

TESTIMONY OF  
M. PETER MCPHERSON  
ADMINISTRATOR  
AGENCY FOR INTERNATIONAL DEVELOPMENT  
BEFORE THE  
SUBCOMMITTEE ON TRADE, PRODUCTIVITY  
AND ECONOMIC GROWTH  
OF THE  
JOINT ECONOMIC COMMITTEE

October 19, 1981

1

Mr. Chairman, I greatly appreciate this opportunity to address the subject of these hearings: "Aid and Private Sector: Can they work together?"

This Administration believes that A.I.D. and the private sector can and must work together in order to generate the kind of long-term development in the less-developed countries that results in strong and sustained economic growth and human progress.

President Reagan outlined U.S. trade and investment initiatives before the World Affairs Council of Philadelphia last week. These initiatives are designed to generate development and growth in the Third World through the force of what the President earlier called "the magic of the marketplace." These initiatives are significant because the less-developed countries now, more than ever, understand the benefits inherent in a strong and viable market economy and the need to expand employment opportunities through a vigorous competitive private sector.

Creation of the Bureau for Private Enterprise in the Agency for International Development, headed by an Assistant Administrator, Elise du Pont, is structural evidence of the new policy direction we have begun to implement. Less emphasis

will be placed on transfer of funds, of taxpayer's dollars. Greater emphasis will be placed on the transfer of those things that generate resources -- the technology, skills, knowhow and capital of the U.S. private sector.

A.I.D.'s mandate under the Foreign Assistance Act encourages private sector activity. Our new emphasis seeks a partnership of government and the private sector in the total development process -- not just involvement at the implementation stage. One important element in A.I.D.'s policy is to encourage recipient countries to pursue sound economic policies. These self-help measures might include, for example, pursuing realistic exchange rates, increasing aggregate private investment, developing intermediary financial markets, encouraging fiscally productive taxes, expanding technical training and the like. I will look to the Bureau for Private Enterprise to formulate and coordinate private sector policy within A.I.D.

It is our goal to establish a relationship between the U.S. private sector and private sectors in the developing countries. That is the best approach, in our view, for technology transfer, employment generation and the generation of resources. Economic development in most Third World countries, in fact, hinges on the vigorous interaction between local and foreign private sectors.

Before proceeding further, Mr. Chairman, I would like to stress that while today's presentation focuses totally on A.I.D.'s involvement with the private sector, A.I.D. most certainly has a continued commitment to furthering development by supporting such other key sectors as health, education and agriculture.

I. Bureau for Private Enterprise

It is important, Mr. Chairman, that I take a few minutes to describe the structure and responsibilities of this new Bureau. In order to achieve the objective of facilitating private sector involvement in the developing world, we believed that it was necessary to create a special structure which would not only visibly symbolize our commitment to private enterprise, but which would also, and more importantly, ensure that A.I.D. developed and implemented new programs and policies.

The Bureau consists of two divisions: One houses the two organizations which have played a key role in A.I.D.'s past involvement with the U.S. private sector, namely, the Office of Business Liaison and the Housing Investment Guaranties Office. Through this division we have the benefit of A.I.D.'s past involvement with the private sector.

The other Division consists of two new units, the Office of Investment and Office of Policy and Project Review and Mission Support. These Offices will be staffed by outstanding professionals. We are now in the process of bringing into A.I.D. a small team of people who are skilled in such fields as investment and capital market formation. In many ways, they and the programs and policies which they will implement represent a

prototype for an A.I.D. of the future -- an A.I.D. which will rely increasingly on leveraging relatively small amounts of public sector funds to attract greater amounts of private sector resources to accomplish goals which in the past have fallen to too great an extent on the shoulders of the taxpayer. Moreover, this Bureau will also use more creatively A.I.D. project funds to help support projects developed by both indigenous and U.S. private sectors. The Bureau will work closely with private sector liaisons designated in each of the other bureaus.

