PN-AAL-980

FINANCIAL LEVERAGE POTENTIAL OF LOCAL CURRENCY PROCEEDS GENERATED FROM THE FOOD FOR PEACE PROGRAM TO STIMULATE PRIVATE ENTERPRISE IN DEVELOPING COUNTRIES

prepared for

Bureau for Food For Peace and Voluntary Assistance
Agency for International Development
Washington, D.C.

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November 2, 1982

(Research for this project was funded under
PDC-0800-0-00-2095-00)

Executive Summary

The President has made a clear statement of U.S. development policy in that the nations of the world should look to the private sector for the capital and technology needed to bring about economic growth. The policy is based on the strong belief in free markets as well as the realization that the U.S. can not afford to provide the level of funds needed by these countries.

In order for the U.S. to stand by its commitment to help nations willing to help themselves, the aid dollars must be used to their greatest potential to attract additional resources from the private sector. One resource that can be used for such leveraging is the local currency generated from the sale of Title I commodities. Approximately an equivalent of half a billion dollars is generated each year in over thirty countries.

Although the historic precedents for using these funds for private enterprise development is not strong, the fault lies in neglecting the potential of these funds, and not in its ineffectiveness. Although certain conditions are placed on the use of these funds, under the current economic situation, these conditions become advantages if they are used to lever the funds to attract private enterprise.

To illustrate the use of these funds for economic leveraging, examples of financial leverage to attract external as well as internal capital are given. Likewise, operating leverage is illustrated by the use of technical assistance. And finally the

combined leverage is demonstrated in an export financing example and an underwriting example.

In order to implement the economic leverage concept by the use of local currency proceeds, a number of recommendations are made.

- The authority for the Cooley loan should be clarified to allow the use of both U.S.-owned and country-owned local currency.
- The responsibility for Cooley loans should be returned to AID to provide continuity in private enterprise planning.
- The private role of enterprise in a country's development plan should be well defined with tangible targets and schedules.
- Countries with good potential for private enterprise development should be included in the justification for multi-year programming.
- A revolving fund should be established within the special accounts to facilitate the relending of funds without going through the mutual consent process.
- Direct or implied linkage should be established between compliance with local currency use agreement and future Title I agreement.
- Budget support for policy reform activities that provide incentives for private enterprise or to increase the credit standing of the country should be made available.

- Missions should also help establish investment, technical, and management advisory organizations to assist new enterprises.
- AID should act as an intermediary between these organizations and the host government, providing advise and counsel to keep the program on the right track.
- To develop the operational requirements to implement economic leverage, a series of country studies should be conducted.

I. Introduction

President Reagan has made a clear statement of U.S. policy on development assistance, in that nations of the world must look to the private sector for the capital and technology needed to bring about economic development. The President's position was based, not only on a firm belief in the free market system, but a realization that the United States and other countries, can no longer afford to provide the same level of public assistance of earlier periods.

The worldwide economic situation has hurt both developed and developing nations alike, a decade of high inflation, slow economic growth, and rising balance of payment problems have caused all nations to look for means to increase their economic base. This new source of economic growth must come from the private sector, if for no other reason than the fact that the public sector must deal with the social problems that has resulted from the prolonged period of recession.

This change in direction will mean that developing nations must adjust their policies to attract private enterprise both within their country and internationally. In the spirit of this new U.S. policy, our foreign assistance programs are focused on helping developing countries attract business and industry that will generate economic growth and employment. However, funds for foreign aid are limited and so must be used to their greatest potential. One source of funds that has not been used to its fullest potential is the local currency generated with a country from the sale of agricultural commodities under the 'Food for Peace' program (PL-480).

Under the conditions of Title I of PL-480, U.S. agricultural commodities are sold to selected countries on long term concessionary terms. The commodities are then sold in the respective countries and the proceeds can be used by the host government for other development activities, during the period from collection to repayment of the loan. Since the sales are on concessionary terms, the U.S. has held that the use of these funds are part of the overall development assistance program, and must be approved by both the U.S. and the host government.

In recent years these local currency proceeds have averaged around a half a billion dollars annually. Last year approximately $545 million were generated in 32 countries.*

Over the course of the Food for Peace Program, the U.S. has made loans under Title I of over $19.5 billion of which only $7.8 billion or 40% has been repaid. These initial loans made in the 1950's are only now reaching full maturity. Of the remaining $11.7 billion equivalent in local currencies still in the recipient countries, $5.2 billion are repayable in local currencies, and $6.5 billion must be converted to dollars for repayment. (See Figure 2)

Although substantial funds have been generated as a result of the Food for Peace Program, these funds have not been viewed as a true economic resource. This is due in part to the structure of the program and part to neglect. Food that is sold under

* The FY82 program for Title I loans distributed $587 million to 32 countries. The total country-owned local currency proceeds from the sale of these commodities are expected to be approximately $545 million after allowing for the initial payment and currency use payment to pay U.S. obligations within the host country. (See Figure 1 for a breakdown by country.)

PL-480 comes from the agricultural support program so the primary benefit to the U.S. is the assistance to domestic farmers; secondly the food is selectively used to support our foreign policy, and only residually are the proceeds from the sale of those goods viewed as an additional development resource. With these first two major national imperatives, the marginal use of the local currencies have never received the attention to be used effectively. Now that funds are scarce and projects that once were financed solely by Official Development Assistance (ODA) sources must now seek commercial financing, the productive use of these local currencies has taken on greater importance.

Attracting private enterprise, both foreign and indigenous, under the current economic conditions will be a challenge. All the economic and political resources available to a country will have to be mobilized to generate the economic growth needed to pull a country out of the recession. One means of extending the economic potential of available resources is by the skillful use of economic leveraging. The World Bank and many regional development banks extend their capital base by co-financing, commercial banks syndicate their loans to extend their funds and other financial institutions use various means of leveraging their resources to meet the needs of their clients.

The purpose of this paper is to examine the economic leverage potential of local currency generated from the sale of PL-480 commodities that can be programmed to stimulate the growth of the indigenous private sector and attract foreign private enterprise to the host country. It will illustrate some of the economic leverage concepts that can be obtained by using the comparative

advantage of the local currencies. A number of questions will be addressed that will define the conditions as well as the expectations from leveraging. In the background chapter, the following questions will be considered: (1) what precedents exist for the use of these funds for private enterprise? (2) what authorities exist or are needed? (3) are adequate funds available? (4) and what conditions are required to attract private enterprise?

In the economic leverage chapter the primary question is what type of leveraging would be suitable and how will the conditions be met. The last chapter will deal with the institutional arrangements necessary to implement the economic leverage concept. The prevailing question being what type of countries would be candidates; what organizational structure would be required; and what policy or authority would be warranted.

For the purpose of this study the following definitions and limitations will be used. Local currency proceeds (LCP) is defined as the net revenues generated from the sale of PL-480 commodities, excluding the initial payment and country use payments. The study will address funds generated from Title I programs only and will not specifically deal with Title III obligations on Title I. Unless specifically stated, the ownership of the local currency is assumed to be the host government, and only government-to-government transactions will be addressed. Excluded from the study will be the more conventional equity participation or direct lending since this practice is commonly used, although this is not due to an underestimation of its importance. Also only private sector leverage will be considered fully recognizing that leverage can be achieved by using other

sources of ODA funds. The purpose of this paper being to attract private sector participation.

