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MANAGING U.S.-OWNED LOCAL

CURRENCY RESOURCES

Draft Final Report

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February 1, 1991

Mr. Jerre Manarolla
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Dear Jerre:

We are pleased to submit a copy of our draft final report in response to Tasks Order No. 1, "Managing U.S.-Owned Local Currency Resources" under Indefinite Quantity Contract OTR-0000-I-00-0138-00. Our team has enjoyed working on this assignment and hope that our findings, conclusions and recommendations contained in this study will prove valuable in your efforts to design a system for the management of local currency resources. We believe that the policy and financial management guidelines currently being drafted by A.I.D. are an excellent beginning in this process.

We appreciate this opportunity to be of service to you on this important assignment. Please feel free to call me if you have any questions. I am planning to remain in the U.S. until February 13 and hope that this will be enough time to incorporate any feedback into the final report.

Sincerely

Robert K. Clark

Robert Clark
International Consulting Services

MANAGING U.S.-OWNED LOCAL CURRENCY RESOURCES

A LITERATURE REVIEW

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I. EXECUTIVE SUMMARY

The study is divided into five sections. Section III attempts to establish a historical framework for the discussion of U.S.-owned local currency issues, examining the generation, accountability and programming of both host country and U.S.-owned local currency resources beginning before the Marshall Plan and ending with the recently enacted Farm Bill of 1990. The emphasis in this section is placed on the development and implementation of various policies regarding programming, control, ownership and accountability of these funds, including the role played by the U.S. Congress in determining these policies and their effects.

Section IV addresses in detail the specific issues of accountability, programming, ownership, control, congressional appropriation, procurement and operating expenses as they pertain to U.S. and host country-owned local currency resources and the practices and policies of other national and international donor agencies such as the World Bank and the International Monetary Fund. These analyses examine trends in policy development and practices and well as impacts, focusing, as much as possible, on recent activities.

Section V contains the conclusions and recommendations drawn from the research conducted for this study. These are subject to the limitations imposed by the economic and political environments of each host country and by A.I.D.'s development objectives and strategies which differ from country to country. However, broad conclusions can be made, the principal of which are:

- Effective management and control of local currency resources do not require U.S. ownership.

- Control over programming and the achievement of development objectives can be effective regardless of ownership rights over local currency resources.

- A balance between accountability requirements and development impact should be key in making programming decisions.

- There is a need for greater cooperation among donor agencies to ensure that local currency plans are in accordance with other existing macroeconomic programs in the host country.

II. INTRODUCTION

A. Background

Local currency management has been the source of controversy and discussion since the initiation of the U.S. Foreign Assistance Program during World War II. Numerous management approaches advocated by the U.S. Congress, the General Accounting Office (GAO), the Office of Budget and Management (OMB), the Agency for International Development (A.I.D.), and other U.S. Government Agencies have been developed and implemented with the objective of ensuring that local currency funds generated from the sale of commodities to beneficiary countries are spent to further A.I.D. and host country development goals. However, the success of these approaches have been limited and the identification of new strategies still continues.

Local currency resources, whether they are owned by the U.S. or by the recipient country, are generated from the sale of commodities under a number of U.S. foreign assistance programs including Public Law 480 (PL 480), the Economic Support Fund (ESF) and the Commodity Import Program (CIP). Since the 1950s, when the foreign assistance provided under these programs increased substantially, local currency resources have been considered a key element in the achievement of U.S. development objectives.

In July of 1989, USAID missions worldwide reported that there were 250 local currency accounts with a total balance of over $1.2 billion.[1] Most of these funds were generated by ESF activities including cash grants and the CIP. The rest, about less than a half, were generated by food aid and by the Development Fund for Africa.

