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Middle Income Countries

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by

D. Woods Thomas

Professor of Agricultural Economics
Purdue University

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U.S. DEVELOPMENT ASSISTANCE POLICY

- MIDDLE INCOME COUNTRIES -

The direct provision of development assistance to economically more advanced developing countries by the United States has been a matter of controversy for a considerable period of time. This controversy has involved both the legislative and the executive branches of government as well as non-governmental organizations. The matter is complex in the extreme. It is confounded by humanitarian, security, political, strategic, and economic concerns which may be related, but marginally to development, per se.

This paper attempts to analyze some of the issues involved and develop a framework within which the controversy might be resolved and national policy in this respect clarified. Specifically, the paper:

- describes some of the possible impacts of current policy on middle income countries;

- suggests implications of current policy for the attainment of certain U.S. foreign policy objectives as well as performance of the U.S. international leadership role;

- outlines an alternative policy and characteristics of that policy;

- suggests principles for determining the terms and conditions under which development assistance might be provided middle income countries;

- proposes a model for U.S. bilateral development assistance presence in cooperating middle income countries.

Current Policy

The United States has provided and continues to provide development assistance on a bilateral basis over a wide range of developing nations. However, there has evolved through time a dichotomy of developing nations with respect to U.S. bilateral development assistance and the terms thereof. One component of this dichotomy consists of the less developed countries (LDCs). The other consists of developing nations which have achieved some pre-determined level of development yet which have not entered the ranks of the high income, industrialized nations -- the Middle Income Countries (MICs).

This dichotomy is established in part, but not exclusively, on the basis of an arbitrary criterion of per capita income (PCI). The category into which a particular country falls as well as the conditions under which assistance is provided may be influenced by its foreign exchange position, political security, strategic, and other factors.

The use of the PCI as an important determinant of LDC/MIC country dichotomy has several limitations. One is that it is an average income figure. Given the badly skewed income distribution patterns in many of these nations and the relatively low PCI level utilized for differentiating between LDCs and MICs, a large number of poor and significant pockets of abjectly poor exist in many nations which have moved from the LDC to the MIC category. Further, this convention, when applied to external development assistance, implicitly assumes that development is a discrete rather than a continuous function. This assumption has important implications for both donors and recipients of development assistance.

Of particular concern here are the implications associated with U.S. policy vis-a-vis the provision of bilateral development assistance to middle-income countries. For friendly nations falling within the LDC category, it is U.S. policy to provide bilateral economic and technical assistance (within budgetary constraints) on a grant or othr highly concessional basis. It is U.S. policy to terminate bilateral concessional aid when an LDC reaches some predetermined per capita income level and, by definition, becomes a middle-income country.[1]

As a practical matter, this means the termination of most direct U.S. development assistance for many developing countries. These nations must depend for external development assistance on the international or regional development banks, certain international donors, multilateral agencies, the private sector or donor nations which do not follow as restrictive a policy.

Middle-Income Country Implications

This policy may have a number of direct and indirect effects on economic development in the MICs.

First, "graduation" from LDC to MIC status is accompanied by the demise of the development-oriented USAID Mission. This leaves the U.S. without a "development" presence in the country. It obviates the possibility of collaborating on development analysis, strategy formulation and program planning. The traditional agricultural and commercial attaches of U.S. Embassies, given their mandates and specified missions, are not effective substitutes. A vehicle through which the MIC might identify U.S. resources which might contribute to continued development no longer exists.

Second, this policy tends to insulate the MICs from access to an important set of external resources vital to the maintenance of the economic development pace at a critical stage. These resources consist of the scientific, technical, and educational capacities embodied in the U.S. system of higher education and research. The result is that at precisely a stage when

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[1] Implementation of this policy is often conditioned by overriding strategic foreign policy and other considerations. Thus, there are MICs which are AID "graduates" and others which are not.

developing nations are in position to utilize such resources most effectively and efficiently, access to them is restricted.