II. Background

This chapter will focus on the factors that influence the use of local currency proceeds by; examining the precedents for their use to stimulate private enterprise, then by defining the necessary conditions to use these funds for economic leveraging, and the requirements of private enterprise to accept the leverage offer.

A. Historic Precedents for the Use of Local Currency to Attract Private Enterprise:

The goal of the U.S. foreign assistance programs from their inception, has been to help developing nations move towards free markets with private enterprise as the foundation. The frequent references to these terms in the principal authorizing legislation is ample evidence of the intent of the United States.[1] However, the use of local currency proceeds has not been a major mechanism for or a consistent force in attaining this goal.

During the reconstruction era of the Marshall Plan, local currencies played a minor role except for the establishment of the 'counterpart fund' concept. Under this arrangement the U.S. provided food aid offsetting the need for foreign exchange requirement to purchase food. The local currencies generated from the sale of the food were termed counterpart funds.[2]

This concept was extended to include concessional sales during the fifties when the U.S. agricultural production expanded resulting in surplus food stockpiles.

The Food for Peace Program was enacted in 1954 to provide a means for the disposal of the surplus. Over $6.4 billion in sur-

plus U.S. agricultural products were shipped during the period from 1955 to 1961. Approximately 60% of the total value of these shipments were sold to countries by providing low interest, long-term loans repayable in non-convertible local currency. This accomodation was necessary to avoid having an adverse impact on a country's foreign exchange position.

The initial repayment of these loans during this period began accumulating in accounts in the host countries and presented what was perceived as a second problem of disposal. The Cooley loan program was initiated in 1957 to make available these U.S.-owned local currencies to American businesses for investment in the recipient countries.[4] The program's basic purpose was to dispose of the local currency which, like the agricultural surplus from which it was generated, was considered to be a burden. It was not considered for use as a tool to develop a viable private sector in the host country.

As a result of the exclusion of private enterprise from development plans, the AID Mission was placed in the difficult position of evaluating complex private investment projects without an adequate criteria. It was placed in the situation of having U.S. businesses looking to them for economic decisions while their counterpart in the host government was looking to them for political decisions.[5]

The early sixties brought together the two separate forces in the U.S. foreign assistance program into a dual concept of aid. The surplus disposal program was directed toward creating foreign markets for U.S. agricultural products while the infrastructure development effort of the reconstruction era was now

focusing on emerging nations. The Agency for International Development (AID) was created during this period and a number of policies were changed, in particular the PL-480 program.

The Congress, concerned about the growing balance of payments problem changed the PL-480 legislation in 1966 to require repayment of Title I loans in U.S. dollars, or in convertible local currency (CLCC). The latter was meant to be a bridge between non-convertible local currency and dollar repayment.* In fact, this change shifted total ownership of the local currency proceeds to the host country, up to the time of repayment. This essentially eliminated U.S.-owned local currency and the funds for the Cooley loan program. U.S.-owned local currency dropped from $1.289 billion in 1966 to only $300,000 in 1974.[6]

The dramatic reduction in U.S.-owned local currency did not provide enough funds to meet normal obligations in many countries. Thus, an advance payment provision called the currency use payment (CUP) was provided. Although the amendment authorizes the use of CUP funds for private enterprise development (Section 103B), administratively it is not included in the budget.[7] One reason for this omission is that in 1971, the Overseas Private Investment Corporation (OPIC) was formed to provide risk insurance to U.S. investors in foreign countries, as part of their mandate, AID transferred the responsibility for the Cooley loan to OPIC, thereby cutting off the use of this

* Over the years however, the only difference in the two types of agreements is that the length of the maturity dollar loans have a 20 year maturity while CLCC have 40 years. From FY80 to FY82 approximately 83% of all Title I loans were in CLCC, consequently the bridge period is longer than originally anticipated.

authority from the development planning process. This final act brought to close the Cooley loan program as a potential tool for private enterprise development.

The demise of the Cooley loan program, however, did not prohibit the use of country-owned local currency from being used to foster private enterprise. The PL-480 agreement calls for mutually acceptable uses of the proceeds, this programming of funds is a critical part of the annual negotiations. However, the massive increase in food aid to sensitive countries such as India and Pakistan earlier in the decade caused large accumulation of U.S.-owned local currencies. It was believed, at that time, that releasing these funds could do damage to the host countries' economy and increase inflation. As a result AID changed its policy in 1972, that had required the programming of these funds.[8] Although this argument was later proved to be erroneous,[9] it was a matter of serious concern at the time. With these major problems confronting the U.S. aid program, the private sector development component was of low priority.

A number of critical events occurred in the early seventies that dramatically changed the U.S. foreign assistance policies as well as our economic policies. Taking each issue separately they provide the prerequisite of our current situation. Coming into the 1970's the export promotion of U.S. agricultural products was a notable success. Commercial sales increased to over 80% of total food exports to developing nations, giving the illusion that many of the recipient countries had emerged from concessionary to market terms for food imports.[10] Consequently, the President ordered the stockpile to be reduced. By 1973 the U.S.

grain stockpile was virtually eliminated (the Soviet grain purchases accelerated the decline). The situation changed abruptly, with a series of crop failures that drove up the world food prices, reducing the volume of food available for export and increasing the demand for PL-480.

Inflation began erroding the value of exports during this period resulting in economic stabilization policies in many countries. In the U.S. price controls plus the shift to a floating exchange rate resulted in the flight of investment capital to the Eurocurrency market. The flood of funds resulted in international banks placing loans in developing countries without adequate evidence of credit worthiness. These funds provided a short term relief to many countries, but increased their debt service levels dramatically.[11]

The energy crisis quadrupled the price of imports, and inflation erroded the value of exports resulting in increased borrowing from commercial banks at floating interest rates. Although official development assistance (ODA) increased somewhat, in real terms it could not offset the impact of the world economic condition.

The development assistance policies of the U.S. changed dramatically in the mid-seventies. In the midst of the mounting world economic crisis, the U.S. adopted a "Basic Human Needs" (BHN) approach to our foreign aid. This approach reversed nearly four decades of institution building to redirect our efforts directly on improving the quality of life of the poorest of the poor.[12] The BHN approach directed ODA into a long range social and rural development program where the economic and social

return on these investments were in the distant future.* This new direction did not recognize the severity of the world economic situation.

As the decade ended, the economic situation had worsened to the point of crisis in both the industrialized and developing nations. An international financial crisis was close at hand, world trade had declined for the first time since World War II, and the ability of the industrialized world to help other countries was (and still is) seriously impaired. President Reagan has defined a direction for the U.S. development assistance program that will focus on the contributions of private enterprise to the production of new wealth in developing countries.

Certain conclusions can be reached from looking back over the history of local currency proceeds and their use to stimulate private enterprise. First and foremost, the private sector was never totally integrated into U.S. development assistance planning. The Cooley loan program could have been a vital part of the early stages of economic development by bringing technical and management skills as well as capital to recipient countries that would have helped stimulate economic growth. Instead the private sector was left outside the process.

