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REPORT #3

FWA/MAC PROGRESS REPORT

FOR WORK ORDER NO. 2 FOR BUREAU FOR PRIVATE ENTERPRISE

UNDER

INDEFINITE QUANTITY CONTRACT NO. AID/OTR-I-1862

DEVELOPMENT OF PROGRAMS RE

COFINANCING PRIVATE SECTOR DEVELOPMENT PROJECTS/PRODUCTIVE CREDIT

GUARANTEE PROGRAM/USE OF COUNTERPART FUNDS

REPORT ON EVALUATION PHASE OF WORK

PROGRAM OBJECTIVES, HISTORY, CURRENT APPROACH, FEASIBILITY OF CHANGES

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I. PROGRAM OBJECTIVES

A. Cofinancing Private Sector Development

The objectives of the new cofinancing program being designed by FWA for AID/PRE are:

(1) Provide medium to long-term credit for larger sized private sector projects in host countries involving the construction of new productive facilities or the expansion and improvement of existing facilities.

(2) Expand financial resources available to achieve AID/PRE goals.

(3) Encourage host country financial institutions to undertake longer term investments, using AID/PRE funds.

(4) Encourage host country project sponsors to undertake worthwhile investments which are not being implemented for lack of funds available for foreign exchange expenditures, which are repayable on longer maturities.

(5) Involve the U.S. private sector, through knowledgeable commercial banks, more heavily in the foreign assistance effort, thereby increasing the sophistication of AID/PRE lending to privately-sponsored projects overseas.

(6) Improve the design of AID/PRE projects to assist development of the host country private sector by drawing on the credit expertise and special knowledge of domestic conditions of the local banks.

(7) Increase the flow of managerial and technical expertise to private sector projects abroad through greater transfers of U.S. equipment, technology, and know-how.

(8) Improve host countries' national productivity and output, increase employment, raise the standard of living, and improve the balance of payments and foreign exchange position.

Experience of other public international lenders has shown that borrowers can obtain various benefits through cofinancing. A private bank may agree to a longer amoritzation schedule for its loan because of the example set by the international financial institution, or may impose less stringent security requirements, relying upon the extra financial strength given the borrower by the IFI's longer term money and the cross-default clause in loan agreements. Although interest rates and charges depend on market conditions, competition among commercial banks for cofinancing opportunities has acted to insure that borrowers obtain the best available rates.

B. Productive Credit Guarantee Program

The PCGP was designed to stimulate the participation of the private sector in the economic development of less-developed countries in Latin America by encouraging and assisting private lending institutions in up to six countries in that area, on a pilot basis, to make small loans to organized groups and individuals to carry out investment and self-help community projects for which such borrowers could not otherwise obtain financing on reasonable terms. From its inception, the goal of this program was to increase opportunities for profitable investment by facilitating access of small entrepreneurs to the regular services of commercial lenders through a reliable credit guaranty system. Absent such a program, alternatives available to small borrowers were either not to use credit, or to use sources that because of their terms and conditions would impede the profitable operation and growth of private enterprise.

During its consideration of the underlying legislation, Congress expressed the desire to develop a method that could allow the curtailment of the dollar drain from the United States by engaging the participation of the local private sector in a peaceful and effective program of economic and social reform. There were also expressions of a desire to establish a program on sound financial bases, where loans would be at legal commercial interest rates but far below the rates charged by money lenders.

Congress also recognized the need "...to put funds to use directly without being diluted through bureaucratic mazes, diversion, corruption, and unfriendly and callous officials..." The hope expressed in the debates was that if the program proved workable, guaranties could be used more in certain types of programs to reduce foreign aid dollar spending.

The 1969 amendment of Section 240 of the Foreign Assistance Act of 1961 authorized issuance of loan guarantees in order to encourage private banks, credit institutions, cooperatives and other nonbank financial intermediaries to make loans on reasonable terms to organized groups and individuals to carry out credit and self-help projects for which they were unable to obtain credit on reasonable terms.

C. Counterpart Funds

The objectives for use of counterpart funds would appear to depend upon the specific applications of those funds. The major applications for counterpart funds to achieve PRE's goals are stated below, together with an analysis of how each application meets PRE's objectives.

1. Studies on Measures to Promote the Role of the Private Sector in Host Country Development

Counterpart funds may be used to finance studies on measures to promote the role of the private sector in host country development. These studies should point out how the private sector's role can be best promoted and the private sector stimulated to contribute more effectively to development.

The studies will offer a brief review of the actual and potential role of the private sector in host country development, identify the major obstacles and facilities for private activities and present recommendations to further stimulate private sector development. Recommendations will be addressed, depending on the problem, to local governments, donor countries, international organizations, and to the private sector itself.

Following these studies, counterpart funds could also be used to cover part or all of the costs of contracting the services of specialists in the areas selected for improvement, to design and implement more detailed action programs to achieve recommended goals.

This program is meant to achieve PRE's objective of stimulating and helping create conditions conducive to the flow of U.S. and host country private capital into productive investments in priority sectors of the economy.

The studies of measures to promote the role of the private sector in host country development also meet PRE's intent to facilitate private sector project identification and provide counsel to host countries on how to create a climate conducive to the growth of private investment.

2. Feasibility Studies

Counterpart funds can be used in developing the host country's capacity to perform project feasibility studies. PRE can become instrumental in this effort by organizing structured courses in project preparation, appraisal and implementation for bankers, investors, businessmen, and government officials. International standards in the preparation of feasibility studies are not prevalent among those engaged in this discipline in less developed countries. However, there frequently exists a cadre of professionals in government, universities, consulting firms, and engineering firms with substantial experience and consulting credentials which is quite capable of participating in the offering of a training program of this nature. It is believed that such organized training will enhance the quality and acceptability of host country origin feasibility studies.

Counterpart funds could also be used to pay for feasibility studies performed by local firms or by foreign firms to the extent they are willing to receive payment in local currency (typically a large portion of foreign firms' expenses for such studies are incurred in local currency).

This program addresses itself to PRE's objective of stimulating and helping to create conditions conducive to the flow of private capital into productive investments in the private sector.

The importance placed on feasibility studies is the first step in meeting PRE's goal of developing economically viable projects and helping to establish programs in support of private sector development.

3. Financing of Infrastructure for Private Sector Projects

Many otherwise acceptable private sector projects prove difficult or impossible to implement because the essential supporting infrastructure is either inadequate or non-existent. Should this lack of infrastructure be a major reason for not implementing an otherwise viable private sector project, counterpart funds could be allocated to create or strengthen the related infrastructure for specific private sector projects.

It is recommended that counterpart funds be made available to finance infrastructure elements such as access roads, railroad sidings, adequate supply of power, water and other utilities, and employee transportation facilities.

Distinction is made between infrastructure elements which are ultimately owned by private sector project sponsors and those elements which are owned by the government agency which has the responsibility for providing the needed infrastructure. In the former case, counterpart funds to finance related infrastructure could be made available through intermediary local financial institutions, public or private, which are participating in financing other segments of the proposed private sector project. In the latter instance, such counterpart funds could be appropriated directly through the budgetary process for implementation of specific public works agreed upon as being essential.

