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MEMORANDUM ON THE COOLEY LOAN PROGRAM
ADMINISTERED BY THE AGENCY FOR INTERNATIONAL DEVELOPMENT

I. Origin, Purposes and Administration

The Cooley loan program was established by an amendment in 1957 of Section 104(e) of the Agricultural Trade Development and Assistance Act of 1954 (P. L. 480) sponsored by Representative Harold D. Cooley, N. C. The purpose of the program is broadly to promote "balanced economic development and trade among nations" through loans "mutually agreeable" to the administering agency and the foreign country whose currency is involved. The statute permits loans to U. S. firms for "business development and trade expansion" in such countries. Loans to foreign as well as U. S. firms may be made "for the establishment of facilities for aiding in the utilization, distribution, or otherwise increasing the consumption of, and markets for U. S. agricultural products." Loans for the production of commodities which might compete with U. S. products are prohibited. The statute permits but does not require repayment in foreign currencies.

Administration of the program was originally assigned to the Export-Import Bank. This function was transferred to AID by the President pursuant to the Act for International Development of 1961, and AID administration of the program commenced on January 1, 1962.

General programs for Cooley loan activity are prepared by AID, in the light of the projected needs for capital, attitudes toward U. S. private investment, and the availability of local venture capital in countries where local currencies are available for this use. Within these general programs, flexibility is maintained to permit AID to consider loan requests as received.

II. Source of Cooley Loan Funds

Funds for the Cooley loan program are derived under agreements for the sale of agricultural commodities pursuant to Title I of P. L. 480. Since sales for local currencies are not to interfere with ordinary marketing or displace commercial sales, P. L. 480 has been confined generally to the less-developed countries. Agreements are negotiated providing for some fixed portion of the sales proceeds for financing "country uses," of which a portion is earmarked for Cooley loans. The portion of proceeds not reserved for country uses is reserved for "U. S. uses." The percentages vary depending on the situation in particular countries. Until recently

allocation of funds for the Cooley program was limited to a maximum of 25 percent of the sales proceeds under individual agreements. This limitation was removed from the statute, which now permits "maximum usable" amounts to be allocated. No agreements have as yet been concluded, however, providing for more than 25 percent.

Funds not committed for loans within three years are normally available for any use under Section 104 of P. L. 480 and under current policy are transferred to Treasury sales accounts when needed for current expenditures. The same disposition is made of receipts of interest and amortization payments; i.e., the funds do not automatically revert to the Cooley loan program, but they could be so applied by administrative decision. On occasion, allocations of local currencies received as repayment on loans extended under other sections of P. L. 480 have been specifically made to the Cooley program.

III. Current Cooley Loan Policies

A. Eligible Recipients and Purposes

1. Affiliation with a U. S. firm will not be held to be established unless the U. S. firm owns at least 20 percent of the applicant's voting stock -- a higher percentage may be necessary in some cases -- and has other commercial and operating ties to the applicant. Affiliation must, moreover, be established with respect to a single U. S. firm.

2. Loans may be made for financing working capital (except in countries where the local government does not permit this). (See Para III B4 below)

3. The loan funds must be used in the borrower's business within the country in question.

4. Loans are ordinarily not made to refinance existing loans or, except in special cases, to acquire equity interest in other enterprises.

B. Terms

1. Maturities are established in accordance with the nature of the project being financed and the applicant's projected cash flow. Grace periods are permitted on payments of principal, but not on interest, until the facilities become productive; arrangements may be made for acceleration of repayment if profitability exceeds expectations.

2. Interest rates are established for each country comparable to the basic rate charged by local development lending institutions, or,

where such institutions do not exist, based on the existing rate structure for similar projects. Interest rates currently applied are listed in Annex 1. They have been established after experience and negotiation with the individual foreign countries. In general, rates tend to be more favorable than those for long-term financing available locally. Constant review is necessary, and AID is alert to factors which might call into question the appropriateness of current rates. Historical precedent is not an overriding consideration in the perpetuation of a particular rate in any country. The most important limiting factors are the attitude of the foreign government, the potentially adverse effects of providing funds at rates lower than the cost of credit to local competing firms, and the danger of fostering uneconomic enterprises through financing at subsidized terms. Within these limitations, rates should be as low as possible to encourage borrowers. Rates higher than comparable dollar loans from U. S. banks can, however, be justified in view of the absence of a maintenance of value requirement on Cocley loans. Interest rates lower than generally applicable to Cooley loans within a given country would be provided in connection with loans to overseas U. S. banks for relending. The lower rates take into account the banks' service in administering the sub-loans and permit the banks to relend the funds at the current Cooley loan interest rate applicable in the specific countries.

