Yet the Index claims "little economic progress has resulted" from foreign assistance, and that these resources have been "squandered" in Indonesia.[5]

***Index of Economic Freedom* Finding:** Indonesia ranked 69th out of 101 countries. Among its restrictions on economic freedom, it maintains high trade barriers, including an average tariff rate of 20 percent. It has tariffs as high as 100 percent on automobiles that are not assembled in Indonesia. Moreover, all foreign investments in Indonesia must be personally approved by the Indonesian president, and foreign firms are not afforded legal protection on an equal basis with domestic firms. Foreign investors cannot own more than 49 percent of an Indonesian company, and investments in some 34 areas like retail trade and transportation are banned. This means that

---

4 Inspector General, U.S. Agency for International Development, *Semiannual Report to the Congress: October 1, 1993-March 31, 1994*, p. 16.

5 U.S. Agency for International Development, "Does U.S. Assistance Work?" undated talking points (December 1994).

if a private U.S. company wanted to invest in Indonesia to repave the road system, it would not be allowed to fully own the company, would have trouble bringing in the necessary construction equipment because of the high tariffs, and might not be able to gain approval from Indonesia's president for the project. Can it be any wonder that the AID road maintenance project has proceeded so slowly?

EGYPT

Egypt, the second-largest foreign aid recipient, received over $2 billion in U.S. economic and military aid last year. Since 1946, Egypt has received over $38 billion in U.S. bilateral assistance. Yet, not all of this aid was used as intended.

IG Finding: AID has provided over 1,200 vehicles costing over $17 million for Egyptian government employees. Not surprisingly, the IG finds that many of these vehicles are being used for personal rather than official business.

Moreover, in a $164 million AID project aimed at expanding Egypt's irrigation system, improving its crop and water management systems, and providing equipment and research facilities, many items were underutilized or not used for their stated purposes. For example, 246 motorcycles intended for project workers' travel between project areas were stored in a warehouse for 10 months while the Egyptian government worked on getting them licensed.

***Index* Finding:** Egypt ranked 76th out of 101 countries. It has an average tariff rate of around 30 percent, income taxes as high as 65 percent, a 40 percent capital gains tax, and a 32 percent "wealth tax." Egypt's huge state-owned sector accounts for about 70 percent of GDP, and its cumbersome bureaucracy is corrupt and inefficient. This would explain why it took 11 months to license the motorcycles AID provided for its economic development projects. The lack of economic freedom in Egypt is causing U.S. aid to be wasted.

MONGOLIA

Mongolia is now a democratic country. AID has rushed "emergency aid" into Mongolia to help it create a market economy. Yet, much of this "emergency aid" has been found in warehouses, "unused" and underutilized, according to the AID Inspector General's report.[6]

IG Findings: For example, in a $35 million energy sector project aimed at financing equipment and spare parts for energy production, the IG finds: "More than $2.5 million worth of equipment—purchased because of the perceived emergency—was either unused, used in non-emergency situations, or not received in time to be installed for the winter emergency."[7] Moreover, "A Russian cargo plane was chartered from New York to Mongolia at a cost of $466,000 to carry $679,000 worth of equipment." The IG states that only $280,000 worth of this equipment was deemed "urgently needed."[8]

***Index* Findings:** Mongolia ranked 67th out of 101 countries. It has an average tariff rate of 15 percent and an outdated customs procedure which can cause imports to sit at points of entry for lengthy periods of time before entering the country. Moreover, Mongolia's banking system is still heavily state-controlled, resulting in inefficient banks unable to provide sufficient capital for economic expansion. Thus, even when U.S. aid is aimed at providing emergency assistance to economies in transition, it is sometimes misspent and has little impact on economic growth.

---

6 Inspector General's report, pp. 20-21.

7 *Ibid.*

8 *Ibid.*

ETHIOPIA

Ethiopia is one of the poorest countries in the world. Most economic aid to Ethiopia comes in the form of AID's "emergency relief" projects that ship food and health care items to the population and transfer cash to the government to pay for basic human needs like food, clothing, and shelter. The IG finds that some of these cash grants have been used to enrich those involved in the projects and not to help the poor.

IG Findings: For example, AID funded a project from 1992 to 1994 that provided over 126,000 metric tons of commodities to Ethiopia at a cost of more than $52 million. In addition, AID gave Ethiopia's government $4.5 million in cash grants. However, the IG finds that one project employee "used local currency sales proceeds to pay for expenses which were not authorized...."[9] This amounted to over $900,000 in cash. Another employee sold over $100,000 of commodities intended for food or work projects and kept the proceeds.

***Index* Findings:** Ethiopia ranked 88th out of 101 countries scored in *The Index of Economic Freedom*. It has an average tariff rate of 29 percent and a top tax rate of 85 percent. Most foreign investment is not permitted. Its banks are heavily controlled by the government. Private property is not legally protected and is subject to government expropriation. Thus, most of Ethiopia's economy is under government control, and corruption such as that discovered by the Inspector General is rampant. Once again, the lack of economic freedom hampers the effectiveness of the U.S. aid program.

---

9 *Ibid.*, pp. 2, 28.