PRE, by implementing this program, meets its objective of stimulating and helping create conditions conducive to attracting private capital into productive investments.

4. Practical Vocational Training Programs

In several of PRE's target countries, a major obstacle to investment in productive entities by private sector capital is the lack of an adequately trained labor force from which the private sector can draw its man-power requirements.

Although management training programs have received considerable attention from PRE, such programs usually address themselves to middle-management and general technology problems. In addition to this, there is a great need for training in more basic skills with particular emphasis on the practical aspects of trades such as carpentry, masonry, electrical work, plumbing, basic mechanics, welding, sheet-metal working, machining and the operational farm and heavy equipment.

By stimulating practical familiarization training programs geared to the more basic trades, a larger number of people can be drawn into the productive segment of a host-country's population and become more valuable in their contribution to the private sector. Work centers can be organized, fully equipped with actual tools and machinery where people can obtain practical proficiency in the trade of their choice.

Counterpart funds could be used either to help finance general vocational training programs in specific skills or they might be provided as a grant or loan tied to individual private sector projects.

Counterpart could be used to equip such work centers with locally produced furnishings, defray travel and accommodation expenses for students from outlying areas, pay a modest living allowance, and support the in-country cost of qualified instructors.

This program would meet PRE's objective of stimulating and creating conditions conducive to the flow of private capital into productive investments of the private sector.

Practical vocational training programs clearly support private sector development.

5. Encourage Development of New Types of Financial Institutions

In many countries, the private sector has very limited options available to it in seeking finance for worthy productive investments. The commercial banks may be extremely conservative and orient their lending only to the wealthier businessmen, with very short terms of payment, high interest rates, excessive collateral requirements, etc. Government development banks are often poorly capitalized, inadequately staffed, and politically motivated in their choice of projects to support. Stock markets and investment banks may be non-existent.

In such circumstances, counterpart may be used to encourage the development of alternative financial institutions which are willing to play a more aggressive role in financing capital investments or the purchase of heavy equipment by the private sector. Counterpart funds could be used to support the inauguration or expansion of services by such alternatives as leasing companies, venture capital firms, finance companies, merchant banks, investment banks, etc. Counterpart could be used to provide technical assistance to new types of financial institutions,to participate in their equity, or to serve as a source of borrowed funds for such ventures.

This use of counterpart funds would clearly meet PRE's objectives of stimulating and helping to create conditions conducive to the flow of U.S. and host country private capital into productive investments in priority sectors.

6. Direct Loans and Discount Loans

In mobilizing available financial resources to meet financing requirements for economically-sound private sector projects, counterpart funds can be considered as an additional source of funds to make loans to either newly-formed or existing private enterprises. Financial assistance can take the form of either a direct loan by a public sector financial institution to a private sector project or a discount loan by the public sector to a private financial institution to fund its project loan commitment to a private enterprise. In either case, the granting of loans financed by counterpart funds could be subject to the provision that an equal amount of borrowing would have to come from private financial institutions.

In order to induce private financial institutions to lend to private enterprises on reasonable terms and conditions, that portion of the borrowings represented by the counterpart funds could be declared subordinate to that of the borrowings provided by the private financial institutions. In the eyes of the private financial institutions this approach may have the effect of strengthening the equity part of the private enterprise which may lead to less reluctance on the part of these private financial institutions to consider lending to private sector enterprises.

This program of direct or discount loans meets PRE's objective of assisting in financing the establishment, improvement, and expansion of productive, developmentally desirable, private enterprises.

Counterpart funds used in this manner will facilitate the formation of new enterprises and expansion of existing ones.

II. HISTORY

A. Cofinancing Private Sector Development

1. AID Policy

Although the private sector thrust of this program and the cofinancing techniques involved are new to AID, the concept of involving other sources of financing in AID development efforts has long been a part of stated Agency policy. AID has always recognized the importance of other Free World and multilateral sources of capital, which may cooperate with AID in financing sectoral development or even specific projects in host countries, and AID noted as early as 1967 with regard to donations, that it must "pay increased attention to the valuable resources available from U.S. non-Federal" sources. It is a general policy of AID that it "must act as a catalyst to stimulate others to provide assistance to the developing nations," and that it "should assist developing countries to coordinate the use of all resources available for development--whether indigenous, AID-provided, or non-AID."

AID is directed by statute to coordinate its efforts with those of private and other public entities providing resources from the United States. It is to do so vigorously, but with full respect for the independence and ultimate autonomy of private and non-federal aid donors. Finally, the AID handbook notes that "rather than directly carrying out all of its own programs, AID must increasingly become a channel through which American resources and skills--wherever located--can be identified, focused, and transmitted to the less developed countries." The same principles should apply to international loan capital as to donations if they are focused on the same kinds of development objectives.

2. World Bank Precedents

Cofinancing with private commercial banks is a technique which was pioneered by the World Bank and International Finance Corporation.

Beginning in the early 1960's, both the World Bank and IFC offered participations in their loans at a fixed interest rate to commercial banks in order to assist in funding their respective operations and, more importantly, to act as a catalyst in inducing private lenders to expand their banking relationships with developing countries.

The commercial banks found these participations acceptable for several reasons: market conditions were then less volatile and the fixed rate, while not overly generous, was expected to result a positive spread over funding costs. Banks often chose this vehicle to initiate a relationship with a developing country, or, in the case of IFC, direct banking contacts with private corporate borrowers, with the expectation of collateral benefits.

As market conditions changed, the World Bank decided that in order to expand its cooperative activities with commercial banks it would be necessary to introduce a new technique to augment its participation program. Hence, in 1975, the World Bank developed the initial "co-financing" arrangements.

In ensuing years the World Bank entered into formal agreements with groups of private creditors for the purpose of helping to finance specific projects in developing countries.

The separate loan agreements executed by the World Bank and the commercial banks assured certain forms of collaboration.

First, to attract private lenders to the project, the World Bank agreed to provide detailed information about the project that would not ordinarily be divulged.

Secondly, the arrangements provided for a "cross-default" clause in the official loan agreements. According to this covenant, the World Bank had the option of suspending disbursement of the loan or accelerating repayment in the event that the syndicate of private banks suspended or accelerated their loan for "good cause."

From the viewpoint of the private bankers, the inclusion of this clause provided an important inducement for participation in the financing because they believed that a developing country borrower would be extremely reluctant to violate any of the articles of a loan agreement in which one of the official lending institutions was involved.

In addition to these two major features, the World Bank agreed to take on a number of administrative duties, such as acting as the billing agent for both loans.

Since fiscal year 1976, the World Bank has participated in thirty-six cofinancings with private financial institutions, aggregating a total of $1.6 billion.

3. IDB Precedents

Another international agency with commercial bank lending arrangements is the IDB. It initiated its program in 1976, using the term "complementary financing." Primary objectives of this program are consistent with those of the World Bank--that is, to assist borrowing member countries in gaining access to international capital markets or to help countries that have already done so to improve and diversify the forms and scope of such access. One difference between the World Bank and IDB's programs relates to documentation. The IDB offers participations in its loans--that is, the commercial bank is not a direct lender but rather a participant in a portion of the IDB loan, a portion structured basically on market practices including, of course, floating interest rates. The IDB has to date arranged over $513 million of bank financing under this program, $85 million during the last year.