Second, AID overestimated the negative impact of using local currency and underestimated the positive impact. The inflation-

* The basic premise underlying the shift to the basic human needs approach has been challenged by showing that the development of economic infrastructure has increased economic growth in middle income countries and has reduced the level of absolute poverty in these countries (See Crosswell (8)).

ary scare brought about by the excess currencies in India and the prevalent short-run view was thought to be a general problem in all countries. The resultant change in policy restricted the AID Missions from constructively using these funds for economic development. If these funds had been put back into the economy and used in activities that produced economic goods, they would have been deflationary in the long run and contributed to economic growth.

Third, the current economic condition of the world gives little hope that funds will be available to developing nations at previous levels or terms. ODA and commercial sources of funds are scarce. The over-exposure of loans to developing nations by international banks has placed the banks' portfolios in jeopardy. A default by a key country such as Mexico or Argentina could have dire consequences on the entire field of development financing. Because of these conditions, development funding will continue at a much more limited scale than in the past and at a much higher price.[13] Developing countries will have to use their available resources selectively and in such a way as to attract additional resources.

B. Necessary Conditions for Using Local Currency Proceeds for Economic Leverage:

The precedence for using local currency proceeds for private enterprise development is not strong. While adequate authority existed and ample funds were available, the administrative structure and policy direction were lacking. Now that private enterprise is recognized by AID as a formal policy, the adminis-

trative arrangement can be made.[14]

In order to use the local currency proceeds for economic leverage to attract private enterprise, three necessary conditions must be met. First, authority to use the funds as well as the condition on the use must be clearly defined. Second, adequate funds must be available and in the proper location to accommodate leveraging. And finally, the mechanism must exist to facilitate the use of these funds. These three conditions will be discussed in relation to the PL-480 financial process.

I. Authority to use Local Currency Proceeds for Economic Leveraging:

The principal authority to use these funds is found in the Agricultural Trade Development Act of 1954, as amended. Specific authority to use U.S.-owned local currencies in the CUP is in Section 103(B) which include private enterprise development.

The U.S. is also authorized to negotiate for specific uses of the local currency proceeds for activities under Section 104 that are not covered by the CUP (e.g. economic development) and for the self-help provisions under Section 106, which includes such activities as development of the agricultural sector, rural development, encouragement of private enterprise (domestic and foreign), and support for effective government economic policies and institutions. The private sector can have a significant impact in all of these areas.

The critical elements of the authority are the provisions which state: (1) that the funds must be used in the recipient

country for development related activities; (2) that these activities must be mutually agreed on by U.S. AID and the host government; and (3) that the selected activities must be in addition to existing or planned development efforts, and not a substitute source of funding.[15]

2. Availability of Local Currency Proceeds for Economic Leveraging:

The key to providing adequate funds for leveraging is found in the process by which these funds are generated. The Food for Peace Program represents approximately one-third of the total foreign assistance provided by the U.S. to other nations. The size and nature of the program involves a number of different agencies of the U.S. Government as well as a number of ministries in the recipient countries. The manner by which these organizations interact determines to a large extent the potential use of the local currencies. (See Figure 3) The determination of which countries will be sold which commodities and under what terms is made by an interagency body, of which AID is a member. It is at this point where private enterprise programming of local currency must start. Since food aid must proceed the generation of local currency, then the selection of countries to receive Title I

commodities should include consideration of those in which a private enterprise activity is planned.

The negotiation stage of this process is the most critical to the potential use of local currency proceeds. When the allocation of credit has been made, those nations that are eligible apply for credit sales through the U.S. Embassies. The host government and the U.S. Embassy agree upon the terms of the credit sales and the condition for use of the commodities as well as the proceeds from their sale during these deliberations. (See Figure 1 for a breakdown of the contract terms by country for FY82). In respect to the use of the proceeds the private enterprise effort must compete with other development activities for the use of these funds, as well as overcome the resistance of the host government to use the funds for budget support.*

Reviews of the local currency programming process stress the need to specify projects or activities to be funded during the initial negotiation to have the mutual agreement made while food aid is a negotiable issue. This links the primary development assistance (food) to the secondary assistance (local currency) in one contract. Although specifying the exact private enterprise venture may not be feasible at the time of the negotiations, the level of funding for economic leverage can be identified.

When the commodities arrive in the recipient country, the host government provides local currency to the U.S. Embassy as

* It should be noted that in theory, the U.S. is borrowing funds to acquire the commodities that are used to generate the local currencies, and if those funds are not used to create new economic growth and development, then it can be inferred that the U.S. is increasing its budget deficit to relieve the budget pressure on the recipient country.

advance payment on the loan (CUP). When the commodities are sold, the sales proceeds flow to the treasury of the host country or to special accounts within the central bank. While special accounts for countries receiving only Title I commodities are not required in the agreement, a substantial number of recipient countries have established such accounts which have proven to be an efficient means of monitoring the proceeds' uses. Still, the existence of a special account does not guarantee that the funds will be used for their intended purpose or that they will be disbursed at the proper time. There are many reasons why a host government will choose to release or retain these funds regardless of prior contractual agreement (See Figure 4). Delaying release of these funds, for whatever reason, creates a great deal of uncertainty and speculation which is disruptive to economic development. This would be particularly true if the local currencies are used to attract private capital.

When the local currency proceeds are earmarked to be used in conjunction with private capital, as in joint ventures or investment financing arrangements, the uncertainty of release of the local funds increases the funding risk of the venture and puts the private capital portion in jeopardy. Even a modest history of a government's reluctance to meet agreed commitments will reduce the country's ability to attract capital and technology.

To encourage the host government to comply with their original agreement AID should make it absolutely clear that (a) one of the objectives of the PL-480 program is the expansion of the private sector by creating a business climate conducive to

private enterprise; (b) firm agreement on the use of local currencies for these purposes will be henceforth made a condition of sales agreement; and that (c) the U.S. willingness to enter into new agreements will depend on the host country's implementation of the private sector provisions in prior agreements.

The judicious management of the Title I process will assure the availability of local currency proceeds needed to facilitate economic leverage.

3. Mechanism to Use Local Currency for Economic Leverage:

A major barrier to the use of Cooley loan funds was the AID Mission's staffing problems in evaluating projects and administering the loans. In the latter days of the program the Missions used intermediate financial institutions (IFI) to carry on this work. The use of intermediate financial institutions are also recommended for economic leveraging - but for other reasons.

The purpose of leveraging is to attract additional resources, therefore the local currency proceeds should be placed in commercial and investment banks in which private capital exist. The addition of the local currency proceeds would raise the level of capitalization and permit these funds to act as a catalyst for other investment funds. Specific examples of how the intermediate financial and credit institutions can be used for economic leverage will be discussed in later chapters.

C. Necessary Conditions for Private Enterprise to Accept Leverage Offer:

The investment environment for private enterprise within many developing nations is not very attractive at present. The well publicized debt problems of these countries has placed the world financial structure in jeopardy. As a result, international banks are tightening up on the conditions for loans as well as the selection of recipient countries. Although funds will still be available to LDC's, the level of participation will be less, the interest rate higher, and stronger risk guarantees will be required.[16]

Within many of these countries indigenous private enterprise investment is also hampered by the government's constraints on the flow of capital, the shortage of long term investment capital, and a lack of managerial and technical skilled labor force that could take advantage of entrepreneurial opportunities.[17] While economic leveraging of local currency proceeds can not resolve these problems, these funds can be used to direct economic resources at their resolution.