B. Objective

The objective of this study is to provide A.I.D. with information which will assist the Agency in designing a local currency management plan that addresses the requirements under the 1990 Farm Bill, as they relate to the generation of U.S.-owned local currency resources from commercial sales of food aid commodities. The primary focus of this study is the identification of a

[1] General Accounting Office, Using Local Currency Generated by U.S. Food Aid for Development Purposes. Statement of Harold J. Johnson, Director of Foreign Assistance Issues. Before the Committee on Foreign Affairs Subcommittee on International Policy and Trade (Washington, D.C: General Accounting Office, April 18, 1990), 3.

balance between the need to effectively control and account for the development impact of local currency resources, while at the same time minimizing the management demands placed on USAID missions by local currency programming.

C. Scope

This objective was achieved through a study based on:

- A review of pertinent literature and documentation related to the issue, including a historical review of local currency management approaches.
- Interviews with representatives of A.I.D., OMB, the U.S. Department of the Treasury as well as representatives of other U.S. Government Agencies and U.S. Congressional staffs.
- Interviews with representatives of international donor agencies as well as the foreign assistance agencies of other donor countries.

The study addresses the approaches to the management of U.S-owned and host country-owned local currency resources as they pertain to the issues of accountability, ownership, programming, congressional appropriation, generation, procurement and control.

III. HISTORICAL REVIEW OF U.S.-OWNED LOCAL CURRENCY MANAGEMENT

A. Pre-Marshall Plan Generations

In examining the issue of local currency management, the pre-Marshall plan experience of the United States and the United Nations is important. It was this experience that established a conceptual framework within which most of the future local currency programs were established, laying the foundation and setting the guidelines that characterize current local currency management practices.

1. War-time Experience

Local currency programs have been utilized by the United States for nearly fifty years. The concept of obtaining local currency for tangible foreign aid was first utilized on a large scale in Italy in 1943. Civilian supplies provided by the U.S. army, and by the Foreign Economic Administration in Italy generated a small amount of Lira. In similar circumstances, Lira was ultimately generated by the sale of a small amount of United Nations food in Italy, which at the same time prompted an agreement between the Italian government and the United Nations Refugee Relief Agency (UNRRA) in 1945.[2]

The first agreement between the Italian government and UNRRA was signed in March of 1945, and constituted the first formal local currency agreement between any two parties. Under this agreement a portion of the proceeds resulting from the sale of food became the property of the Italian government. In return, the Italian government was bound by this agreement to cover the domestic costs of the program, including the transportation and administrative expenses of the UNRRA mission.

A second UNRRA agreement with Italy established a structural and philosophical precedent for the current U.S. local currency program. Signed in January 1946, this agreement specified that proceeds resulting from the sale of the commodities were to be paid into a special account technically owned by the Italian government. The government of Italy agreed to draw on the account to meet the program's costs and to finance assistance and reconstruction programs agreed upon with the United Nations. The

[2] U.S. Congress, Library of Congress, Congressional Research Service - Foreign Affairs Division, The Availability and Use of Local Currencies in U.S. Foreign Programs, (Washington, D.C.: U.S. Congress, Library of Congress, Congressional Research Service, Foreign Affairs Division, 1974), 11.

three main elements of the current U.S. local currency program later established in this agreement were:

1) The creation of a special recipient government account for deposit of the local currency proceeds from the sale of aid commodities.

2) The use of part of the funds in the special account to defray the donor's administrative expenses.

3) The practice of using the bulk of local currency in the special account for constructive purposes to be decided upon after joint consultation between the recipient and the donor.[3]

2. Public Law 84 and the Foreign Aid Act of 1947

The first substantial local currency agreement which directly involved the United States was Public Law 84 (PL 84). PL 84 was signed in March of 1947. This agreement was much more restrictive than the UNRRA agreements because the country-owned local currencies could only be programmed with U.S. approval. In addition, PL 84 specified that any unobligated balances remaining in the special holding account were to be liquidated by the end of the following fiscal year.