Third, the demise of a U.S. development assistance mechanism in the middle-income country tends to make difficult the systematic mobilization of U.S. private sector resources to work with MIC private and public organizations in development activities. The MIC has little alternative but to do without, turn to other sources of private sector external assistance or to access those of the United States through circuitous, imperfect routes.

Fourth, some important fraction of the middle-income countries face budgetary, foreign exchange, policy or priority constraints which make it difficult or impossible to pay the full cost of U.S. development assistance.

Fifth, bilateral development assistance programs establish important and effective interdependencies -- intellectual, scientific, economic and political. Termination of bilateral relationships reverses this process and allows many mutually beneficial interdependencies to erode.

Sixth, many of the most productive bilateral development assistance activities are long-term in nature. Termination, even with feasible phase out, often negates the full productivity of such investment.

The net effect of all this, from the viewpoint of the MIC, may be one of lowering the chances of achieving or maintaining an acceptable level of economic development.

Implication for the United States

Current US/MIC bilateral development assistance policy appears to have significant implications for the United States. These can be best understood and evaluated in a foreign policy context.

United States foreign policy concerns itself with a broad array of issues involving both the self interests of the United States and the international leadership role placed upon it by its overwhelming economic, technologicial, scientific, military, and other strengths. In the first instance, U.S. foreign policy concerns itself with factors impinging upon the economic, political, social and physical security and well-being of the nation. In the second instance, U.S. foreign policy must deal with the issues of international leadership in assuring an environment in which similar objectives may be sought and achieved by other nations. This dual role of U.S. foreign policy is complex in the extreme. It has become increasingly so as the interdependencies among nations have grown and expanded.

The commitment of the United States to provide economic and technical assistance to other nations in their struggle to accelerate economic development has been a significant part of U.S. foreign policy since the end of World War II. While the levels, form, and means of providing such assistance have varied through time, it has been and continues to be an important tool of U.S. foreign policy.

Foreign policy initiatives cut across U.S. self interest and world leadership roles. While the dominant objective of foreign development assistance has varied with circumstances through time, these activities have always been grounded in an interrelated multiple objective framework. Among the several objectives, three appear to be of particular relevance to the purposes of this paper.

The National Security Objective of U.S. Foreign Policy

New and old nations which have failed to achieve acceptable rates of economic development, reasonable income levels and distribution patterns, and realistic opportunities for continued economic growth and social progress do not have a propensity to be stable, reliable, or friendly. The corollary is that the U.S. has resources which, properly mobilized, deployed, and utilized, may be highly catalytic in assisting these nations to achieve acceptable levels of economic development. As a result of such measures, these nations may be inclined to be friendly to the United States and supportive of the U.S. role and positions in international affairs. In brief, this is the basis for development assistance as a contributor to the attainment of national security and international leadership objectives.

The Economic Self-Interest Objective of U.S. Foreign Policy

One of the most significant developments during the past four decades has been the sharp and pervasive increase in the economic interdependence of the world's nation states. It is difficult to find a single economic activitiy in any nation the success of which is not importantly dependent upon external economic events.

This is particularly significant to the agricultural and industrial complex of the United States. The long-term vitality of these economic sectors depends importantly upon the growth of effective foreign demand for their products. With the decline in U.S. population expansion, the diminution of much of its natural resource base and the leveling off of real personal income, historically important shifters of the demand function for the products of U.S. farms and factories have weakened. The same phenomena tend to characterize some of the historically important export markets for U.S. goods and services. The single most important potential source of expanded demand for U.S. commodities rests in the expanding populations of the less developed and, particularly, the middle-income countries. Evidence continues to accumulate to support the notion that economically emerging nations constitute significant markets for the U.S. economy.

United States economic self-interest, in this context, is a prime objective of U.S. foreign policy. To the degree that U.S. development assistance can contribute to acceleration of the rate at which improved income levels of people in lesser developed countries permit them to enter world markets, the U.S. economic self-interest will be served. And the middleincome countries are considerably closer to achieving this status than are many of the LDCs!