1. Comparative Advantage of Local Currency Proceeds:

To use these proceeds to the best advantage for leveraging the comparative advantage of these funds should be matched with the requirement of potential financiers. In contrast with earlier attitudes about the economic worth of these funds, under current conditions they have a number of distinct advantages. First, PL-480 loans have very long maturities, up to 40 years with a ten year grace period, and with extremely low

interest rates (3%). Since the proceeds are generated usually within the first year of the loan, funds can be made available for relending on maturities up to 39 years and at fixed interest rates (presuming that floating rates will not drop to the three percent level during the loan period). Secondly, the return on investment (ROI) of the proceeds can be adjusted to accomodate the needs of other funding sources if it is required to attract capital. Since the objective of using these funds is to stimulate private enterprise, the trade-off can be made between short-term returns and longer term economic growth. A third advantage could be in the use of these funds for pre-investment studies to package ventures in such a way as to increase their economic or financial attractiveness to investors (activities precluded by many financial institutions). These are but a few of the comparative advantages of local currency proceeds that can be used to attract additional resources.

2. Objective of Investment Section:

To use the comparative advantage of the proceeds, economic leverage mechanisms should be addressed to the principal elements in the investor decision, to that of capital, risk, and benefits.[18] Regardless of the world economic situation, these three factors play the major role in project selection. As mentioned earlier, the over exposure of international banks' loan portfolios in developing nations will necessitate a reduction in the level of participation in many ventures. This will result in either redefining projects into smaller units with different maturities or changing the mix of capital, shifting more of the

expenditure from foreign exchange to local currency, thereby sharply reducing the level of risk that investors will be willing to accept.

Risk in international ventures is distinguished by: (1) the project risk associated with economic feasibility of the project; (2) the funding risk that results from having returns on long term commitments fall short of short term obligations (a problem of all financial institutions) and (3) the political risk, that overshadows all venture in developing nations, the prospect that local laws or policies will prevent the investor from realizing the benefits of his investment. These risks are real and must be dealt with if private enterprise is to succeed.

The third area of concern is the benefits expected by the investor. While profits from successful operations is still the most prominent objective of investors, access to new markets or to critical resources have always been reasons to invest in developing countries. During the early sixties the major objective of foreign direct investment was access to resources that were used in the production and sale of goods outside the host country.[19] Granted the resources were cheaper to produce in these countries, but also these new nations were emerging from colonial rule and had not developed markets for either their own or imported goods. Currently, the focus of direct foreign investment has changed. The U.S. now imports over fifty percent of the manufactured goods produced by developing nations and in turn export a like number of manufactured goods to these countries.[20] The emphasis of investment differs with each prospective investor, and the design of economic leverage must be suited

to each.

This chapter has presented the precedents for using local currency proceeds to stimulate private enterprise, along with the necessary conditions to use these funds to attact private enterprise and complemented by similar conditions required to use these funds effectively for economic leverage. In the next chapter a range of leverage schemes will be presented to illustrate how these conditions might be met. These examples are presented to show the wide range of mechanisms that can be formulated with local currency and certainly not to be considered an exhaustive set of options.

III. Economic Leverage Potential of Local Currency Proceeds

Food aid has long been known for its political leverage potential to obtain specific policy objectives or as a symbol of U.S. power and influence.[21] The funds generated from the sale of these commodities have an equal leverage potential in the economic area. The key to the effective use of these funds to stimulate private enterprise is through realizing this economic leverage potential.

Economic leverage is a common mechanism in investment finance and is defined generally as the effective use of a limited resource to attract the services of much larger resources.[22] This concept can be extended to AID's efforts to attract private enterprise by considering the proceeds as the limited resource whose economic potential is to be maximized by various means of economic leveraging while meeting the necessary conditions stated earlier.

Two types of economic leverage will be discussed in this paper. First financial leverage will be demonstrated in examples where external funds are sought from international commercial banks and internally from domestic investment banks. Next, operating leverage will be illustrated in the increased productivity of regional export markets, and by import markets. And finally both financial and operating leverage are used to illustrate how underwriting can increase the private enterprise.

A. Financial Leverage With International Commercial Banks:

Development finance was the domain of official sources before the 1970's, primarily through development assistance grants

and loans. The combination of expansion of the Euro-credit market and the contraction of official sources brought the developing countries together with commercial banks. Over 100 projects have been financed through this linkage since 1971, raising nearly $25 billion in syndicated loans.[23]

Commercial banks, particularly international banks, base their lending on three general criteria: the exposure, the return on investment, and risk involved.[24] The exposure level or country limits is concerned with the volume of funds that are concentrated in a given country or region for a length of time. (The current international financial crisis is due to an over exposure of banks' loan portfolio to selected countries i.e. in Mexico and Brazil.) International banks generally finance only the foreign exchange portion of a venture, the proceeds can be used to offset a portion of the foreign exchange requirement by organizing efforts to shift the more specific capital expenditure into local purchases or leases using local currency. Such efforts would require foreign exchange only for project specific capital goods, lowering the capital participation and exposure level of the bank.

The timing of loans also have a significant impact on the exposure levels of banks. While the return on investment (ROI) is generally computed on the total capitalized cost without differentiating the foreign exchange component from that of the local currency, the maturity of these different financial components can be separated. By allowing the international banks to receive the early loan repayments on their portion of the investment, the return on investment for the foreign exchange component

increases significantly over the overall project return. Likewise the exposure level reduces with the reduced time frame and the funding risk drops accordingly. By using various means of shifting the capital expenditure and the timing of both expenditure and returns, a project can be made attractive even when the country has a high exposure level.

Banks evaluate an investment opportunity based on the expected cost and returns against their cost of capital, usually based on the LIBOR rate. The spread between the cost of funds to the bank and the interest received from the project must be sufficient to warrant the bank taking the risk. Since the LIBOR rate depends on the overall supply and demand for capital at any given time, a project may be considered acceptable at one time and not at another. Consequently, if a portfolio of projects were made available and submitted to the banks in such a manner as to insure the spread between returns and LIBOR would be acceptable, then more private enterprise ventures would be financed. Local currency procceds could be used to provide such a service. Mechanisms such as the two discussed can be used to attract external capital by skillfully using a portion of the local currency proceeds.

B. Leverage to Attract Internal Capital:

With the pending international financial crisis slowing the flow of investment funds to developing nations, countries must look to their own investors for capital to finance private enterprise. One problem that has marked investment funding in many countries is the shortage of long-term investment capital at a

fixed interest rate. A number of reasons have contributed to this shortage of funds, not the least of which is the economic policies of many countries that discourage long term investment. For whatever reason, this deficiency of such funds has hurt private enterprise development.

The proceeds from PL-480 are well suited to fill part of this gap, with long maturities averaging forty years, and fixed interest rates averaging less than three percent. To gain the most leverage and to attract indigenous investors, these funds should be used in a holding company type arrangement, in which the proceed represents only a portion of the total capitalization. To illustrate, assume AID and the host government made available a certain amount of local currency proceeds in a special development fund, and the fund raised its remaining capital from internal sources. For simplicity assume the proceeds represented half of the capital stock at the cost of 3% (the PL-480 interest rate) and say the average cost of long-term (3-5 years) investor capital was 11%, the average cost of capital to be relent is only 7% and the proceeds have realized a two to one leverage.