4. IFC Precedents

The International Finance Corporation has also cooperated closely with financial institutions, primarily commercial banks, since the early 1960's. The IFC's most active program in this area relates to the syndication of participations--that is, an arrangement whereby banks are offered "shares" or "participations" in an IFC loan with the banks taking the same credit risks, on a pro rata basis, as IFC. Under this technique, the loan agreement is signed by IFC and the borrower with a participation agreement between IFC and the participating commercial bank. Unlike a normal Eurocurrency credit agreement, the participating bank is not a direct lender--it has no direct contractual arrangement with the borrower.

The IFC loan agreement normally provides for two portions, one for the account of IFC with terms as outlined above, including fixed interest rates, and the second for the account of participating banks with normal market conditions. These conditions generally include a floating interest rate usually tied to the six-month London Interbank Offered Rate (LIBOR) together with a spread, commitment fee, and front-end participation fee which are negotiated in each instance. The term of the loan is a minimum of five to seven years--occasionally longer--depending on the market's preference for a particular country. Often the IFC portion of the loan will be composed of maturities longer than those applicable to the commercial banks. If the loan is secured, for example by a mortgage, and should it become necessary to foreclose, the participants would share on a pro rata basis in the proceeds resulting from any foreclosure proceedings. The commercial bank participation is without recourse to IFC.

IFC, as the lender, will administer the loan. Its responsibilities include sending out billings, collecting payments, promptly distributing to participants their pro rata shares, overseeing the progress of the project, and administering the loan documentation.

This participation program is extremely important to IFC. Out of total cumulative loan commitments of $3.8 billion since IFC's establishment in 1956 through fiscal year 1981, participations placed with financial institutions totaled $1.4 billion, or approximately 37 percent.

B. Productive Credit Guarantee Program

1. Legislation

In 1969, by amendment of Section 240 of the Foreign Assistance Act of 1961, the Overseas Private Investment Corporation (OPIC) was authorized to issue loan guarantees of up to $15 million in five Latin American countries in order to encourage private banks, credit institutions, cooperatives and other non-bank financial intermediaries to make loans on reasonable terms to organized groups and individuals to carry out credit and self-help projects for which they were unable to obtain credit on reasonable terms.

After four years of administration by OPIC, authority to implement the PCGP was transferred to AID in May 1975 by virtue of Section 8(a)(2) of the Foreign Assistance Act of 1974 and is reflected in Section 222A of that act which provides in part:

(a) Agricultural and Productive Credit and Self-Help Community Development Programs.

"(b) To carry out the purposes of subsection (a), the agency primarily responsibile for administering Part I is authorized to issue guarantees, on such terms and conditions as it shall determine, to private lending institutions, cooperatives, and private nonprofit development organizations in not more than five Latin American countries assuring against loss of not to exceed 50 per centum of the portfolio of such loans made by any lender to organized groups or individuals residing in a community to enable such groups or individuals to carry out agricultural credit and self-help community development projects for which they are unable to obtain financial assistance on reasonable terms. In no event shall the liability of the United States exceed 75 per centum of any one loan.

"(c) The total face amount of guarantees issued under this section outstanding at any one time shall not exceed $20,000,000. Not more than 10 per centum of such sum shall be provided for any one institution, cooperative, or organization..."

The Senate Report accompanying the bill which was enacted as the FAA of 1974 states in part:

"The Program is designed to encourage private banks, other credit institutions, cooperatives, and private nonprofit development organizations to make small loans on reasonable terms to individuals and to organized groups to carry out small investment and self-help community projects for which they are unable to obtain financing from other sources. The program covers loans for agricultural purposes and community development projects."

2. Eligible Countries

Under Section 222A of the Foreign Assistance Act of 1974, AID is impowered to "...establish pilot programs in not more than six Latin American countries..." The particular countries in which such programs might be established are not specified and it is generally understood that compliance with the act limits to six the number of countries in which the program may be active at one time.

Since 1975, efforts have been made to develop guarantee systems in Bolivia, Costa Rica, Colombia, Ecuador, Guatemala, Honduras, Nicaragua, Panama, and Paraguay.

Mainly because the PCGP was less attractive than the then typical financial assistance offered by AID, the model was never adopted for implementation in Colombia, Guatemala,and Honduras. In Nicaragua, a PCGP agreement was authorized in February 1977. The program experienced operational difficulties and as current banking practices did not require the pledging of collateral for small business loans, the program was terminated by the Mission.

More recently, aware of operating results of the active programs, the Central Bank of Ecuador and the Bankers Association of Ecuador and Panama initiated discussions for implementation of PCGP systems in their respective countries. However, the only programs active in January 1982 were in Bolivia (authorized 12/77), Costa Rica (authorized 2/79), and Paraguay (authorized 5/77).

3. Amount of Guarantee Authority

The total face amount of guarantees issued under FAA Section 222A may not exceed $20,000,000 outstanding at any one time and not more than 10 percent of such sum may be provided for any one institution, cooperative, or organization. Of the $20,000,000 of loan guarantees which AID is empowered to issue, $12,000,000 has been allocated to the programs in Bolivia, Paraguay, Nicaragua, and Costa Rica as follows:

(In U.S. $000's)

	Potential Liability	Actual Liability
Bolivia	$2,500.0	$1,291.0 1/
Paraguay	3,500.0	1,607.0 2/
Nicaragua	3,000.0	55.0 3/
Costa Rica	3,000.0	76.0 3/
Total	12,000.0	3,029.0

1/ As of 1/31/82

2/ As of 2/28/82

3/ Estimated as of 2/28/82

As is apparent from the foregoing, there is $8,000,000 available from the $20,000,000 authorized by FFA Section 222A to support the PCGP in other Latin American countries. However, this $8,000,000 might be increased as may the number of countries in which the program might be implemented by under-utilization of the amounts already allocated and by termination of the program in any of the countries where it has been initiated.

4. Conceptual Model

In its implementation of the PCGP, AID has sought to develop a self-sustaining system that would generate bankable projects for target group applicants, assure broad risk sharing with local institutions, expand liquidity in the credit system, and stimulate capital markets. To this end there was designed a program model which, in theory, could be tailored to the needs of any country receiving assistance from AID. The model consisted of five major components: borrower; lender; technician; AID; and a recipient country administrator. The role conceived for each of these participants was as follows:

a. Borrower

The borrower is a small entrepreneur (individual or group) engaged in any of a variety of productive activities located in rural areas or market towns, in agriculture, small industry and retail trade. To qualify as a "small" entrepreneur, the borrower must meet eligibility requirements normally specified in terms of land areas owned and worked, number of employees, total assets, net worth or annual income. The borrower must be (a) willing and legally able to contract debt, (b) capable of operating a viable project that will support repayment of debt, but (c) unable to obtain institutional credit without some form of guarantee.

Conceptually, the borrower's role in the PCGP system is to operate a viable, eligible project which serves as his or her main source of income and to repay the PCGP-guaranteed loan (plus interest and other charges).

b. Lender

The PCGP lender must be a privately-oriented credit institution located in the recipient country and approved by the recipient country PCGP administrator. Normally, PCGP lenders are commercial banks.