The Humanitarian Objective of U.S. Foreign Policy

An important value of the American people holds that it is necessary for the United States to help people less fortunate than themselves in times of emergency or in situations of chronic need. This basic value is tempered by pragmatic recognition that it is futile to engage in a worldwide welfare program. Equally, there exists understanding that the only rational, permanent way to satisfy this national objective is by assisting less advantaged nations to place themselves in position to meet the basic needs of their people. And, in this respect, it is highly doubtful if the American people differentiate between the poor, hungry, and disenfranchised of, say, North East Brazil and Niger!

To the degree that current U.S. development assistance policy mitigates against continued economic development of the MICs, the implications for national self-interest foreign policy objectives are straightforward:

1. fullest possible attainment of U.S. national security objectives will be constrained;

2. the demand effects of economic development in this set of important or potentially important export markets on the U.S. economy will be deferred;

3. fulfillment of U.S. humanitarian objectives in a rational, effective and permanent way will be diminished.

The U.S. International Leadership Role

Current policy would appear to hinder U.S. effectiveness in its leadership role in international affairs. The middle-income countries are increasingly vocal, powerful, and persuasive on the international scene. Despite having achieved "middle-income" status, the principal concern of most such nations continues to be economic development. It is most difficult to envision the United States being able to play a completely effective leadership role with this set of nations when it has unilaterally decided to opt out of a bilateral role in the most important game being played!

Other Considerations

This policy also impinges on the well-being of the United States in a variety of other subtle but important ways. One comes about through the diminution of opportunities for young professionals from the MICs to study in the United States. In addition to improving their professional capabilities, international students in U.S. universities tend to develop in-depth understanding of the American people, society, economy, government, institutions, and the nuances of the nation's philosophy and doctrine. Interpersonal linkages formed at this stage are lasting. A majority of these young professionals rise to positions of power, of one sort or another, as they pursue their careers in their home countries. Through time, they can be quite helpful to the United States in a variety of public and private endeavors.

Another comes about through the diminution of opportunities for mutually beneficial interaction between U.S. and MIC public and private institutions, scholars, scientists, students, businessmen, and the like. The United States has much to gain in this quarter; policies which impede such interaction are, at best, questionable.

There appears to be good reason to re-examine, carefully and critically, the U.S. policy position vis-a-vis bilateral development assistance to the middle-income countries. Other policies might serve U.S. global interests better. To this end, one alternative is suggested below.

An Alternative Policy

The United States might well consider the development and implementation of an alternative policy [2] relative to providing development assistance to nations which have ascended partially the development ladder and been declared "middle-income countries" yet which could benefit developmentally from U.S. assistance.

The policy should be sufficiently explicit to serve as a decision-making framework in particular cases, yet be general enough to cover the range of economic and other relevant conditions existing across the spectrum of middle-income countries. The following would seem to be essential components of that policy.

A. The United States will actively seek opportunities to collaborate with MICs in development activities through the provision of services in which the United States has distinct comparative advantage and which:

   1. will contribute, directly or indirectly, to the attainment of the objectives of U.S. foreign policy and the U.S. international leadership role;

   2. will contribute importantly to continued economic development, sustained growth and social progress in the MIC. Particular emphasis will be given to "traditional" economic sectors or subsectors, lagging sectors or subsectors, and to specific phenomena constraining development;

   3. are consistent with or complementary to the objectives of U.S. bilateral development assistance policy and initiatives in the LDCs.

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[2] This may be more of a policy specification, definition, and clarification than a policy reversal.