Next, assume these funds are lent to investment banks or other financial institutions that also use this long term fixed rate capital to combine with market rate funds, say on a 50-50 basis, and if the private capital remains at 11% than the cost of capital to the investment bank is now only 9% and the proceeds have increased their leverage to four to one. And finally, if the investment bank lends these funds to projects that require at least a 25% equity participation then the final leverage is five

to one.

In such an arrangement the borrower at each level would assume all project risk and the conditionality of the Title I agreements (e.g. rural and agricultural development) would be passed on to the lending institution as a condition of the loan.

C. Financial Packaging:

In both of the above financial leverage examples it is implied that skillful and well informed investment advise is available. In many developing nations this is not a valid assumption. One means of providing such counsel is to use portions of the proceeds directly, or in the latter case the interest earned on the proceeds, to finance an investment advisory service. This service could be made available through established investment banks or consultants to package the financing of a project to realize the maximum benefit of capital as well as the best operating efficiency from the productive facilities (economies of scale). To insure success, the packaging organization would be paid by the investment advisory service only a portion of the operating cost while preparing the project. If the project is successful in finding funding, then their fee (? to 3% of the capitalized cost) would be included as part of the project cost. This would insure that those firms involved in the financial packaging would be selective in their projects, innovative in their financing, and aggressive in marketing their projects.

AID sponsored such a program during the mid-1960's, in which it underwrote half of the expenses of investment survey teams.

AID paid $500 thousand in expenses which produced over $50 million in investments during the course of the program, or a leverage ratio of 100 to one. In contrast, AID also funded a series of feasibility studies of prospective investment opportunities identified by the host governments during the same period. The studies went unnoticed by government agencies and none of the investment opportunities identified in the studies were ever undertaken.[25] This comparison demonstrates the impact of proper incentives.

D. Operating Leverage:

The shortage of technical and managerial skills have long been a constraint on private enterprise development in emerging nations. This shortage has resulted in many businesses operating inefficiently, underutilizing their facilities, and not servicing their markets. Operating leverage deals with the skillful use of a marginal resources, in this case the local currency proceeds, to increase the economic efficiency of fixed productive resources.[26] Similar to the way the same marginal resource was shown to increase the financial leverage of a venture.

Organizations that provide technical and managerial advise have long been a major factor in newly industrialized nations such as Korea or Tawian. To establish such organizations would probably require the talents of external consultants to train personnel within the country and to assist in the early stages of operations. Generally this would require foreign exchange to fund such an effort - and indeed some foreign exchange will still be required. But the overall level can be reduced by using the

convertible portion of the proceed (usually two percent) to pay out-of-country cost such as fees or honorarium, while using the proceeds to cover in-country expenses including international airfare. Use of local currency to offset foreign exchange cost is frequently done to pay U.S. obligations and the normal operation expense of Embassies, so should not be difficult to accomplish.

Once the technical and managerial advisor organizations are functioning on their own, the proceeds can be used to cover their operating cost until such time that fees charged for their service can sustain their ongoing operations. The funds provided to these organizations should be granted on a long-term fixed interest rate to insure that the organization is weened from the support of the host government as soon as possible. The exact leverage potential of such organization is difficult to predict, particularly in developing nations. However, for comparison an operating rule for such activities in the U.S. is approximately ten to one, that is, the gross increase in revenue is increased by ten times the cost of the service.

E. Combined Financial and Operating Leverage:

As a practical matter both financial and operational leverage are usually employed to realize the maximum efficiency of a business activity. In such a manner high operating risk can be offset by financial leverage, as well as high operating efficiency can offset uncertain financing. In the following discussion the combined leverage advantage will be demonstrated in an export credit example and an underwriting example.

By the use of the proceeds to underwrite technical assistance for businesses to improve their productive efficiency, as discussed earlier, less fixed assets are used for each product. This idle capacity will exist unless the market for these goods is expended. The expansion of markets internally is a tricky question, often having more efficient producers eliminating the less efficient with little new economic growth realized. If the expansion could be realized by exports then the new markets could absorb the idle capacity.

The authority under Section 104(g) allows the use of local currency outside the host country. This so called tri-trade provision allows other countries to buy goods from the host country with payment made from the local currency proceeds. Using this concept, a regional export credit bank could be established using the proceeds as part, but not all, of its capitalization. These funds would provide a source of export financing to indigenous businesses that is essential to the expansion of export markets even on a regional basis. The combined leverage is realized first from increased productive efficiency, reducing unit cost and increasing marginal revenues. Secondly, the export financing allows idle capacity to be used at optimal production levels.

F. Combined Leverage of Underwriting:

One of the largest means of financial leverage comes from the insurance of investments and business enterprise, by reducing the risk premium to the lending institution and the interest rate to the borrower. Financial institutions are asking for

guarantees on their loans more frequently as capital becomes more scarce. Twenty-eight percent of the private external funds were guaranteed in 1973. This had risen to 37% by 1981. Forty-eight percent of the guaranteed loans were with banks in 1973; which increased to 77% by 1981.[27] This is an important factor to small and medium-sized business that may not have a long credit or business history.

Two major barriers to establishing such enterprises in the past have been the availability of sufficient capital for adequate reserves to cover the risk, and the lack of sound actuarial data on which a reserve level could be based. Very little data is available on the type and characteristics of business risk in developing countries, because most studies have focused on the success, and not on the failure, of business.[28]

The barriers can be overcome by the combined use of operating leverage to assess the actuarial risk, and financial leverage to provide financing. First, risk assessment need not be based on actuarial data, at least not in the early stages of underwriting. Industrial insurance premiums can be based on a risk assessment determined by a trained appraiser. The proceeds can be used to train an insurance assessor in much the same manner described above for a technical and a managerial advisor. When trained this corp of assessors could build the necessary data base for establishing rate structure for business insurance as well as the basics for a credit rating system that would serve financial institutions.

Generally, the reserve fund established by industrial insurance firms is based on some actuarial history on which the

level of funding is based. In the absence of this historic base, the reserve fund can only be a calculated guess, with a reasonable expectation that a wide variance may occur. Consequently, an insurance company would be required to maintain very large reserves, which is expensive and an inefficient use of capital. However, the availability and the long-term maturity of local currency proceeds make these funds an ideal source for a contingency reserve. For example, an industrial insurance company could borrow funds from the proceeds special account on two bases. The first for normal expected reserve funds (say two to three percent of the total value of coverage), then a second loan or line of credit for a much larger sum as a contingency against unanticipated claims.

Investment underwriting based on reserves of local currency would normally not be able to cover foreign exchange losses, without some form of convertability or maintenance of value condition. These conditions are usually provided by the host government. However, commercial banks can provide similar services by using a portion of reserve funds for foreign exchange hedging i.e., buying futures in the foreign exchange market to cover the expected demand.

As the actuarial data base improves the need for the contingency fund will reduce. But the presence of the proceed could facilitate the beginning of industrial insurance companies where they would be uneconomical without these funds.