PCGP-guaranteed loans are to be made by the lender at legal rates of interest. Loan proceeds are to be used for productive purposes, generally for the purchase of fixed and/or current assets. More specific PCGP loan characteristics and requirements vary from one recipient country to another. These include maximum loan term, maximum loan amount, and definition of "Default Period" under the Guarantee Contract.

The lender's role in the PCGP system is to: review applications, approve and disburse PCGP loans; receive loan repayments, monitor loan status, and take remedial action (technical assistance, refinancing) on problem loans as needed; submit monthly reports on disbursements and delinquencies to the recipient country administrator; and handle default situations--to call the PCGP guarantee, foreclose, recover invested capital, and repay the PCGP guarantee fund any amounts due.

c. Technician

The PCGP technician is any individual approved as a technician by the recipient country administrator. They may be independent consultants or employees of consulting firms, banks, or other organizations.

The technician's role is to identify eligible borrowers, conduct pre-investment analyses to determine project financial and technical viability, provide follow-up technical assistance as needed and, where follow-up is recommended in the pre-investment study, report monthly to the lender and the program administrator on operating projects. The inclusion of technicians in the PCGP system model is intended to ensure project viability and borrower eligibility and expand PCGP-guaranteed lending.

Technicians are paid from the proceeds of approved loans. When a PCGP loan disbursement is made, a fee is paid to the technician who analyzed the project. A small portion of each fee payment is set aside to pay technicians on an hourly basis for work performed on projects subsequently not recommended by them.

d. AID

The role of AID is to: provide a partial guarantee of PCGP loans; provide technical assistance for initial program planning, development, and implementation; and monitor and control program operations.

The role of AID missions in the recipient countries is to provide a continuous communication link between the country administrator and AID headquarters and to participate with the Technical Director in responding to the program status reports. The missions also collect a guarantee fee from the recipient country administrator and coordinate the activities of the AID Technical Unit professionals when they are on site.

e. Recipient Country Administrator

The recipient country administrator is a central institution in the recipient country, whose role in the PCGP is to: plan and develop the program according to the basic concept, adapted to country-specific needs, in cooperation with AID; provide a guarantee to complement the AID guarantee; administer the PCGP guarantee fund; supervise the provision of technical assistance and take remedial action (feasibility study improvement, training, suspension, expulsion) with problem technicians as needed; monitor guaranteed loans and take remedial action (application improvement, training, suspension, expulsion) with problem lenders as needed; record PCGP data, transmit lenders' monthly reports to AID, and submit quarterly and annual reports on program status to AID; and conduct program evaluations.

These responsibilities are normally fulfilled by a single central institution of the recipient country, typically, the country's central bank. However, the system model allows for assignment of the roles to any of several institutions such as the central bank, the national development bank, insurance companies, commercial banks, or the national bankers association.

f. Guarantee Coverage

The PCGP conceptual model's provision for guarantee coverage is based on two requirements established in the program's authorizing legislation: (1) AID is authorized to issue guarantees "assuring against loss of not-to-exceed 50 percent...of the [PCGP] portfolio of...any lender", and (2) U.S. liability under the program is limited to a maximum of "75 percent...of any one loan."

Subject to the 50 percent limitation on its guarantee of a single lender, the PCGP guarantees 75 percent of losses for each loan made under the program. In case of default, this guarantee commitment would be honored with payments: first, from the guarantee fund administered by the recipient country administrator; second, if and when the guarantee fund is depleted, by AID--until aggregate payments to any one lender on defaulted loans originated in any one calendar year reach a flexible maximum negotiated country by country as a percentage (up to 50 percent) of the outstanding PCGP portfolio of loans generated by that lender in that year; and third, if and when AID liability limit is reached, by the recipient country guarantor.

The PCGP guarantee fund, which is administered by the recipient country administrator, is intended to be sufficient to cover all PCGP guarantee payments and administrative expenses. Its major revenues are:

1. Guarantee commissions paid as a one-time fee of four or five percent of the original principal on each PCGP loan.

2. Pre-investment technical assistance fees paid as a one-time fee of about three percent of the original principal on each PCGP loan.

3. Recoupment of loses by lenders--75 percent of all amounts recouped must be paid into the fund.

4. Guarantee payments by AID

5. Guarantee payments by the recipient country administrator

6. Subsidies by recipient country administrators.

7. Interest earned on fund balancies

8. Donations

Major expenditures from the PCGP guarantee fund include:

1. Administrative expense: salaries, fringes, overhead and other expenses of the recipient country administrator.

2. Technical assistance payments

3. Guarantee payments to lenders

4. A guarantee fee of 0.25 percent of the original principal of PCGP loans to be paid to AID.

Although AID's guarantee liability limit as authorized by FAA Sec. 222A is 50 percent of each lender's annual PCGP portfolio, that limit is subject to redefinition and was in fact reduced to 20 percent in the case of Paraguay by agreement of AID with the Central Bank of Paraguay which served as administrator of the PCGP in that country. At the same time the Central Bank increased its complementary guarantee coverage to supplement the AID guarantee.

C. Use of Counterpart Funds

1. General

Whenever a foreign country is the recipient of U.S. dollar loans or grants, the equivalent local currency value is injected into the recipient country's economy. To the degree that AID loans or grants require a deposit in local currency in exchange for the use of these loans or grants by entities or persons, public or private, within the host country, the local currency thus generated represents counterpart funds.

The generation of counterpart funds in substantial amounts began shortly after World War II during the Marshall Plan era and applied primarily to large grant programs composed almost exclusively of general commodity import programs (CIPs) designed to overcome the shortfall of foreign exchange in recipient countries. For grant-aid counterpart, the U.S. requested only accounting of, and nominally had a veto power over, its use.

The next major event in the evolution of counterpart took place with the implementation of the Agricultural Trade Development and Assistance Act of 1954 (Public Law 480) which, at the outset, allowed recipient countries to pay cash for U.S. agricultural commodities with their own currnecies. However, these currencies could not be converted into U.S. dollars. The U.S., then the owner of these currencies, deposited them in interest-bearing accounts in the local banking systems, from which loans were made to private enterprises (Cooley loans). Consequently, even today, the U.S. funds itself the owner of a number of foreign currencies which are still augmented by interest earned on these accounts and repayments of principal and interest from Cooley loans. The U.S. and the recipient country were to agree on the use to which the currencies would be put in the recipient country.

In 1959, a provision was added to PL-480 requiring the more developed recipients to pay for PL-480 commodities in U.S. dollars on liberal credit terms. Next, in 1966, PL-480 was amended to phase out the local currency sales entirely and make future sales to all recipient countries as dollar credit sales. To the extent this was not possible, a transition could be made to credit sales for foreign currencies which could be converted into dollars. Today, most, if not all, developing countries avail themselves of this letter provision. PL-480 has accounted for nearly 30 percent of total U.S. direct economic aid to developing countries since 1954.

Foreign currencies resulting from repayment of local currency loans made under earlier agreements are generally available to U.S. Government agencies only when their use is charged to regular agency appropriations. These currencies are used for the payment of U.S. Government obligations and for accommodation exchange sales for dollars. The dollars received from the various agencies are credited to USDA/CCC. Such local currencies are controlled by the U.S. Treasury Department and requests for use of these currencies by other agencies are channelled through OMB. Presently, such available local currencies only apply to Burma, Egypt, Guinea, and Pakistan.