B. In the public or quasi-public sector, such initiatives may include but not be limited to collaborative activities in science, technology, education, management, and public policy such as:

1. technical and related assistance in strengthening indigenous institutions to provide expanded and improved services in priority areas essential to continued development;

2. collaborative research on problems which are of high priority for development, of mutual interest to the U.S. and the MIC, and/or hold potential benefit for other developing nations;

3. opportunity for MIC personnel to pursue advanced degree programs or specialized training programs in U.S. universities in disciplines critical to accelerated development;

4. joint US/MIC initiatives designed to contribute to accelerated economic development in the LDCs. These initiatives may include but not be limited to:

   a. development of "centers of excellence" for the education and/or training of LDC personnel in the MIC or jointly in the MIC and the U.S.;

   b. collaborative research on problems critical to development in the LDCs;

   c. joint technical assistance initiatives on institution building and other development projects in the LDCs;

   d. systematic modification and transfer of high payoff technology from MICs to LDCs.

5. cooperative analyses of the probable impacts of alternative public policies on MIC development, specifically including interaction effects between such policies and the domestic and international policies of other nations.

C. In the private sector, such initiatives may include but not be limited to development activities such as:

1. technical and managerial assistance by U.S. private businesses in strengthening the capacity, effectiveness, and efficiency of MIC firms and industries essential to accelerated development;

2. opportunities for MIC private sector personnel to pursue technical and managerial training as interns or in other capacities with U.S. firms;

3. cooperative research and development on technology adapted to the economic, technical, cultural, and social conditions of the MIC;

4. collaborative analyses designed to determine the nature and scope of private sector initiatives required to accelerate development of geographic areas or regions and economic sectors or subsectors, including alternative means by which such necessities might be put in place;

5. joint U.S. public/private and MIC public/private development projects in which the expertise of both public and private organizations is required;

6. systematic identification of opportunities for joint US/MIC commercial ventures in areas important to accelerated development.

D. The United States will promulgate this policy and implement activities consistent with the policy in collaboration with interested middle-income countries through the Agency for International Development. In so doing, the Agency will enter into appropriate partnership arrangements with U.S. public and private institutions and organizations as necessary to the fullest possible achievement of the objectives of the policy.

Characteristics of the Alternative Policy

The alternative U.S. development assistance policy for middle-income countries outlined above embodies a series of characteristics which would seem to be of importance in a U.S. foreign policy, bilateral development assistance context. Some of these are:

1. The policy is proactive rather than reactive. This could be helpful in terms of the U.S. leadership role in foreign affairs.

2. The policy suggests that U.S. bilateral inputs will be limited largely to those which tend to be associated with high rates of return, the middle-income countries have difficulty in obtaining from most other sources and the United States has a comparative advantage in providing.

3. US/MIC bilateral activities implemented under this policy will have high degrees of interpersonal and interinstitutional interaction. Lasting, mutually beneficial relationships between the MIC and the U.S. will have an opportunity to develop.

4. The policy would limit activities to those which are strictly developmental in nature and to the most critical economic sectors in the middle-income country. It would provide opportunities to assist in strengthening fundamental development institutions in the MIC. In addition to concentrating on activities having high payoff potential, this policy would provide a clear cut division of labor among U.S. agencies; e.g., AID, the USDA, and the Department of Commerce. It

would permit the latter two agencies to follow their specific mandates to work in the middle-income countries on behalf of U.S. agriculture and U.S. business and industry largely in the more developed and commercial sectors. It would allow AID to follow its specific mandate and apply its considerable expertise to development issues.

5. The policy would exclude the U.S. bilateral effort from the capital transfer business. External capital needs of the middle-income countries would be met by the international or regional development banks and/or the commercial banking community.

6. The U.S. bilateral inputs suggested by this policy would be low budget items. This is critical in view of current and foreseeable budget constraints on development assistance funds.

7. The policy spells out appropriate roles for both the U.S. public and private sectors in bilateral development assistance in the middle income countries. It also suggests a straightforward demarcation between the role of the U.S. private sector in development assistance activities as contrasted to commercial operations in these countries.