Finally, the Bureau for Private Enterprise will have the lead responsibility for coordinating and relating to the activities of two other agencies which fall within my purview, namely, the Trade and Development Program, which reports to me in my capacity as Acting Director of the International Development Cooperation Agency (I.D.C.A.), and the Overseas Private Investment Corporation (O.P.I.C.) of which I am the Chairman of the Board. The Bureau for Private Enterprise will also be responsible for coordinating with the aid activities of the International Finance Corporation (I.F.C.). Mr. Nalen, President of O.P.I.C. will also be testifying today on O.P.I.C.'s role in fostering trade and investment.

Trade and Development Program (T.D.P.)

The T.D.P. is unique and therefore requires further elaboration. This program plays a special role in fostering

the development of countries while also promoting trade opportunities for the U.S. The Fiscal Year 1982 budget of the program under the Continuing Resolution is \$4 million. Although this is relatively small, particularly in comparison with similar programs carried out by our major competitors, such as Japan, France, and Germany, the program has a tremendous multiplier effect for U.S. exports.

Essentially, the program seeks to tie U.S. firms into large-scale projects which will be financed by developing countries. Since many of the projects T.D.P. is interested in run into hundreds of millions of dollars, the export potential for the United States is very high. The Trade and Development Program is thus an ideal way in which to foster a mutually beneficial relationship between the U.S. and the developing world. The following, Mr. Chairman, are some of the main approaches which the Reagan Administration plans to take to facilitating U.S. trade through the T.D.P.

-- First, T.D.P. funds will be made available at the most critical stage in the planning process of a development project -- namely, at the point where U.S. firms are in the final stages of the bidding process for feasibility studies for large-scale projects. For example, we plan to replicate a major success T.D.P. achieved early this year in the Philippines. It was brought to our attention that several countries had offered to

conduct, free of charge, a feasibility study for a major steel mill which the Government of the Philippines planned to construct. T.D.P. learned that several U.S. firms were competing for this study and concluded that, given the offer of other nations to conduct the study free, a U.S. firm would most probably not win the bid for the feasibility study. We in turn offered a grant of \$300,000 to the Government of the Philippines to cost-share on the study if a U.S. firm would be awarded the feasibility study contract. The Philippine Government agreed and U.S. Steel was awarded not only the T.D.P.-financed \$300,000 contract but also an additional \$4.8 million contract from the Government of the Philippines.

-- Second, we will concentrate increasingly on the coal and alternate energy sectors. Developing nations desperately need to move away from oil-based energy sources to other sources of energy. Both the U.S. government and the private sector have devoted huge sums of money to develop new energy technologies with the result that the U.S. is highly competitive in these areas. T.D.P. is very active in marrying the needs of the developing nations with available U.S. technology and the U.S. firms which can supply it. Moreover, by helping a nation to convert its power base from oil to energy sources such as coal -- as T.D.P. is now doing in Jamaica -- we also help open export markets for U.S. coal.

-- Third, we will attempt to use T.D.P. to facilitate access to natural resources of interest to the U.S. Section 661 of the Foreign Assistance Act, which authorizes funds for T.D.P., specifically encourages the use of T.D.P. funds in this area. In light of our nation's reliance on developing nations for minerals and metals of strategic importance to the U.S., we are reviewing with the U.S. Geological Survey, the Bureau of Mines and other concerned agencies how a portion of T.D.P.'s budget might be used to help nations develop the resources we badly need.

## II. Private Sector Approach

I would now like to address our strategy for furthering trade and investment to be carried out by the new Bureau for Private Enterprise.

Recognizing that limited A.I.D. funds require a targeted approach, the Bureau for Private Enterprise, working with A.I.D.'s regional bureaus and missions abroad, has selected several countries to receive initial attention -- Indonesia, Sri Lanka, Thailand and Pakistan in Asia, Ivory Coast, Kenya and Zimbabwe in Africa, Jamaica and Costa Rica in this hemisphere, and Egypt in the Middle East.

Criteria for selection included whether the targeted country had a private sector that was recognized and supported by the host government, whether it was strategically and commercially important to the United States, and whether the U.S. already had a presence there in the form of an A.I.D. mission.