2. PL-480 Program Details

The PL-480 program as known today consists of four categories. A brief description follows for each of the categories together with provisions relevant to the uses of counterpart generated when the commodities are sold in the recipient country for local currency.

Title I provisions of convertible local currency credits decree payment terms of a small down payment, sometimes a "currency use payment" which represents the amount of local currency made available for use by the U.S. Government within the recipient country, a grace period, long-term repayment periods, and low interest rates. Title I agreements initially required that local currency proceeds generated under these loan agreements were to be put into special accounts in the name of the recipient country at the time such local currencies or counterpart were generated. In addition, utilization of such funds required extensive U.S. control in the programming, implementation, and monitoring/ reporting phases of the programs carried out with these funds. In 1972, the special account requirements and U.S. involvement in the actual utilization of such funds were substantially reduced to the point where today special accounts are no longer mandatory and Title I agreements contain a broad spectrum of self help measures determined with various degrees of AID involvement. The self help measures require recipient countries to undertake to help the development of their own economies, primarily in agriculture, but also in other sectors. Emphasis on monitoring and reporting on program requirements has also greatly diminished. Present AID policies are trying to reverse this process and are calling for more U.S. involvement wherever possible.

Title II encompasses all grants of agricultural commodities under the PL-480 program carried out by cooperating sponsors which included governments operating under bilateral agreements with the U.S., and non-profit voluntary U.S. and international agencies. These grants support regular specific ongoing programs such as school feeding, maternal/child health program, and food-for-work community development projects as well as emergency relief activities.

Title III, which was added to PL-480 in 1977, allows recipient countries to purchase U.S. agricultural commodities on Title I terms. However, instead of paying the U.S. for these commodities, an equivalent dollar value of the proceeds or counterpart used for specific self-help rpograms may be offset from Title I debt obligations.

Adequate technical and economic analyses and review are required in designing the specific programs as well as in monitoring and evaluating programs.

Title IV covers a number of general aspects of PL-480. Under the farmer-to-farmer assistance program of Title IV, counterpart can be used to disseminate U.S. knowledge and experience through the funding of training programs, either in foriegn countries or at U.S. land-grant universities. Title IV also permits exchanges of farm leaders and farm youths and authorizes spending for research on tropical and sub-tropical agriculture.

3. PL-480 Statistics

Considering AID's present policy of encouraging more involvement in programming the utilization of counterpart funds and PRE's objectives of using counterpart for private sector initiatives in target countires, it appears that under PL-480 only Title I provides any scope in which utilization of counterpart can be influenced. Utilization of counterpart from the other sectors of PL-480 is already defined and allocated for specific programs and purposes. In order to quantify the scope of PL-480 Title I, the following Table 1 depicts the historical dollar value magnitude of this program in PRE's target countries.

Table 1

Value of U.S. Agricultural Exports
Under Public Law 480 Title I
to PRE Target Countries
(in millions of dollars)

	1954 - 1980	1981	1982 (est.)	1983 (projected)
Costa Rica	-	-	180	10.0
Egypt	1,928.7	275.0	275.0	250.0
Haiti	44.4	9.0	9.0	11.0
Indonesia	1,471.2	50.0	27.5	20.0
Ivory Coast	6.7	-	-	-
Jamaica	44.8	15.2	17.5	20.0
Kenya	28.5	16.0	15.0	15.0
Pakistan	1,900.0	50.0	50.0	50.0
Peru	97.9	20.0	17.0	20.0
Sri Lanka	293.2	18.2	17.6	25.0
Thailand	16.7	-	-	-
Zimbabwe	-	-	-	-
	5,832.1	453.4	436.6	421.0

Table 2 segregates the PL-480 Title I sales to PRE target countries during the 1954-1980 period into (a) sales for local currency, and (b) long-term credit sales.

Table 2

Value of U.S. Agricultural Exports
Under Public Law 480 Title I
to PRE Target Countries
(in millions of dollars)

	Sales for Local Currency	Long-Term Credit Sales	Total
Egypt	757.7	1,171.0	1,928.7
Indonesia	274.3	1,196.9	1,471.2
Ivory Coast	1.6	5.1	6.7
Pakistan	1,237.3	662.7	1,900.0
Peru	38.3	59.6	97.9
Sri Lanka	29.6	263.6	293.2
Thailand	4.1	12.6	16.7
	2,342.9	3,371.5	5,714.4

Continued local currency sales under PL-480 Title I are no longer customary but not ruled out completely. Use of counterpart generated in the recipient's country under PL-480 Title I is programmed when long-term credit sales are negotiated and agreements executed. Unused or unobligated amounts of counterpart available to AID and carried forward for utilization into subsequent years for all intents and purposes are non-existent.

4. <u>DA and ESF Statistics</u>

Other legislative acts such as the Supplemental Appropriations Act of 1953, the Mutual Security Act of 1954 and the Foreign Aid and Related Agencies Appropriations Act of 1963 and others were instrumental in generating counterpart funds. The single most important act under which AID dispensed most of the loans and grants, and under which AID operates today, is the Foreign Assistance Act of 1961 as amended. Loans and grants provided under this act can be classified under two major categories:

(a) Development Assistance Programs and (b) Economic Support Fund Programs. Under the former came such categories as agriculture, rural development and nutrition, population planning, health, education and human resources development, energy, science and technology, and international disaster assistance. The latter provides economic assistance to countries and organizations to promote economic or political stability and can range from cash transfers for balance-of-payment support to loans for financial institutions for specific funding programs, and commodity import programs. Some programs require deposits of counterpart into special accounts, others do not. The majority of assistance was, and today still is, earmarked for specific programs prior to providing the actual loans or grants. Present programming policies of local currencies or counterpart under PL-480 stipulate that counterpart generated under PL-480 should not be used as a substitute for existing normal recipient country expenditures in sectors supported by Development Assistance programs.

Considering the above in light of PRE's objectives of using counterpart for private sector initiatives in target countries, it appears that only the Economic Support Fund programs provide scope in which utilization of counterpart can be influenced, since the Development Assistance programs are already earmarked for specific purposes. In order to quantify somewhat the scope of Foreign Assistance Act programs, the following Table 3 (a) shows the historical dollar value magnitude of these programs in PRE's target countries, while Table 3 (b) breaks this down between loans and grants during the Foreign Assistance Act period 1962-1981.

Table 3 (a)

Value of Loans and Grants
of Economic Assistance
Under the Foreign Assistance Act
to PRE Target Countries
(in millions of dollars)

	1962 – 1981	1982 (est.)	1983 Projected Total	Economic Support Fund
Costa Rica	209.5	34.7	75.0	20.0
Egypt	5,133.7	771.0	750.0	750.0
Haiti	132.6	12.2	15.0	-
Indonesia	1,122.8	67.3	65.0	-
*Ivory Coast	31.9	-	-	-
Jamaica	172.5	71.4	92.0	55.0
Kenya	247.7	37.3	58.0	30.0
Pakistan	2,050.8	102.9	200.0	175.0
Peru	416.6	33.1	27.0	-
Sri Lanka	192.0	48.0	40.3	-
Thailand	546.9	37.3	38.0	10.0
Zimbabwe	49.5	75.0	75.0	75.0
	10,306.5	1,290.2	1,435.3	1,150.0

*Not in AID Congressional Presentation FY 1983 under this name.