The above two examples demonstrate how financial and operating leverage can be used in combination to achieve economic efficiency of an enterprise that otherwise would have been

rejected. Indeed, throughout the examples given the common thought is the effective use of economic resources. As funds become more scarce and competition becomes more heated, the successful projects will be those that use their resources to the most creative advantage. In the next chapter, the institutional arrangement necessary for the effective leveraging of the proceeds will be discussed.

IV. Implementation of Economic Leverage Concept

This paper has addressed the concept of using the local currency proceeds generated from the sale of Title I PL-480 commodities as economic leverage to attract private enterprise. This concept was demonstrated by a number of examples of both financial leverage and operational leverage. In order to use these funds for economic leverage a number of necessary conditions must be met. Although existing authority is adequate to use the proceeds for economic leveraging, some confusion still exists over the use of U.S.-owned and country owned local currency. Therefore, the Cooley loan provision should be removed from the CUP authority (Section 103g) and incorporated in a new section that merges the uses of all local currency proceeds (sections 104 and 106).

Secondly, the responsibility of the Cooley loan program should be returned to AID from OPM. This action would provide continuity within the planning process, allowing private enterprise activities to be incorporated in country development planning regardless of their origin. On this point, the role of private enterprise in the development process should be well defined with tangible objectives, goals and plans which are integrated into the country development planning as well as the Title I PL-480 planning process.

AID has encouraged multi-year programming of PL-480 commodities. While such efforts reduces the uncertainty of local currency availability for private enterprise, this reasoning would not be adequate justification for multi-year programming by itself. But the advantage to the private sector should be

included in the rationale for such programming.

In the negotiation stage, AID should establish a direct or at least implied linkage between the host government with compliance of local currency programming agreement and future Title I agreements. Secondly, a revolving funds provision should be established within the special accounts so that the reflow of funds can be relent throughout the maturity period. Also, in the negotiations, the precedent should be made for allocating certain amounts of funds to intermediate financial institutions and technical service organizations without specifying exact projects. Finally, budget support should be provided if the country agrees to make economic policy reforms that are targeted specifically at increasing incentives for private enterprise and at improving the credit worthiness of the country. (The latter is a long standing AID objective.)

The AID Missions should seek out or help establish commercial financial institutions to develop the leverage potential of funds placed on deposit. AID staff should participate in the policy making process of these organizations and not in the administration or evaluation of loans. In a like manner, the Missions should help establish technical, investment, and managerial advisory organizations that can provide operational and financial packaging assistance to an indigenous enterprise. To support the efforts of these intermediate institutions, AID should act as an intermediary between the host government and these organizations.

In order to advance the economic leverage concept towards implementations, AID should conduct a series of country studies

to identify the operational criteria for using economic leverage in different situations. In general such criteria might include, but not limited to such items as: (1) the existence of an active Title I program; (2) the existence of well functioning commercial credit or financial institutions; and (3) a willingness to establish rational economic policies.

END NOTES

1 For example, see Sections 104, 106, and 109 of Agricultural Trade and Development Act (PL-480) and Sections 102 and 106 of the Foreign Assistance Act.

2 See AID (1) or Lachman (18), GAO (12).

3 See USDA (10).

4 See Wallerstein, p. 31-33 (28), Mason (23).

5 See AID (1).

6 See USDA, p. 11 (10).

7 See USDA, p. 14 (10).

8 See AID (1).

9 See Mayer, p. 82-112 (14).

10 See Wallerstein, p. 45-47 (28).

11 For a discussion of the impact of the world financial situation on LDC's see Fleming (11), O'Brien (26), McAlpine (24).

12 See Crosswell (8).

13 See Billerbeck and Yasugi (7).

14 See AID (2).

15 See AID Handbook Four (3).

16 See Fleming (11), Davis (9).

17 See AID (1), Krause (17), and Kobrin (16).

18 See Goodman (13), Lal (19), and Marple (22).

19 See Krause (17), Lall (20), and La Palombara (21).

20 See Billerbeck and Yasugi (7).

21 Wallenstein, p. 121-144, (28).

22 See Amling, p. 404 (4).

23 See McAlpine (24).

24 See White (29), Radez (27), and Nagy (25).

25 See Winter, p. 11, (30).

26 See Amling, p. 404 (4).

27 See Billerbeck and Yasugi (7).

28 See Anderson (5) and Anderson and Khambata (6).

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FIGURE 1

TERMS AND AGREEMENTS FOR FY82 PL-480 PROGRAM

September 1, 1982

TABLE I
FY 82 TITLES I/III PL 480 AGREEMENTS

Country	Grant Element * %	GNP Per Capita ** 1981 (Dollars)	Type Agreements	Amount $ Mil	Terms Years	Years Grace	Annual Installments	% Interest Grace Period	% Interest Continuing	% Initial Payment	% CUP
Bangladesh	67.1	140	CLCC-III	64.0	40	10	31	2	3	-	-
[illegible]	67.1	650	CLCC-III	15.0	40	10	31	2	3	-	-
Senegal	67.1	500	CLCC-III	7.0	40	10	31	2	3	-	-
Sudan	67.1	380	CLCC-III	20.0	40	10	31	2	3	-	-
Zambia	67.1	590	CLCC-I	7.0	40	10	31	2	3	-	-
Haiti	66.4	300	CLCC-I	13.0	40	10	31	2	3	-	5
Sierra Leone	66.4	320	CLCC-I	3.0	40	10	31	2	3	-	5
Somalia	66.4	280	CLCC-I	14.5	40	10	31	2	3	-	5
Sudan	66.4	380	CLCC-I	5.0	40	10	31	2	3	-	5
Tanzania	65.0	300	CLCC-I	5.0	40	10	31	2	3	-	10
Sri Lanka	63.7	300	CLCC-I	17.6	40	10	31	2	3	5	-
Egypt	63.7	650	CLCC-I	200.0	40	10	31	2	3	5	-
Pakistan	63.7	350	CLCC-I	50.0	40	10	31	2	3	5	-
Ghana	63.0	400	CLCC-I	7.0	40	10	31	2	3	-	15
Egypt	61.8	650	CLCC-I	60.0	40	10	31	2	3	5	10
Kenya	61.8	430	CLCC-I	15.0	40	10	31	2	3	5	10
Zaire	54.9	230	CLCC-I	10.0	30	5	26	2	3	-	10
El Salvador	54.7	640	CLCC-I	19.9	25	5	21	2	3	-	-
Liberia	54.7	540	CLCC-I	15.0	25	5	21	2	3	-	-
Guinea	54.1	300	CLCC-I	5.0	30	5	26	2	3	5	-
Madagascar	50.5	330	CLCC-I	5.0	20	8	13	2	4	5	5
Indonesia	49.4	570	CLCC-I	17.5	30	5	26	2	3	10	10
Congo	47.4	1,110	CLCC-I	2.0	25	5	21	3	3	5	5
Bolivia	46.5	600	CLCC-III	10.0	18	4	15	2	3	-	-
Morocco	46.3	870	CLCC-I	35.0	24	5	20	3	4	-	-
Jamaica	45.5	1,180	CLCC-I	17.5	20	4	15	3	4	-	-
Honduras	43.7	590	DC-III	7.0	20	2	19	2	3	-	-
Dominican Rep.	39.2	1,340	CLCC-I	17.0	20	4	17	3	4	5	5
Peru	39.2	1,120	CLCC-I	17.0	20	4	17	3	4	5	5
Costa Rica	37.6	1,430	CLCC-I	18.0	20	5	16	3	6	-	5
Mauritius	35.4	1,340	DC-I	3.5	20	2	19	3	4	5	5
Tunisia	32.1	1,420	DC-I	10.0	20	2	19	3	4	15	-