8. The policy permits a set of bilateral activities with the MICs which is consistent with the economic development mission and the institutional expertise of the U.S. implementing agency; i.e., the Agency for International Development.

9. The policy is consistent with the global mission of AID and the foreign policy objectives of the United States.

10. Development assistance activities in the middle-income countries implemented under this policy would allow the United States to capitalize on earlier investments in these countries through joint US/MIC development activities in the present set of LDCs.

Terms and Conditions

It will be necessary to establish a mutually acceptable set of terms and conditions under which the United States will provide bilateral development assistance to the MICs. These terms and conditions will determine, in large part, the degree to which the middle-income countries will access and utilize U.S. expertise in the continuation of their development process as well as the degree to which such activities will contribute to the attainment of U.S. foreign policy objectives.

In establishing terms and conditions, several matters will need to be taken into consideration.

First, it would seem important to recognize the duality of the U.S. international role. One component deals specifically with the national security, economic self-interest and humanitarian policy objectives of the United States. The other deals with the global leadership role which the

United States is obliged to play. There may well be differential impacts associated with bilateral initiatives within and between these components.

Second, within the framework of the suggested policy, there exists a broad array of possible bilateral development assistance activities. The incidence of benefits among the United States, the MIC and third countries will differ from activity to activity, and probably in the extreme.

At one extreme are activities the benefits of which will accrue largely to the United States in terms of one or more of its international objectives. For example, assistance in strengthening a "center of excellence" in a middle-income country to serve educational and training requirements of nationals from AID-LDC-client countries would be in the U.S. interest in the short to medium-term even though a significant national educational resource might be established to the long run benefit of the cooperating middle-income country.

At the other extreme are interventions the benefits of which, in the short to medium-term, will accrue largely to the middle-income country even though longer-term benefits might accrue to the U.S. private sector. For example, the U.S. private sector might provide technical or managerial assistance to a MIC in developing a particular firm or industry. Initially, the primary beneficiary will be the middle-income country. In the longer-term, opportunities for commercial participation by the U.S. private sector could evolve. The multiplier impact of increased income levels on U.S. exports can be significant. Between these extremes, given the rich array of possible bilateral development initiatives, all possible permutations of the incidence of benefits exist.

Third, in establishing terms and conditions, the MICs' "ability to pay" for development assistance from the United States must be taken into account. This will vary from MIC to MIC in accord not only with its internal stage of development and fiscal resource situation but also with its foreign exchange position. As recently demonstrated, the latter may vacillate widely as a result of both internal conditions and externalities.

It is difficult to avoid the conclusion that there is no simple formula for the allocation of costs among the United States, cooperating middleincome countries and other beneficiaries. Terms and conditions will need to be "tailored" not only country by country but also assistance activity by activity.

This will be a difficult task; however, it is possible. To do so, it will be necessary to develop relevant decision-making, cost-sharing principles and, based on these principles, develop guidelines applicable to particular middle-income countries and types of bilateral development assistance.

Cost-Sharing Principles

US/MIC bilateral development assistance activities will result in direct and indirect benefits to both the U.S. and the MIC recipient. Incidence of benefits will vary with the type of activity. Generally, benefits to the U.S. will be associated with contributions of the activity to attainment of its specific and general foreign policy objectives. Benefits to the MIC will be associated with contributions of the activity to the attainment of its development objectives. It follows that a cost-sharing arrangement between the U.S. and the MIC is called for.

General principles upon which case-by-case determination of the U.S. and the MIC cost shares might look like:

1. The United States will pay a share of the total cost of a development assistance project consistent with the estimated contribution of the activity to the attainment of:

    a. U.S. self-interest foreign policy objectives;

    b. U.S. world leadership objectives.

2. The MIC will pay a share of the total cost of a development assistance project consistent with the estimated contributions of the activity to the attainment of its economic development objectives.