Table 3 (b)

Value of Economic Assistance
Under the Foreign Assistance Act
to PRE Target Countries
(in millions of dollars)

	Loans	Grants	Total
Costa Rica	141.6	67.9	209.5
Egypt	2,678.6	2,455.1	5,133.7
Haiti	26.5	106.1	132.6
Indonesia	879.7	243.1	1,122.8
Ivory Coast	26.2	5.7	31.9
Jamaica	123.1	49.4	172.5
Kenya	96.2	151.5	247.7
Pakistan	1,859.8	191.0	2,050.8
Peru	289.3	127.3	416.6
Sri Lanka	170.3	21.7	192.0
Thailand	87.4	459.4	546.9
Zimbabwe	-	49.5	49.5
	6,378.7	3,927.8	10,306.5

From the above tables it is interesting to note that Egypt and Pakistan combined accounted for almost 70 percent of the total economic assistance during the Foreign Assistance Act years until 1981 and that this trend continues in FY 1982 and for projected FY 1983.

Of the past total economic assistance, 62 percent consisted of loans with the remaining 38 percent accounting for by grants.

Of the FY 1983 projected total assistance to PRE target countries, almost 78 percent is under the Economic Support Fund category.

Of the vast amounts of counterpart generated by PL-480 Title I and the Foreign Assistance Act from AID dollar loans or grants which generated counterpart, at the time such loans or grants were made, only a small fraction remained unobligated and available to AID as of March 31, 1982. Tables 4 (a) and 4 (b) show in which PRE target countries such unobligated amounts are in existence, their size, sources, and restrictions.

Table 4 (a)

Recapitulation of "Unobligated"
Balances of "Counterpart"
U.S. Owned and Country Owned
March 31, 1982
(in millions of dollars)

	U.S. Owned	Country Owned*	Total
Costa Rica		.1	.1
Egypt		15.6	15.6
Indonesia		.5	.5
Kenya		**	
Pakistan	4.3	.1	4.4
	4.3	16.3	20.6

*Country-owned funds may be withdrawn only by mutual agreement between the participating government and the U.S.

**Less than US$50,000.

Table 4 (b)

Recapitulation of Sources
and Restrictions of
"Counterpart" Available to AID
U.S. Owned and Country Owned
March 31, 1982
(in millions of dollars)

	U.S. Owned PL-480		Country Owned		Total
	Emergency Relief	Cooley Loans	Special "Counterpart"	Technical Assistance	
	*	**	***	****	
Costa Rica			.1		.1
Egypt				15.6	15.6
Indonesia				.5	.5
Kenya				*****	
Pakistan	.2	4.1		.1	4.4
	.2	4.1	.1	16.2	20.6

*These currencies were generated by CCC dollar expenditures for U.S. surplus agricultural commodities pursuant to PL-480 Title I as amended. They are allocated to AID by the Office of Management and Budget for emergency relief assistance as rpovided under Section 104(d) of the above act.

**These currencies were generated by CCC dollar expenditures for U.S. surplus agricultural commodities pursuant to PL-480 Title I as amended. They are allocated to AID by the Office of Management and Budget for loans to domestic or foreign business firms under Section 104(3) of the above act which has been re-appealed.

***These currencies which are in the custody of the participating government were generated under AID dollar loans or grants which required counterpart deposits by the participating government in a "Special Account." They are available for activities as mutually-agreed upon by the U.S. and the participating country.

****These are currencies deposited by participating countries to be held in trust and used only for specific purposes designated by the participating country. In the event of liquidation, unused balances in these accounts would be returned to the participating country.

*****Less than US$50,000.

As indicated above, local currencies available to AID for country program uses by virtue of the statutes under which they are generated, may be either U.S. owned or country owned. The significance of the ownership of the currencies lies mainly in the U.S. statutory requirements applicable to the custody and management of the currencies, rather than in the purpose for which currencies are available. The uses of both types of local currency are subject to agreement between the U.S. and the recipient country, with varying degrees of influence on the part of U.S. AID.

Over the years, U.S. AID's degree of involvement in programming and monitoring the use of counterpart has varied considerably. During the late 1940s the use of counterpart generated by the Marshall Plan was mainly left to the discretion of the recipient country. The U.S. requested only accounting for its use and nominally had the veto power over its allocation.

5. Policy Changes on Counterpart

In the early years of PL-480, the emphasis was mainly on combatting hunger and malnutrition in countries most seriously affected by food shortages and by the inability to meet immediate food requirements on a normal commercial basis, while encouraging economic development in the developing countries. Counterpart was generated from sales of agricultural products under local currency sales and since such counterpart was U.S. owned, this made it easier to control its use. Emphasis was gradually changed under PL-480 from combatting hunger to economic development of the recipient country. Gradually a number of self-help provisions found their way into the PL-480 Title I sales agreement as is required by the present PL-480.

These self-help measures, among others, include:

i) devoting land resources to the production of needed food rather than the production of non-food crops;

ii) developing agricultural inputs and infrastructure;

iii) training and instructing farmers in agricultural methods;

iv) constructing storage facilities and improving marketing and distribution systems;

v) creating a favorable environment for private enterprise and investment;

vi) establishing or expanding institutions for agricultural research; and

vii) carrying out voluntary programs to control population growth.

Gradually, the degree of U.S. AID participation in the programming, executing, and monitoring processes became more prevalent. In 1972, because of severe criticism from many of the recipient countries as to U.S. AID's degree of involvement in the use of counterpart, U.S. AID changed its policy from extensive involvement in programming of counterpart to one of greatly reduced involvement. Programming procedures were simplified, and special account requirements were reduced, which in turn "solved" many of the problems associated with monitoring the compliance with the self-help measures by the recipient country.

Once more in 1976, because of the mixed results from the earlier policy of reduced involvement in the use of counterpart programming, U.S. AID reversed itself and started to increase the degree of involvement in the utilization of counterpart. In 1982, PL-480 was amended by adding that self-help measures under Title I and Title III agreements must be specific and measurable and must be additional to those measures which the recipient country otherwise would have undertaken irrespective of such an agreement.

Private sector initiatives during these years included the Cooley loans named after the Senator who introduced the legislation which allowed loans to be made to private sector foreign and U.S. entities with U.S.-owned counterpart. Despite internal AID references to the contrary, the Cooley loan statute has never been repealed and the provision is still in effect. The then (1975) IDCA administrator simply transferred the authority to make this type of loan to OPIC. It is only recently that U.S. AID has placed greater emphasis on programming the uses of foreign assistance, part of which is generated counterpart.

Counterpart funds generated through PL-480 programs and loans and grants under the Foreign Assistance Act are currently utilized in programs and projects under some six major categories:

1. Agricultural rural development and nutrition
2. Population planning
3. Health
4. Education and human resource development
5. Energy, private voluntary organizaitons, and selected development activities
6. Science and technology

All of these uses are grouped under the Development Assistance programs. To the maximum extent feasible, assistance from the Economic Support Fund conforms to the basic policy directions underlying Development Assistance.