The Foreign Aid Act of 1947 established local currency policies that differed significantly from PL 84 in that practically all of the aid commodities under this Act were to be sold to rebuild the private sector. The legislation abandoned the concept of depositing the actual proceeds from the commodity sales and instituted a "commensurate value" system whereby the lira equivalent of the dollar value of the aid goods was to be deposited in a special Italian Government local currency account. The Interim Aid Agreement also provided that any unresolved balances remaining in the special account after June 30, 1948, would be disposed of within Italy, for mutually agreed-upon projects.[4]

B. The Marshall Plan

Under the Marshall Plan the Italian precedent was carried over to more than ten European countries. The basic structure of segregating local currency deposits from other funds of the recipient was maintained. However, the amount of local currency

[3] Ibid.

[4] Ibid., 13.

generated as the result of the U.S. grants was to be much greater under the Marshall Plan than under earlier legislation.

1. Accountability and Control

The issue of accountability and control arose as local currency generations increased and accumulated. Both House and Senate committee documentation on local currency reflected Congressional interest in increasing control over counterpart funds. Consideration was given to tightening control over local currency funds through actual U.S. ownership of all of the funds. The concept was rejected because congress believed that the magnitude of the potential U.S.-owned local currency deposits would, in effect, make the United States responsible for the financial stability of the recipient countries.

However, Congress did agree to establish a 5 percent deposit requirement of local currency generations for U.S. use. These funds were placed in a separate account under the control of U.S. Disbursing Officers. Any amounts remaining from these funds were transferred to the U.S. Treasury for use by other U.S. Government Agencies. The remaining 95 percent of the counterpart funds remained with the recipient country to be used to implement policies to support the internal monetary and financial stability of the host country. The agreement of the United States government was required for any proposed use of the counterpart funds.[5]

2. Programming

The approved uses of local currency funds was a debated topic during this period. A background study and draft bill prepared for the Senate Foreign Relations Committee by the State Department in December of 1947 indicated that the following uses for local currency, host country- and U.S.-owned, would be appropriate:

1) Withholding local currency from circulation as an anti-inflationary or fiscal reform measure (sterilization).

2) Retiring national debt to promote internal financial stability.

[5] Economic Cooperation Administration, Statistics and Reports Division, Local Currency Counterpart Funds: Midpoint Review, (Washington, D.C., Economic Cooperation Administration, Statistics and Reports Division, April, 1950), iii.

3) Funding costs incidental to the exploration and development of additional raw materials in potential short supply in the United States.

4) Defraying local costs of projects contributing to general European recovery (Infrastructure).

5) Funding local administrative costs of the U.S. aid program.

6) Financing for other mutually agreed-upon purposes.[6]

The economic situation and recovery strategy of each country varied greatly. The stabilization of inflation and retirement of debt was most significant in the United Kingdom, Denmark, Norway and the Netherlands, while project spending was more important in other countries. By 1952, the U.S.-use portion of the counterpart funds was primarily used to acquire strategic materials for the United States from the U.K., Netherlands, France, Denmark and Norway. Commitments for this purpose amounted to more than half of the total funds obligated.

As in the Foreign Aid Act of 1947, the final disposition of any unobligated balances remaining in the recipient country's local currency accounts as a result of Marshall Plan aid after June 30, 1952 would require congressional approval. As indicated in the text which follows, section 115 (b) (6) of the final bill retained the "commensurate value provision" of the Foreign Aid Act by stating that the bilateral agreement between the United States and the recipient would contain provisions for:

> Placing in a special account a deposit in the currency of such country, in commensurate amounts and under such terms and conditions as may be agreed to between such country and the Government of the United States, when any commodity or service is made available through any means authorized under this title, and is furnished to the participating country on a grant basis. Such special account, together with the unencumbered portions of any deposits which may have been made by such country pursuant to section 6 of the joint resolution providing for relief assistance to the people of countries devastated by war (PL 84) and section 5(b) of the Foreign Aid Act of 1947 (PL 389) shall be held or used within such country for such purposes as may be agreed to between such country and

[6] U.S. Congress, The Availability and Use of Local Currencies in the U.S. Foreign Aid Programs, 14.