3. The Unites States may pay its share of the costs of an activity either through a grant of funds or through a concessional loan under terms which make the present (life-of-the-project) value of loan funds approximately equal to the U.S. cost share.

4. The United States may agree to assume a share of project costs greater than that attributable to the incidence of benefits to the U.S. under extenuating circumstances including but not limited to:

    a. foreign exchange constraints in the MIC;

    b. internal budgetary constraints in the MIC;

    c. benefits of the US/MIC development activity attributable to U.S. development assistance activities in LDCs;

    d. political exigencies.

5. Certain of the activities implemented under this policy may result in benefits to the non-foreign-policy objectives of the participating U.S. institution or to the non-development objectives of the collaborating MIC institution. Collaborative research on some problems of mutual interest may be a case in point. In such cases, the collaborating U.S. and/or MIC institutions may be expectd to share an appropriate part of project costs.

The U.S. Development Assistance Presence

Th effective implementation of a policy such as that suggested in this paper will require a U.S. development assistance presence in each middle-income country or in some manageable combination of smaller countries. Without some such "mechanism" to serve as a focal point for the bilateral development assistance activities envisioned, it is not likely that much will happen.

The traditional USAID Mission has been dismantled in AID-graduate countries; it has never existed in other similar countries. While this model serves well in most LDCs, it appears to be inappropriate for a U.S. bilateral development assistance program in middle-income countries. It would be costly, unnecessary and, in some cases, unacceptable.

The functions essential to the successful implementation of the proposed policy might be performed well by a binational in-country office. This might be identified as the US/MIC Binational Development Institute (BDI). The BDI would be small and low profile. It might be structured and operate something like the country offices of some of the major U.S. foundations.

In some cases it would be most effective if the BDI were binationally quasi-governmental although functional ties to the respective governmental entities would be essential. The Institute would be "permanent." It would be staffed with professionals from both the U.S. and the host MIC. Binational leadership through a co-directorship would appear to be desirable. Composition of the Institute leadership and support staff, in terms of professional areas of competence and public sector/private sector orientation, would vary from MIC to MIC in accord with the nature of potential bilateral development assistance activities.

The Institute would serve several functions. It would be the primary point of contact for public and private MIC institutions interested in the possibility of collaborative development activities with the United States. It would serve as the principal liaison point between the United States (through the U.S. Embassy and AID) and the multiplicity of internal and external organizations interested in or involved in economic development activities in the country. The Institute would be the primary channel for communications and "feed in" to AID/Washington. Through existing AID mechanism (e.g., Regional Bureaus, S&T, BIFAD, and others), programs would be funded and appropriate U.S. institutional expertise mobilized for collaborative work with the MIC.

The Institute would need to have an analytical capacity capable of sorting out areas in which joint economic development ventures would be possible, desirable, and productive. The Institute would identify resources (U.S., MIC, and other donors) which might be drawn upon in support of particular bilateral activities. The Institute would be responsible for developing specific recommendations, activity-by-activity, on cost sharing arrangements in accord with principles and guidelines adopted. It would also participate in planning joint development activities with host institutions.

The Institute would also have the responsibility of structuring, mobilizing, coordinating, and utilizing the joint commissions suggested below.

The work of the Binational Development Institute might be effectively supported with one or more joint commissions. Conceptually, a joint commission would consist of a small number of U.S. and host country professionals who would be highly knowledgeable about the development requirements of particular sectors or problem areas of the MIC. A joint commission would meet regularly, perhaps once or twice a year. Within its area of expertise and concern, a joint commission would review ongoing activities, recommend to the Institute (and therefore to AID) as well as involved host country institutions, on new bilateral initiatives being considered, identify high priority areas in which bilateral development assistance ought be considered, and assist the Institute in establishing priorities and similar functions.

Properly structured, "seats" on joint commisions would be highly attractive to professional leadership in both the public and private sectors. With sufficient prestige and authority embodied in appointments to joint commissions, a great deal of talent could be engaged.