Programs vary from country to country. In Africa, emphasis has been placed on such program areas as ranch development, rural roads system, agricultural research and system support projects, dry lands cropping system research, on farm grain storage, family planning, health planning and information, education and manpower development, renewable energy development, and savings union support.

In Asia, counterpart has often been used for such things as protection and restoration of Asian forests and other ground cover, agricultural research and education, transmigration, rural electrification, rainfed agricultural intensification projects, assistance to scale fish producers, secondary food crops marketing, land mapping and titling, and science and technology research. In addition, loans and grants have paid or will pay for reconnaissance missions in support of additional U.S. private sector investment and private investment promotion.

In Pakistan, the current Economic Support Fund assistance is allocated to continue projects which were already initiated in prior years such as irrigation rehabilitation, population welfare training, primary health care projects, resolving low agricultural productivity, and private sector mobilization. In Egypt, counterpart is used to improve Cairo water and sewer systems, textile plant rehabilitation, private sector feasibility studies, and industrial structural adjustment projects.

In Central/South America and the Caribbean, counterpart has been used for projects and programs such as soil conservation, land use inventory, an agro-forestry outreach program in Haiti which is oriented almost exclusively to the private sector, basic skills training, technical consultancies and training, urban small business development, expanding facilities for making available short-, medium-, and long-term credit to farmers, private sector export credit, co-op banking services and credit, private sector productivity, and economic stabilization and recovery programs.

Having identified those sources of counterpart with relevance to PRE and the historical disposition of counterpart, there remains from the historical programs only the "unobligated counterpart" made available to AID as at March 31, 1982 in the equivalent amount of U.S. $20.6 million (Table 4 (b)).

One other major source of counterpart, representing the repayment proceeds of local currency loans from AID's traditional concessional loan programs, cannot now be applied to new loans without Congressional appropriations. This "re-flow" authority was first cut back and then phased-out in the late 1970s. Reinstitution of this authority would provide a source of counterpart with which to establish a revolving fund generating a succession of new private sector initiatives. Such a reinstitution of authority, however, would require an amendment to the Foreign Assistance Act of 1961.

It is therefore evident that counterpart from past programs is not generally available for new uses and that ways to utilize counterpart for private sector initiatives should be found in current programs and appropriations starting with FY 1983.

6. FY 1983 Lending Programs Relevant to PRE Objectives

Based on submitted appropriations for Congressional approval, and considering PRE's target countries as set forth in its policy statement, the following lending programs and other sources are identified as generating counterpart which may be in part available for private sector initiatives by PRE.

(a) The traditional concessional sales of agricultural commodities under PL-480 Title I which for FY 1983 in PRE target countries are projected at US$421.0 million.

(b) AID assistance identified as "Economic Support Funds" which for FY 1983 in PRE target countries are projected at US$1,115.0 million.

(c) Other appropriations such as the Caribbean Basin Program which if approved earmarks US$125.0 million for PRE target countries.

(d) Another sphere of possible PRE influence is PL-480 Title III sales which, if executed, provide that an equivalent dollar value of the proceeds or "counterpart" used for additional specific self-programs may be offset from Title I debt obligations.

(e) The local currency or "counterpart" balance as of March 31, 1982 made available to AID in the amount of US$20.6 million.

III. CURRENT APPROACH

A. <u>Cofinancing Private Sector Development</u>

The basic AID approach to development at present does not incorporate cofinancing with commercial banks or other private financial institutions. The advantages to the current approach are:

1. It is easier to arrange and disburse financing when one does not have to coordinate one's actions with other lenders.

2. The element of concessionality is greater when AID is the sole lender than when its funds are combined with those of private lenders.

3. It is easier to grant loan relief if one does not have to consider the effects of one's actions on other lending institutions involved in the transaction.

The disadvantages of the current approach are:

1. It does not maximize the potential leverage of AID by involving other sources in financing a transaction.

2. It does not subject AID to the beneficial pressures of having other competent financial institutions analyze and approve worthy transactions, thereby giving additional legitimacy to AID-financed projects and possibly assisting in skill transfers between AID and private lenders.

3. It does not provide an optimum degree of AID exposure to the private sector, both in the U.S. and abroad.

B. <u>Productive Credit Guarantee Program</u>

From a functional point of view, a clear distinction should be made between two types of productive credit guarantee schemes:

1. Guarantee support for Credit Mobilization intended to enlarge the availability of funds (internal or external) on a relatively broad base to particular sectors of the economy; and

2. Guarantee support for Credit Allocation designed to facilitate the channelling of available funds to particular groups of beneficiaries or sectors of the economy.

The mobilization of financial resources of external origin for various development activities is a basic function of AID. However, it is aimed at increasing the total fund of such resources available to the beneficiary country rather than at accomplishing the more limited objectives of the PCGP which are to employ credit guarantees as a means of allocating already available internal resources. Accordingly, it is essential that PCGP be so structured as to minimize the need for dollar transfers to the beneficiary country and in its present form, with guarantee payments made from a guarantee fund established in the host country and financing with local-source funds. The program has indeed worked to reduce or even eliminate the need for foreign exchange funding of guarantee payments. Other advantages of the current PCGP approach are:

1. The guarantee approach provides an incentive to lend to small borrowers at rates and on terms more favorable to the latter with less stringent collateral requirements than would otherwise be demanded.

2. The sharing of the credit risk by the guarantor with the lenders constitutes an incentive for the latter to pursue sound lending practices.

3. The program recognizes the importance of the technical aspects of projects being financed and provides for their treatment in the processing of loan applications. It also provides for follow-up assistance to borrowers where such assistance is indicated. Thus, both project preparation assistance and follow-up technical assistance are available to borrowers.

4. In general, the program is based upon a comprehensive conceptual model adaptable to the specific conditions of each country.

5. Administration of the program calls for detailed operational procedures which should facilitate control by the guarantor.

Disadvantages of the current PCGP approach in large part stem from its structuring. They include the following:

1. The five-component conceptual model is unwieldy by virtue of its including more participants than necessary to implement an effective loan guarantee program. The country administrator and the technician have been superimposed upon a structure which consists essentially of lender, borrower, and guarantor and have been assigned a degree of importance that make the program's success dependent upon their attitudes and competence. A restructuring of the program should include a re-assignment of their functions or elimination of these components.

2. Employment of a central bank or other host government agency as an independent country administrator for implementation and operation of the program works to place AID in a position too remote from the action and subjects the PCGP to the requirement that it conform with Central Bank objectives with which it may not be in harmony or to which it may be subordinated.

3. Although the conceptual model presently applied to the PCGP places the technician under the direction and supervision of the recipient country administrator, the technicians' role is one which in practice embodies a high degree of independence. Technicians are paid from the proceeds of approved loans. When a PCGP loan disbursement is made, a fee is paid to the technician who analyzed the project. A small portion of each fee payment is set aside to pay technicians on an hourly basis for work performed on projects subsequently not recommended by them. There thus appears an unusual incentive for the technicians to bring forth loan guarantee applications irrespective of the quality or indeed the eligibility of such proposals.