> the administration in consultation with the National Advisory Council on International Monetary and Financial Problems, and the public advisory board provided for in section 107(a) for purposes of internal monetary and financial stabilization, for the stimulation of productive activity and the exploration for and the development of new sources of wealth, or for such other expenditures as may be consistent with the purposes of this title, including local currency administrative expenditures of the United States incident to operations under this title *** under the ECA Act.[7]

By June 30, 1952, when the Marshall Plan was to have concluded, some $10.9 billion of local currencies had been deposited. Of that figure, $9.9 billion had been available for country-use and, based upon the 5 percent deposit requirement, a total $474 million had been available for U.S. use during that period.

C. The Mutual Security Act

The Mutual Security Act of 1951 had a significant impact on local currency management. Upon establishment of the Mutual Security Agency, the Director of the Mutual Security Agency program was authorized to sell dollar funds destined for Asia and Africa in exchange for local currency from the recipient countries. This provision was designed to circumvent the "commensurate value" provision by allowing the United States to advance dollars to a recipient for local currency, rather than waiting until the aid commodities had arrived and the required counterpart deposit had been made. The Act also allowed U.S. agencies to use local currencies which had accrued through this program without requiring reimbursement from appropriated dollars.[8]

The flexibility provided by the Mutual Security Act of 1951 was short-lived. The Mutual Security Act of 1952 introduced strict programming and management requirements, setting a precedent for the PL 480 program. Under the new legislation:

- Counterpart funds could only be used for programs for which new dollar funds authorized by other assistance acts would be available. The use of counterpart funds for fiscal and monetary stabilization and debt relief was prohibited.

[7] Public Law 80-472, 62 Stat. 137.

[8] U.S. Congress, The Availability and Use of Local Currencies in U.S. Foreign Aid Programs, 15.

- Loan repayments in local currency were to be deposited in a special counterpart account, the use of which had to be determined in an agreement between the United States and the recipient country.

- The U.S.-owned counterpart provision was increased from 5 percent to 10 percent because, in the view of policy makers, counterpart-generating grant aid was decreasing while U.S.-uses were increasing.

- Counterpart funds were authorized for international education activities.

1. Congressional Appropriation

A large portion of U.S.-owned local currency for U.S.-uses was not subject to accounting control, reporting or audit procedures until July, 1952, when Congress enacted Section 1415 of the Supplemental Appropriation Act of 1953. This section prohibited the use of foreign currencies for U.S.-use except as provided for annually in appropriation acts.[9] Under this legislation,

> Foreign credits owed to or owned by the United States Treasury will not be available for expenditure by agencies of the United States after June 30, 1953, except as may be provided for annually in appropriation Acts and provisions for the utilization of such credits for purposes authorized by law hereby authorized to be included in general appropriation Acts.[10]

While Section 1415 was designed to increase control over the expenditures of U.S.-use local currency, it created problems which became most pronounced when large-scale sales of agricultural commodities for foreign currencies were later authorized. This required each agency to make a trade-off between programs which were important enough to be funded with appropriated dollars and projects whose actual expenditures were to be in local currency since they were not of sufficient priority to be funded by dollars.[11] The result was a reluctance

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[9] Comptroller General of the United States, "Opportunities for Better Use of United States-Owned Excess Foreign Currency in India," (Department of State, Agency for International Development, Washington, 1971), 15.

[10] PL 82-547, 66 Stat., 63.

[11] U.S. Congress, The Availability and Use of Local Currencies in U.S. Foreign Aid Programs, 16.

on the part of field personnel to utilize local currency resources.

The immediate effect of section 1415 was to bring the U.S.-owned counterpart balances generated after June 30, 1953, as a result of the Marshall Plan and the Mutual Security Acts, as well as the unobligated balances of U.S.-use counterpart funds, under the control of the appropriation process.[12] The long-term effect was unintended excess local currency balances in some countries. Moreover, the relationship between Section 1415, the Mutual Security Act and later, Section 105 of PL 480 complicated local currency policy significantly.