* DAC Definition: 10% Discount Rate Comparison
** World Bank Estimates (July 1982)

\[illegible]/FMA/FFP/I:W Phoenix:ecw

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FIGURE 2

FUNDING OF FOOD FOR PEACE PROGRAM

SUMMARY FOR ALL COUNTRIES @ (U.S.FISCAL YEARS - MILLIONS OF DOLLARS)

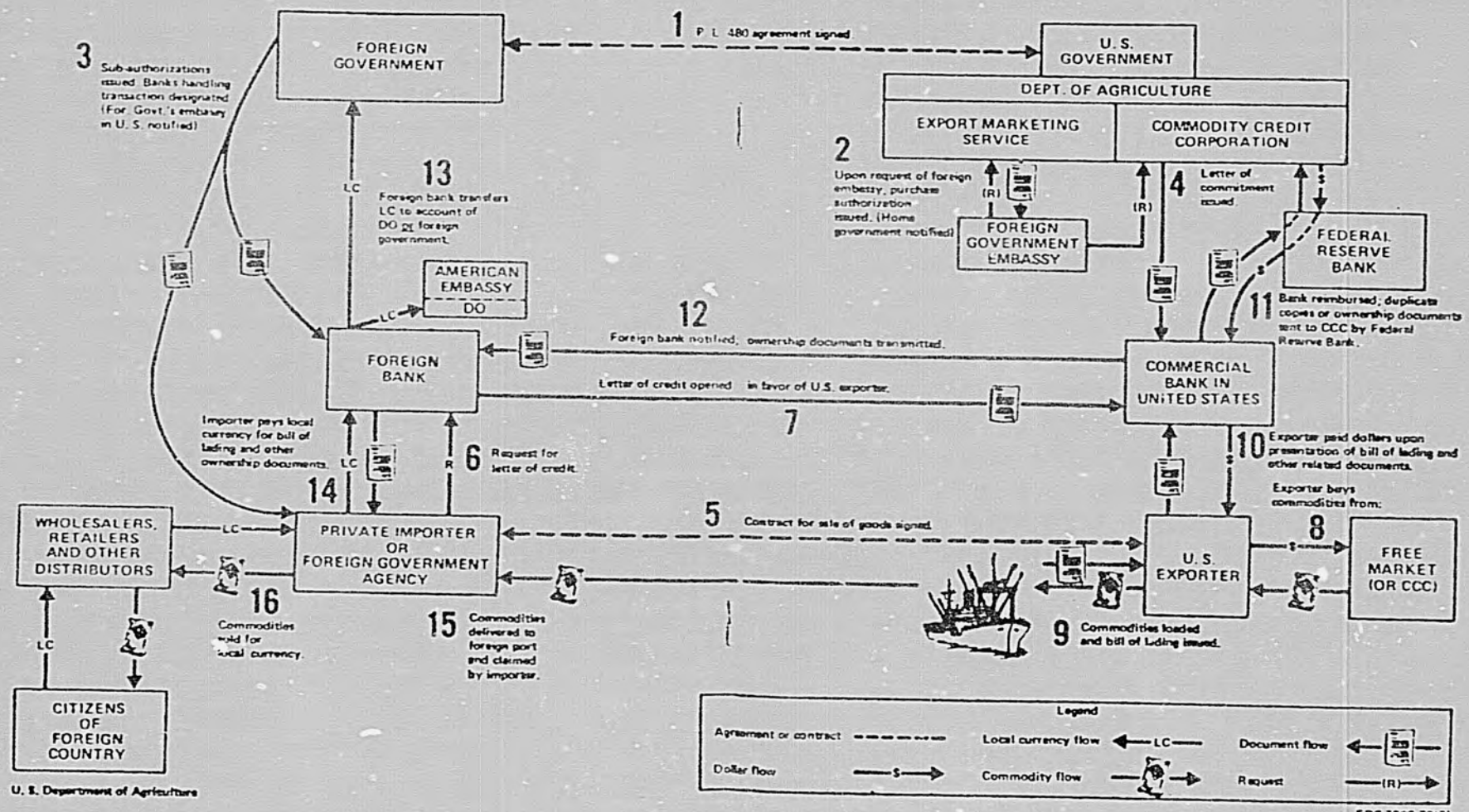
PROGRAM	POST-WAR RELIEF PERIOD 1946-48	MARSHALL PLAN PERIOD 1949-52	MUTUAL SECURITY ACT PERIOD 1953-61	FOREIGN ASSISTANCE ACT PERIOD 1962-77	1978	1979	1980	1981	TOTAL FAA PERIOD 1962-81	TOTAL LOANS AND GRANTS 1946-81	REPAY-MENTS AND INTEREST 1946-81	TOTAL LESS REPAYMENTS AND INTEREST 1946-81
	U.S.OVERSEAS LOANS AND GRANTS-OBLIGATIONS AND LOAN AUTHORIZATIONS											
										**		**
I.ECON. ASSIST.-TOTAL...	12,482	18,634	24,053	68,780	6,661	7,120	7,572	7,305	97,437	148,872	24,822	124,050
LOANS.....	5,967	2,551	5,850	28,649	2,530	1,900	1,993	1,460	36,533	48,765	24,822	23,943
GRANTS.....	6,515	16,083	18,203	40,131	4,131	5,220	5,579	5,845	60,904	100,107	-	100,107
A.AID AND PREDECESSOR..	-	14,506	16,885	37,444	4,086	3,848	4,062	4,209	53,650	81,975	9,850	72,125
LOANS.....	-	1,577	3,266	16,748	1,763	1,154	1,150	685	21,500	24,938	9,850	15,088
GRANTS.....	-	12,929	13,619	20,696	2,323	2,694	2,912	3,524	32,150	57,037	-	57,037
(SEC.SUPP.ASSIST.)...	(-)	(348)	(8,853)	(13,056)	(2,221)	(1,982)	(2,183)	(2,199)	(21,642)	(29,815)		
B.FOOD FOR PEACE.....	-	83	6,415	20,451	1,229	1,287	1,436	1,542	25,945	31,657	7,787	23,870
LOANS.....	-	-	2,526	10,843	767	746	843	774	13,974	15,724	7,787	7,937
GRANTS.....	-	83	3,890	9,608	462	541	593	768	11,971	15,933	-	15,933
TITLE I-TOTAL.....	-	-	3,867	13,245	767	746	843	774	16,376	19,466	7,787	11,67[illegible]
REPAY. IN $-LOANS.....	-	-	-	7,265	767	746	843	774	10,396	9,635	3,166	6,4[illegible]
PAY. IN FOR. CURR.....	-	-	3,867	5,980	-	-	-	-	5,980	9,831	4,619	5,21[illegible]
TITLE II-TOTAL.....	-	83	2,549	7,206	462	541	593	768	9,569	12,191	-	12,1[illegible]
E.RELIEF,EC.DEV & WFP.	-	-	754	3,208	143	167	253	297	4,067	4,808	-	4,80[illegible]
VOL.RELIEF AGENCY.....	-	83	1,795	3,998	319	374	340	471	5,502	7,383	-	7,383