An independent evaluation of the PCGP in Paraguay found that while some technicians had performed well, others had submitted substandard feasibility studies, incorrectly stated information relating to borrower eligibility, or failed to provide follow-up technical assistance. Of 16 cases examined in detail in the course of that study, only four were found to have been correctly identified as eligible projects and to have benefitted from competent technical assistance. Of the remaining twelve, two were agricultural projects which were made to qualify as eligible by an understatement of the acreage owned by the applicant; two embodied an undisclosed equity position by the technician who studied them; eight had never been visited by the technician either before or after the feasibility study was written (and one of the borrowers involved had never met his technician); and four were part of a larger feasibility study involving several projects and borrowers which the technicians said were so similar that it was unnecessary to state precise facts with respect to each case although each borrower was charged 5 percent of the loan principal for a study which he never saw.

C. Counterpart Funds

Based on the analysis and study of the origin, scope, and history of counterpart by such programs as PL-480, loans and grants under the Foreign Assistance Act and other appropriation acts, advantages and disadvantages to the current approach have become evident as follows:

Advantages

1. Historically, since the end of World War II these existing programs have contributed substantially to the successful development of a number of countries in Western Europe, Taiwan, Thailand, India, Korea, and others.
2. The present decision-making process for programming the use of counterpart starts in the cooperating country itself, and involves interaction between the host country, the Agricultural Attache, and the AID mission. This has generally resulted in the selection of programs which were regarded as important to host country development.
3. Recognition of private sector initiatives is already evident to a large extent in the definitions of the self-help measures in PL-480 programs and the underlying reasoning for loans or grants under the Foreign Assistance Act.
4. The existing programs in their present format are accorded a large measure of acceptance in the cooperating countries as well as domestically.

Disadvantages

1. Eligibility requirements for PL-480 assistance are vastly different from those under the Foreign Assistance Act and other appropriations acts benefitting some countries which are eligible for both types but impeding others which are eligible for only one or the other.
2. PL-480 assistance is on a year-to-year basis while Development Assistance and ESF support under the FAA is on a multi-year basis making selection of programs under the FAA much more meaningful than those under PL-480.
3. Programming of counterpart utilization requires the full cooperation of the recipient country's government which in many instances has reached the point of relying heavily on this program as an integral part of the recipient country's national budgetary framework.
4. U.S. AID's degree of influence under the current approach is often minimal and restricted to general policy formulation only, which precludes active participation in the implementation phase making the impact of these assistance programs difficult to measure.
5. U.S.-sponsored individual assistance programs are not fully integrated with assistance programs from other donors for overall development of the recipient country. In other words, counterpart is often utilized for programs on a piecemeal basis thereby diminishing the potential total beneficial impact of such programs to a recipient's country.
6. The time element between the programming phase through the phases of Interagency approval, congressional appropriation, and actual implementation is excessively long with the Interagency approval phase cumbersome and complicated which makes these programs not conducive to private sector development where timing is a crucial factor.

IV. FEASIBILITY OF CHANGES

A. Cofinancing Private Sector Development

Because AID has not heretofore engaged in cofinancing with commercial banks to any appreciable extent and, accordingly, because the techniques of this form of financing are new to AID, a discussion of the "feasibility of making changes" in a current AID program is not directly applicable. Instead, consideration is given to the feasibility of AID's entry into cofinancing arrangements as a type of financing new to AID.

Cofinancing and other corresponding programs are receiving increasing attention--both from the major international agencies and from a growing number of internationally-minded commercial banks. A result may well be that a larger proportion of future project lending to developing countries will be carried out by banks in partnership with the international institutions such as the World Bank, IADB, and IFC. Indications are that AID's participation in similar arrangements would be welcomed by the private banking community.

There appears to be no question as to AID's authority in principle to engage in the negotiation and commitment of cofinancing arrangements, as these arrangements seem clearly to implement AID's general policy that it must "act as a catalyst to stimulate others to provide assistance to the developing nations," and that it "should assist developing countries to coordinate the use of all resources available for development--whether indigenous, AID-provided, or non-AID."

Apart from AID's authority to engage in cofinancing, it is essential that those members of AID's staff who are selected to consider cofinancing proposals be persons having the requisite professional skills and experience in financial and economic analysis to assess the advantages and disadvantages of cofinancing proposals, whether initiated and advanced by AID or proposed to AID by others who seek AID participation.

B. Productive Credit Guarantee Program

The advantages which have been noted as applicable to the current approach to the PCGP relate to elements which can and should be retained in whatever revisions may be undertaken. The disadvantages can be readily overcome by re-structuring and modifying the current approach and applying the revised model initially as a pilot operation in a single country with provision for such further changes in details of operations as may be there indicated before proceeding with introduction of the scheme to other countries.

In the interest of promoting private enterprise initiatives in the target countries it is considered essential that the Central Bank or other host government agency be eliminated as a component of the model which will replace the one presently employed in PCGP. Administration of the program within the host country may be performed to better advantage both in terms of operating efficiency and in terms of ultimate control by AID/PRE with assistance of the AID mission in the host country when requested by AID/PRE. The guarantee function heretofor exercised by the central bank may be re-assigned and divided as between AID and the lender with an appropriate division of repayment security as between the same two parties. Such a rearrangement should provide the necessary incentive to the lender to exert the required promotional effort while observing sound lending practices. It would also provide an appropriate division of risk as between the lender and loan guarantor.

The technicians who have been regarded as an essential component of the present PCGP model should also be eliminated as a separate element in the revised model. Their function could be assumed (as it already has in some cases) by personnel of the lending institutions performing regular duties as loan officers or administrators or, in those instances where such personnel lack the technical competence to exercise that function, by outside consultants employed on specific assignment. Such a change would serve to support the mode of operation normally pursued by lending institutions and would eliminate the incentives the independent technicians now have to produce the greatest possible number of loan applications, good or bad.

C. Counterpart Funds (Feasibility of Making Changes)

In arriving at the conclusion as to the feasibility of making changes from the current approach, a number of more general aspects have to be dealt with first, such as:

1. Consultations/negotiations with recipient country governments on the use of counterpart is a sensitive issue. Greater assertiveness on the part of U.S. AID in this area may not be welcomed.

2. With many recipient countries presently having financial difficulties and relying heavily on assistance programs for general budget purposes, the timing for any changes in the current approach may be a critical consideration.

3. Considering the state of the U.S. economy, stronger emphasis on helping the foreign private sector will have to be carefully designed to assure that U.S. businessmen do not feel that their own interests are in any way endangered. Bringing them into the decision-making by cofinancing and other devices is highly advisable.

4. The original intent of PL-480 and other development assistance programs is gradual country development and not an immediate adequate and measured return on investment which should be the prime consideration in any PRE sponsored programs.
5. Direct participation by PRE in the programming phase of counterpart utilization adds another "body" to the already cumbersome and sensitive process. In addition, active participation in implementing the PRE objectives in twelve target countries requires an entire range of private sector business disciplines which may or may not be available in the present organization.

Once the above matters have been satisfactorily disposed of, certain changes can be made within the framework of the existing programs which will bring about improvements in a more subtle manner.