D. Public Law 480

In 1954, Congress enacted the Agricultural Trade and Development Assistance Act (PL 480) which gave the President authority to sell surplus agricultural commodities for foreign currencies in accordance with certain provisions of the Mutual Security Act.

Title I of PL 480 authorizes the provision of long-term, low interest loans to friendly countries to purchase U.S. agricultural products -- generally food -- for sale in local markets. Under Section 108, Title I also authorizes the on-lending of U.S.-owned local currencies through Intermediate Financial Institutions (IFIs) to support the development of private enterprise in beneficiary countries.[13] Today self-help measures in the agreements promote the improvement of infrastructure needed for better food production, storage, marketing and distribution, and for policy reforms to increase private agricultural production.

Title III of PL 480 is similar to Title I. However, agreements can be made on a multi-year basis and loan repayment obligation offset is possible if the importing country uses the local currency generated by the sale and/or the commodities for specified agricultural and rural development activities to improve the well-being of the rural poor. However, the demanding management requirements and the complexity of the multi-year agreements has limited the use of Title III for development purposes. Title II authorizes food donations on a grant basis,

[12] Ibid.

[13] U.S. Congress, Library of Congress, Congressional Research Service - Foreign Affairs Division, The 1990 Farm Bill: Food Aid Reauthorization Issues, (Washington, D.C., U.S. Congress, Library of Congress, September 5, 1990).

principally for humanitarian and economic development programs, including emergency disaster relief.[14]

1. <u>1954-1969</u>

The early years of the Marshall Plan saw the provision of large amounts of grant aid and, as a concomitant, large accumulations of counterpart funds. With the advent of PL 480 (Title I) and the MSA, U.S.-owned local currency balances began to grow rapidly. Prior to fiscal year 1956, U.S.-owned worldwide local currency cash balances were less than the equivalent of $175 million. However, during each fiscal year between 1956 and 1963, there were rapid increases.[15]

The Foreign Assistance Act of 1961 implemented a new local currency-generating mechanism. It authorized ESF payments to countries of particular political importance. Through ESF, local currencies were generated from the U.S. assistance when the United States provided dollars as cash grants, or commodities through the commodity import programs to a recipient country.[16]

a. <u>Accountability and Control</u>

Accountability and control of U.S.-owned local currency remained an issue even though Section 1415 applied to PL 480 funds. The debate revolved around excess local currency accumulations in some countries. Despite flexible programming guidelines, Section 1415 placed potential local currency funded projects in direct competition with high-priority dollar funded projects for congressionally appropriated funds. This dynamic caused excess local currency in a number of countries, resulting in significant problems throughout the 1960s and 1970s. The management policies implemented to control the excess accumulation of local currency funds significantly affected the U.S.-owned local currency generated under PL 480.

[14] U.S. Agency for International Development <u>Congressional Presentation; Fiscal Year 1991</u>, Main Volume, 118.

[15] U.S. Congress, <u>The Availability and Use of Local Currencies in U.S. Foreign Aid Programs</u>, 41.

[16] General Accounting Office, Foreign Assistance, <u>Briefing Report to the Chairman, Committee on Foreign Affairs, House of Representatives: Use of Host Country-Owned Local Currencies</u>, (Washington, D.C., General Accounting Office, NSIAD-90-210BR, September 25, 1990).

In the mid-1960s, The Executive Branch established a new system of management and control over foreign currencies for U.S. uses that could be implemented without having to change the many provisions of the then-existing law. Although Section 1415 had prohibited the use of foreign currencies without appropriation, increasing amounts of currencies generated under PL 480 were being used without appropriation for purposes exempted from this restriction by PL 480 provisions.[17]

Under this system, the primary objectives of managing foreign currencies were established as follows:

- To obtain maximum use of these funds as a substitute for U.S. dollar expenditures.
- To treat the currencies as a real fiscal asset to be spent for programs approved on the basis of annual budget review.