3. Repayment of principal and payment of interest are normally in the currencies lent without maintenance of value provision.

4. In its experience in administering the Cooley loan program, AID has found that working capital funds are often available in ample supply from local commercial banks and that there has been no need to provide such funds through Cooley loans -- especially where adequate long-term capital is lacking. Furthermore, extending loans for working capital financing in such countries would place AID in direct competition with local commercial banks. Some working capital loans have been made, in cases in which for one special reason or another such credit could not be obtained from local banks. In addition, in one case -- in Turkey -- AID has extended a Cooley loan to a U. S. joint venture banking arrangement for relending. Similar loans may be made in other countries. The interest rates would be lower than the prevailing Cooley rates in order to permit the banks to relend at prevailing local rates; AID would intend, however, that sub-loans be at terms of at least three years to avoid competing with local banks. The sub-loans could be made to local as well as U. S. business enterprises, for working capital as well as other purposes. AID does not believe it would be desirable or feasible to limit sub-loans to U. S. firms.

AID does not propose to operate in competition with local banks when in its judgment adequate local financing is available to U. S. enterprises. This judgment often involves the question of the appropriate interest rate, and, as discussed above AID does not believe that Cooley loans should carry rates out of line with local sources of financing. Credit is always available at a price, however, and the extent to which AID would be in competition

with local lending institutions in providing financing at any term depends upon judgment in each case.

C. Procedures

1. Applicants may submit applications to AID/Washington or to overseas Missions. Negotiation and execution of loan agreements may also be conducted either in Washington or, by specific delegation of authority, by the Mission. Both the Washington office and the Mission receive copies of all applications.

2. Both the Washington office and the Mission review and appraise each application.

3. The type of information called for in the application is set forth in Annex 2.

4. After approval, the loan is submitted:

(a) to the NAC for review, and

(b) to the foreign government for a formal statement of no objection. P. L. 480 sales agreements provide for a 60-day period for this clearance.

D. Priorities

When available funds are not sufficient to meet both working capital and capital investment needs, AID tends to give greater priority to capital investment. Capital investment operations usually require longer terms, and long-term capital for investment tends to be much more scarce than short-term credit. In some countries, e.g., India, loans for working capital will not be approved by the government.

IV. The Balance of Payments Effects of Cooley Loans

Receipts of local currency in payment for commodities delivered under P. L. 480 do not affect the level of U. S. monetary reserve assets or liquid liabilities, and such deliveries are therefore comparable from the balance of payments view with commercial exports extended on credit. The credit period is effectively terminated only when P. L. 480 currencies are sold by the Treasury for dollars. The use of the local currencies in the interim for other purposes is neutral in its effect on the balance of payments. Cooley loans can, therefore, by replacing transactions which do reduce the U. S. net reserve position, make a positive balance of payments contribution. Cooley loans may also relieve some of the pressure on U. S.

parent companies that would otherwise have to draw upon other credit sources. For overseas U. S. firms these funds may take the place of dollar financing from the United States.

V. Applications and Rejections

Through speeches, press releases and its publication, AIDS TO BUSINESS (OVERSEAS INVESTMENT), A.I.D. informs potential U. S. investors about the Cooley loan program generally and about availabilities in the various countries. A large volume of preliminary inquiries is received, relatively few of which lead to formal applications. In many cases this is because of lack of availability of funds. For example, in Latin America, applications can be accepted at the present time only for projects in Bolivia and Paraguay although the demand for local currency financing throughout the area is intense.

Many of the applications received do not contain sufficient information to permit A.I.D. to form a judgment as to the soundness of the project and whether it meets the statutory and administrative criteria. In these cases, A.I.D.'s requests for further information often lead to exchanges of correspondence and discussions which can extend for a number of months. Frequently, applications are in effect withdrawn due to the applicant's realization that he will not be able to satisfy the criteria. Very few applications have ever been formally rejected - only one in the Near East and South Asia region in the last 12 months - but many never become perfected applications due to the inability of the applicant to provide necessary substantiating material.

The most common reasons why initial applications do not mature into loan authorizations are as follows:

Africa

- Funds have not been available in the areas which attract the greatest U. S. investor interest, i.e. Nigeria and East Africa.

- Excessive delays in host government approval of projects leading to cancellation of projects.

- Badly conceived projects with no showing of economic, financial or technical feasibility.

- Cooley funds conceived of by the applicant as a substitute for his investment rather than as a supplement to it.

At the present time there is a marked increase in applications, particularly in Morocco and Tunisia.