For each country we expect to target a portion of 1982 or 1983 funds for private sector-related activities; this target will fall within the existing A.I.D. overall country budget. As to the specific amounts, we are now in the process of consulting with the House and Senate Appropriations Subcommittees on Foreign Operations, the Senate Foreign Relations Committee and the House Foreign Affairs Committee. This is not merely ratification but an exchange of views and no numbers can be given

until consultation is completed. As to the internal A.I.D. mechanism for approving the projects the project concept will be jointly agreed upon by the A.I.D. country mission and the Bureau for Private Enterprise.

On Wednesday, the first of seven reconnaissance missions, headed by an A.I.D. official, but including business representatives and financial and investment experts, will leave for Indonesia to explore investment and other development opportunities. The team will include George M. Ferris, Jr., President and Chief Executive Officer, Ferris & Company, Washington, D.C.; Dr. Joel Goldhar, a prominent Washington consultant on business strategies; Mr. Ron Katz, an Indonesian-speaking lawyer and Rhodes Scholar with a San Francisco law firm; and Mr. Leonard H. Jordan, a well-known agribusiness specialist. Their findings will determine exactly what A.I.D. may be able to do to stimulate private sector activity in that important nation.

Missions are also scheduled to go to Kenya, Sri Lanka, and Thailand before the end of the year. A.I.D. will also be represented on O.P.I.C. missions scheduled for Jamaica and Zimbabwe between now and February 1982.

The purpose of the private sector reconnaissance missions will be threefold: to determine, one, whether the country has an active and innovative private sector which wishes to expand or diversity investments in job-creating enterprises; two, whether the government has created the climate and infrastructure in terms of policies, procedures and financial markets to

support expanded private sector investments; and, three, what are key opportunities, ideas or proposals for private sector investments that are developmentally oriented and where A.I.D. in some way could facilitate the investment being made. In this latter case, we see a very important role for U.S. private sector involvement, either as a joint partner, or as a source of technology, marketing and managerial skills or other mutually advantageous arrangements.

These missions will be assisted by ad hoc advisers primarily from the private sector, in thinking through both the opportunities and the problems of assisting the targeted countries in private sector development. A.I.D. will then suggest to the government and to the A.I.D. mission how we, or the U.S. private sector, might be of assistance, either through advisory services in the policy area, capital market development, or in training to facilitate private sector development in that country. A.I.D. will also suggest what we perceive as good developmentally oriented private sector opportunities.

The Bureau will be working closely with O.P.I.C. which has considerable experience in identifying investment opportunities. However, unlike O.P.I.C., we will engage in actually devoting U.S. financial resources now managed by A.I.D. to help further U.S. and indigenous private sector involvement in the development process.

A.I.D.'s subsequent role in developing these opportunities further may be no more than bringing the parties together or

financing some preliminary marketing or pre-feasibility studies that would clarify the investment opportunity. I want to stress that A.I.D. will take a more active role in assessing the various constraints affecting the success of a particular project and will suggest to the potential investors how they and we might put the various pieces together to make it a good investment.

In so doing, we will also examine host country policy affecting the investment and, where necessary, make appropriate recommendations to the host country so as to facilitate the investment.

We could envision A.I.D. in some cases making a financial contribution to particular developmentally oriented projects, either through financial intermediaries that we would support, or more directly. If training or small infrastructure investments were particularly important in generating a significant amount of new private sector investment, e.g., processing and marketing agricultural produce, A.I.D. might become involved in financing more traditional A.I.D. programs to meet that need. We envision some projects, when fully developed, being managed primarily by the private investors but with A.I.D. oversight. I believe there are many cases in the developing world where the U.S. investor in particular would feel more comfortable in terms of assessing his risks and making an investment decision if the U.S. government had an involvement in the project in

some way. Depending on the circumstances, A.I.D.'s role might be as a facilitator. In others, we might be a co-financer with a private bank, the International Finance Corporation (I.F.C.), the World Bank or other multilateral or bilateral and donor agencies.

An illustrative project we might package and finance is as follows: A developing country desires to export packaged or processed vegetables, rather than fresh vegetables, to a neighboring high-income country. Productivity per hectare is relatively low by international standards; use of water per irrigated hectare is high. However, agriculture pricing policy provides the right market signals to the farmer and labor costs in the country compared with alternative suppliers of similar products are low. What the country lacks is packaging, processing, and export marketing know-how. The entrepreneur in the developing country has money and managerial talent but lacks knowledge of cost accounting, training of labor in the vegetable processing field and marketing. This is an opportunity for A.I.D. to help put the project together combining new production, marketing and training technology which the U.S. can offer with indigenous resources of land, labor and entrepreneurial talent.