* LESS THAN $50,000. TQ - TRANSITIONAL QUARTER (7/1/76 - 9/30/76) @ SEE COMMENTS IN COUNTRY NOTES SECTION
** VALUES IN THESE COLUMNS ARE NET OF DEOBLIGATIONS. SEE GENERAL NOTES-REPORTING CONCEPTS

Source: U.S. Overseas Loans and Grants and Assistance from International Organizations
July 1, 1945 - September 30, 1981

FIGURE 3

PUBLIC LAW 480 FINANCIAL OPERATIONS



U. S. Department of Agriculture

FIGURE 4

COMPARISON OF ADVANTAGES AND DISADVANTAGES OF PROGRAMMING LOCAL CURRENCY PROCEEDS BY AID MISSIONS

IN COUNTRIES WHERE OUR ACTIVE PARTICIPATION IN THE PROGRAMMING OF THE LOCAL CURRENCY PROVED TO BE EFFECTIVE, THE MAJOR REASONS WERE:

- THE READY AVAILABILITY OF LOCAL CURRENCY IN A SPECIAL ACCOUNT SPECIFICALLY EARMARKED FOR DEVELOPMENT PROJECTS (INCLUDING AID PROJECTS) PREVENTED PROJECT IMPLEMENTATION FROM BEING STALLED AS THE RESULT OF RED TAPE, SLOW AND INEFFICIENT TECHNIQUES FOR RELEASING NORMAL BUDGETARY REVENUES, OR LACK OF PROMISED BUDGETARY REVENUES;

- UNDESIRABLE PRESSURES TO DIVERT LOCAL CURRENCY RESOURCES FOR POLITICALLY MOTIVATED "PORK BARREL" PROJECTS, POORLY PLANNED DEVELOPMENT PROJECTS, OR NON-DEVELOPMENT PROJECTS COULD BE RESISTED BY GOVERNMENT OFFICIALS OR DEVELOPMENT-ORIENTED MINISTRIES SIMPLY BY THEIR POINTING OUT THE NECESSITY FOR AID TO CONCUR IN THE USE OF THE RESOURCES;

- THE VOLUME OF THE LOCAL CURRENCY GENERATIONS RELATIVE TO TOTAL DEVELOPMENT RESOURCES WAS RELATIVELY SIGNIFICANT, THEREBY PERMITTING AID TO INFLUENCE RESOURCE ALLOCATION POLICIES; (WHEN THE LOCAL CURRENCY RESOURCES WERE LESS SUBSTANTIAL, AID COULD INFLUENCE ONLY THE CHOICE AND IMPLEMENTATION OF INDIVIDUAL PROJECTS);

- AID PARTICIPATION IN THE PROGRAMMING OF THE LOCAL CURRENCY CONSTITUTED A VEHICLE FOR PROVIDING TECHNICAL ASSISTANCE TO PUBLIC OFFICIALS OF THE RECIPIENT GOVERNMENT AS WELL AS FOR POLICY DIALOGUE, THEREBY HELPING TO MODERNIZE AND UPGRADE PROJECT APPRAISAL AND BUDGETING PROCEDURES AND TO DEAL MORE EFFECTIVELY WITH MACROECONOMIC POLICY AND RESOURCE ALLOCATION ISSUES;

- A SIGNIFICANT FACTION IN THE HOST GOVERNMENT SHARED OUR GOALS FOR THE COUNTRY'S DEVELOPMENT AND THERE WAS AGREEMENT CONCERNING THE BEST APPROACH FOR ACHIEVING THOSE GOALS;

- AID PARTICIPATION IN THE PROGRAMMING OF THE LOCAL CURRENCY WAS NOT VIEWED AS UNJUSTIFIED INTERFERENCE BY FOREIGNERS IN DOMESTIC AFFAIRS.

IN SOME COUNTRIES, ALTHOUGH OUR ACTIVE PARTICIPATION IN THE PROGRAMMING OF LOCAL CURRENCY SEEMED EFFECTIVE, THIS WAS PERHAPS PARTLY BECAUSE OUR PARTICIPATION WAS NOT NEEDED. FOR EXAMPLE, THE HOST COUNTRY ALREADY HAD AN EFFECTIVE PROJECT APPRAISAL, BUDGETING, AND FINANCIAL CONTROL SYSTEM; MET ITS COMMITMENTS TO SUPPORT DEVELOPMENT PROJECTS; AND HAD A GOOD DEVELOPMENT PROGRAM OVERALL.

IN COUNTRIES WHERE OUR PARTICIPATION IN THE PROGRAMMING OF LOCAL CURRENCY HAS PROVED TO BE INEFFECTIVE, THE MAJOR REASONS WERE:

- THE HOST COUNTRY REGARDED AID'S INVOLVEMENT IN PROGRAMMING THEIR LOCAL CURRENCY AS A HIGHLY VISIBLE, UNJUSTIFIED, AND INTOLERABLE INTERFERENCE IN THEIR DOMESTIC AFFAIRS, AND THEY FELT THAT FOREIGN INTERVENTION IN THEIR BUDGET PROCESS SMACKED OF COLONIALISM (ESPECIALLY THOSE COUNTRIES THAT HAD JUST BECOME INDEPENDENT);

- THE ESTABLISHMENT OF A SEPARATE ACCOUNT FOR THE LOCAL CURRENCY, SUBJECT TO SPECIAL RULES, FRUSTRATED THE FINANCE MINISTRY IN CARRYING OUT ITS NORMAL BUDGETARY PROCEDURES;

- THE HOST COUNTRY FEARED THAT AID'S PARTICIPATION IN THE PROGRAMMING OF LOCAL CURRENCY WOULD STIMULATE OTHER DONORS TO FOLLOW THIS PRECEDENT, RESULTING IN CONFLICTING ADVICE AND CONFUSION WITHIN THE GOVERNMENT CONCERNING HOW ITS DEVELOPMENT PRIORITIES SHOULD BE ORDERED;

- THEY FEARED THAT AID'S MOTIVATION MAY BE TO PROMOTE THE COMMERCIAL INTERESTS OF THE U.S. RATHER THAN THE WELFARE OF THEIR COUNTRIES;

- JOINT PROGRAMMING OF THE LOCAL CURRENCY REQUIRED ADDITIONAL AID AND HOST COUNTRY MANPOWER AND MANAGEMENT RESOURCES, WHICH ADDED TO THE ADMINISTRATIVE COSTS OF THE TITLE I PROGRAM BUT DID NOT PRODUCE COMMENSURATE RESULTS;

- IN THE ABSENCE OF NECESSARY MANAGEMENT STAFF, ACTIVITIES FINANCED BY THE LOCAL CURRENCY WERE SOMETIMES UNSUCCESSFUL, AND AID BECAME ASSOCIATED WITH THESE SHORTCOMINGS.

Source: AIDAC/State Cable 187442