Far East

- Insufficient funds to meet demand.
- Unsound financial structure of the projects.
- The enterprise plans to make substantial exports to the U. S.

Latin America

- Insufficient funds to meet demand.
- Insufficient U. S. equity in the local company.
- Applicant intends to convert local currency funds to meet foreign exchange costs of the project.
- Low priority industry (for example, an office building in Colombia where availabilities have been very low).

Near East and South Asia

- Unsound capital structure (typically an unacceptable debt-equity ratio).
- Insufficient U. S. equity in the local company.
- Loan to be used for working capital (applies to India, in particular, where the government will not approve loans for this purpose).
- Lack of necessary host government approval.
- Resources or experience of the applicant insufficient to give reasonable prospects of success for the project.

VI. Favorable and Adverse Comment

The most frequent criticism of the program is that funds are not available in sufficient quantities to meet demand in a number of countries. Where adequate funds are available, as for example in India and Pakistan, the program is widely used by American investors. A very large percentage of new U. S. investment projects in these two countries receive partial financing through Cooley loans. In Latin America, however, the demand for local currency financing far exceeds the availabilities.

A.I.D. does not, of course, have extensive control of the availability of Cooley funds, in that they are generated as an incident to P. L. 480,

Title I sales. Assuming a Title I sales agreement is to be negotiated, the percentage set aside for Cooley lending is not in itself completely within A.I.D.'s control, in that the host country must agree on the percentage and, perhaps more importantly, anticipated U. S. Government uses make a large claim on the total counterpart to be generated.

Nevertheless, when funds are available to meet demand, the program is much appreciated by U. S. investors and is a valuable part of A.I.D.'s programs to encourage U. S. investment in the less developed countries.

The second most commonly voiced criticism is undue delay in processing an application through authorization, negotiation of a loan agreement and disbursement of the funds. In some cases, this criticism is justified, particularly in those regions where there are large availabilities, high demand but limited numbers of A.I.D. personnel to review and process the applications. In many cases the delays are attributable to the length of time that it takes the applicant to supply the necessary supplemental information. A.I.D. constantly endeavors to improve its procedures and expedite the processing of applications to be as responsive as possible to legitimate needs of U. S. investors.

A third criticism sometimes voiced is that interest rates are too high. The cost of money tends to be high in less developed countries and, therefore, by domestic U. S. standards, Cooley loan rates seem high. However, it is important that the Cooley program not cause political difficulties to the U. S. by giving rise to charges that American businessmen are subsidized on terms more favorable than local businessmen can obtain. In addition, economically viable projects should be able to exist in competition with local business without enjoying subsidized interest rates.

A fourth criticism is that AID has unjustifiably refused to make Cooley loans for working capital purposes. In some countries, such as India, the host government will not approve loans for this purpose. In others, such as Turkey and a number of countries in Latin America, availabilities are so low in relation to demand that the agency has given a higher priority to capital asset financing, the most difficult to obtain.

VII. Benefits of the Program

Despite the fact that Cooley loans, unlike dollar loans, are often made without security and without guaranty the record of the program is good. Although A.I.D. makes these loans in projects involving substantially greater risks than commercial lenders are willing to assume the loss record compares very favorably with that of U. S. commercial loan sources.

The program has brought substantial benefits to the host countries and has helped to meet the objectives of our foreign economic assistance program.

New productive industries have been established. In many cases these would not have gone forward without this source of supplemental financing. The export of U. S. private capital and technical and managerial skills has been encouraged. Private enterprise development in the host countries has been strengthened.

In addition, the program has produced other benefits for the U. S. The branches, subsidiaries, and affiliates of American firms which have been assisted generate substantial dollar reflows of fees, royalties, interest and dividends. Exports of U. S. capital goods, components and raw materials have been expanded. Finally, the creation of effective working relationships between U. S. investors and local businessmen in the less developed countries is itself an important political plus value.

VIII. Over-all Evaluation

The Cooley loan program has, on balance, been highly successful. However, the program is subject to inherent constraints. The most significant limiting factor is that availabilities of funds can seldom be generated to respond to expressed demand. Those countries with the largest unused availabilities (usually representing only 5% of the Title I sales proceeds) are countries where the investment climate does not attract U. S. private investment. On the other hand those countries where the investment climate is good and is improving because of flourishing private economic development are likely to be countries where Title I sales agreements are not, or soon will no longer be, appropriate.

Thus, in some countries, the Cooley loan program can and does make a major contribution to furthering increased U. S. private investment, thereby serving a wide range of U. S. national interests. Nevertheless, the constraints on the program are such that it cannot be viewed as a generally applicable solution to the problem of providing local currency financing for sound private projects at reasonable rates.