An American partner in this project may offer the technology for higher-yield production of vegetables for the export market -- seed, irrigation, plant protection -- which

would be offered to private farmers to produce on contract to the processing plant. A guaranteed quantity and price before planting would reduce the farmer's risk and be an incentive for him to use the new technology offered. The American partner may also make an equity investment in the processing plant, provide cost accounting and training advice and perhaps undertake the marketing of the processed product either as a joint partner or on contract. A.I.D. may be involved directly or through an intermediate institution in putting the project together, doing studies, providing credit for the farmers, financing pilot demonstration plots on new technology or more efficient use of water, or take a financial position in the processing plant for the first few years to get the project going and arrange for training.

I should note, Mr. Chairman, that this method should be of particular interest to you as it has been used in this country to revolutionize the broiler industry -- an industry with which you have considerable familiarity. Moreover, Campbell Soup and Heinz have used this approach quite successfully in their respective industries.

Let me turn now to the work we are doing with the International Finance Corporation. The Bureau for Private Enterprise is developing a close working relationship with the International Finance Corporation (I.F.C.), the World Bank arm

that promotes private enterprise projects in developing nations, where we find a common purpose. The Bureau will work with the I.F.C. on capital market development and job-creating investment in the targeted countries. In the action program enunciated by President Reagan last week was this reference:

"We seek to increase co-financing and other private financing with the multilateral development banks. We want to enhance the International Finance Corporation activities -- which fosters private sector debt and equity financing of investments in the developing countries. Its program is increasing in both size and diversity and the bulk of I.F.C. projects are privately financed in the developing countries from domestic and external sources."

The Bureau will also manage a program to seek out and respond to particularly attractive developmentally oriented private sector opportunities outside the framework of the specific country allocations. Agribusiness, training, co-financing with development banks or venture capital organizations and the I.F.C. will be a particular focus. The Bureau will also have the responsibility for managing the International Executive Service Corps(I.E.S.C.) centrally funded project.

As I'm sure you are aware, this private and voluntary organization, comprised of retired executives, plays an important

role in augmenting A.I.D.'s manpower. We are honored that they are a part of this team effort. We are also reviewing other centrally funded projects which we may move to the new Bureau as appropriate.

In developing its program, the Bureau for Private Enterprise will benefit from the advice of a Private Sector Advisory Council, drawn from all segments of the private sector, which is now being formed.

### III. New Approaches

In addition to the work to be undertaken by the new Bureau for Private Enterprise and the ongoing A.I.D. projects, we also plan to take the following steps:

-- Expand A.I.D.'s Trade and Development Program efforts to conduct feasibility studies and other planning services for development projects. Missions will also expand their funding of studies to identify and encourage private sector development and U.S. exports;

-- Establish significant co-financing programs for development projects with private commercial banks and venture capital firms, both U.S. and LDC-based. I would like to stress, Mr. Chairman, that in referring to co-financing, we are not talking about mixed credits for export promotion in the context of the activities of the Export-Import Bank; the matter of mixed credits is now under review by the Administration. Rather, in referring to co-financing, we are talking in terms of joint ventures to stimulate private investment in productive enterprises. The World Bank and most bilateral aid agencies have also found that co-financing, whether in the form of parallel or joint financing, is an important means of drawing private debt capital into development projects. By "blending" concessional funds with private credits, two principal benefits are realized: (1) scarce appropriated funds are "stretched" or "leveraged" and (2) private funds are channeled toward

developmentally sound projects or transactions. On an ad hoc basis, A.I.D. in the past has co-financed projects with other bilateral and multilateral development agencies. We intend now to develop a program to encourage co-financing with private capital.

-- Expand support of intermediate credit institutions, such as local private development banks, to provide capital to developing country private sector enterprises. For example, we are working with the private sector to establish a privately owned development bank in the Eastern Caribbean.

-- Increase support for managerial and technical training oriented to the private sector.

-- Work in close cooperation with appropriate institutions in providing advisory services to developing countries in the following areas: a) capital market development; b) investment policy; c) industrial and agribusiness policy.

-- Stimulate private investment through development of investment opportunities in conjunction with O.P.I.C. guarantees and Export-Import Bank credits. We would envision a limited A.I.D. role in debt financing, either through the host country or direct lending to U.S. investors against bonds or debentures.

-- Help alleviate bottlenecks in the marketing of LDC products. For example, two projects are in formative stages to facilitate inter-island marketing in the Caribbean. One involves support to a privately owned regional shipping company which would service the small Eastern Caribbean islands. The other is a regional agricultural marketing facility which would trade in fresh produce in the region.

-- Increase investment promotion activities. In this regard, international conventions are planned to link small and medium businesses from the U.S. with Caribbean businesses for the purpose of launching new joint ventures and transferring technology. A Caribbean project entails project identification activities, linking likely investing partners, and providing follow-up support to facilitate investment decisions. Also in the Caribbean, we are funding a project development program which will finance resident industrial development advisers. One of the primary functions of these advisers is to identify and appraise business ventures in the small Eastern Caribbean islands. The advisers will help identify potential U.S. investors and facilitate business transactions.

#### IV. Newly Approved A.I.D. Projects

Early this year, I undertook a comprehensive inventory of all A.I.D. private sector activities. The following is a highlight of those planned or ongoing activities which I believe merit continued support and, in many cases, replication.

In Latin America and the Caribbean, we have developed and funded a number of projects this year which strengthen private sector institutions and support private financial mechanisms.

In Jamaica, after the election of a new government dedicated to the free market under Prime Minister Seaga, the United States was the first nation to offer assistance, providing "bridge" financing to fill the gap pending larger-scale support from the International Monetary Fund (IMF).

Our long-term objective in Jamaica is to strengthen key sectors of the Jamaican economy in order to stimulate production, exports and jobs. We and the government have been working closely with the Rockefeller Committee in identifying opportunities for private investment to create jobs and expand foreign exchange earnings. Through the offices of the Rockefeller Committee, and financed by A.I.D., four American private sector advisers screened 408 investment proposals received by the Jamaicans. For those that looked promising, the consultants made contacts, initiated a dialogue and helped bring interested parties together. We expect new and significant American and Jamaican investments will result from this pioneer effort.

The A.I.D. Mission also recently responded to concerns raised by the tourism subcommittee of the Rockefeller Committee about the ability of hotels in Jamaica to respond adequately to an expected good winter tourist season. The International Executive Service Corps (I.E.S.C.) and private consultants financed by A.I.D. reviewed the situation and made recommendations which may result in the hotels better preparing themselves for this tourist season.

In Costa Rica, we have made a \$10 million loan to the privately owned Agro-Industrial and Export Bank of Costa Rica (BANEX) to promote non-traditional exports from that country. Credit, banking, and marketing services are provided to help Costa Rican producers sell their products abroad. The A.I.D. loan is structured to leverage an equivalent amount of private commercial bank lending to BANEX.

A recent \$6 million loan to the Latin American Agribusiness Development Corporation (L.A.A.D.) will allow that organization to finance some 45 agribusiness projects expected to create 10,000 jobs in Central America. This program also encourages a co-financing arrangement whereby L.A.A.D. will match the A.I.D. loan with \$6 million in private bank borrowings. With the A.I.D. and private bank loans and L.A.A.D.'s own resources, more than \$29 million will be available for agribusiness projects in Central America. I should note that we are now considering replicating the L.A.A.D. approach in Africa.

In the Near East, a major development, which I personally approved, is the establishment of a new \$25 million Trade Financing Facility to enable U.S. companies who are low bidders to compete more favorably on international tenders where better terms of financing are necessary.

In closing, Mr. Chairman, let me stress our deep appreciation for the interest you and your subcommittee have shown in our program. Today's hearing occurs on the eve of the Cancun Conference where President Reagan will again stress the vital role of private enterprise in the development process. I will be joining our delegation to the summit and I can assure you, Mr. Chairman, that we will very much keep in mind the thoughts and advice you will have offered today on the interaction of aid and trade.