The country-use portion of the funds generated by Public Law 480 sales was restricted by agreement for use under specific programs and could not be used for other purposes without the consent of the recipient governments. The U.S.-use portion was unrestricted. During this period, the U.S. Treasury developed a system to maintain accounts for the sale of non-restricted currencies to any U.S. government agency for official uses, as appropriated, and for accommodation exchange.[18]

b. Programming

The programming of U.S.-owned foreign currencies in this period was generally committed by the terms of the international agreements under which they were received. Repayments of PL 480 loans, which were U.S.-owned, were used to meet the foreign obligations of U.S. agencies abroad. Section 104 of PL 480 provides for using foreign currencies to:

- Pay U.S. obligations entered into under other legislation.

[17] Comptroller General of the United States, "Use of United States Owned Foreign Currencies: Report to the Chairman, Subcommittee on the Near East and South Asia Committee on Foreign Affairs, House of Representatives," (Washington, Department of State, Agency for International Development, 1974), 17.

[18] Ibid., 3.

- Carry out U.S. programs authorized by section 104, such as:

  - Market Development
  - International Education
  - Cultural Exchange
  - Research and Scientific Activities Overseas
  - Acquisition of Buildings and Sites
  - Emergency Relief
  - Loans and Grants for Economic Development.[19]

c. Excess Currency Balances

Public Law 480 resulted in the well-known excess currency "crises" in several countries as U.S.-owned currency balances in many countries exceeded the amount necessary for U.S. operations in the foreseeable future. U.S. ownership of large amounts of local currency funds created potential threats to U.S. relations with recipient countries. This situation gave rise to a debate on the advantages and disadvantages of using U.S.-owned local currency resources based on the following arguments:

ARGUMENTS AGAINST

- It would be buying up another country's economy.
- Inflationary Pressures.
- Potentially harmful to the balance-of-payments (BOP) of recipient country.
- The U.S. may not wish to spend all of its foreign currencies because it may one day run a BOP deficit with that country.
- The transfers which gave rise to the local currency were

ARGUMENTS FOR

- The currency was originally acquired through bilateral international agreements in which the wording was clear. The commodities provided were a sale and should be treated as such.
- The negative balance of payments effect on the recipient country is a positive balance of payment effect for the United States.
- The use of excess currencies in the recipient's economy

[19] Ibid., 4.

the result of the U.S. domestic political argument that these sales were loans and not grants.

would provide the necessary demand for expanding the export-led sectors.

Excess balances existed because local currencies were being generated faster than they were being spent. Government agencies were reluctant to make use of these funds because they competed for dollars as long as they were under congressional appropriations restrictions.[20] These restrictions and other U.S.-owned local currency issues resulted in a disinterest in generating any more U.S.-owned funds in the following two decades.

2. 1969 to 1989

a. Accountability and Control

Throughout the 1970s and 1980s U.S. policy makers made a philosophical shift away from U.S.-owned local currency generation. In this period most major decisions concerning food aid management, still the largest generator of local currency, were made by the Food Aid Subcommittee of the Development Coordination Committee (DCC). The DCC was established by Executive Order in 1977 to ensure coordination of development policies and programs within the U.S. Government.[21] However, the day-to-day administration of the funds was still in the hands of A.I.D. and the Department of Agriculture (USDA), with A.I.D. having overall responsibility for programming and monitoring the use of these funds.[22]

A 1990 GAO study of the ownership, accountability and control issues related to local currency management described the overall management of local currency programs and the conflict between A.I.D. and its Inspector General (IG) over the weaknesses in its accountability and control systems. The GAO study stated that

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[20] U.S. Congress, The Availability and Use of Local Currencies in U.S. Foreign Aid Programs, 70-72.

[21] U.S. Congress, The Farm Bill: Food Aid Reauthorization Issues, 4.

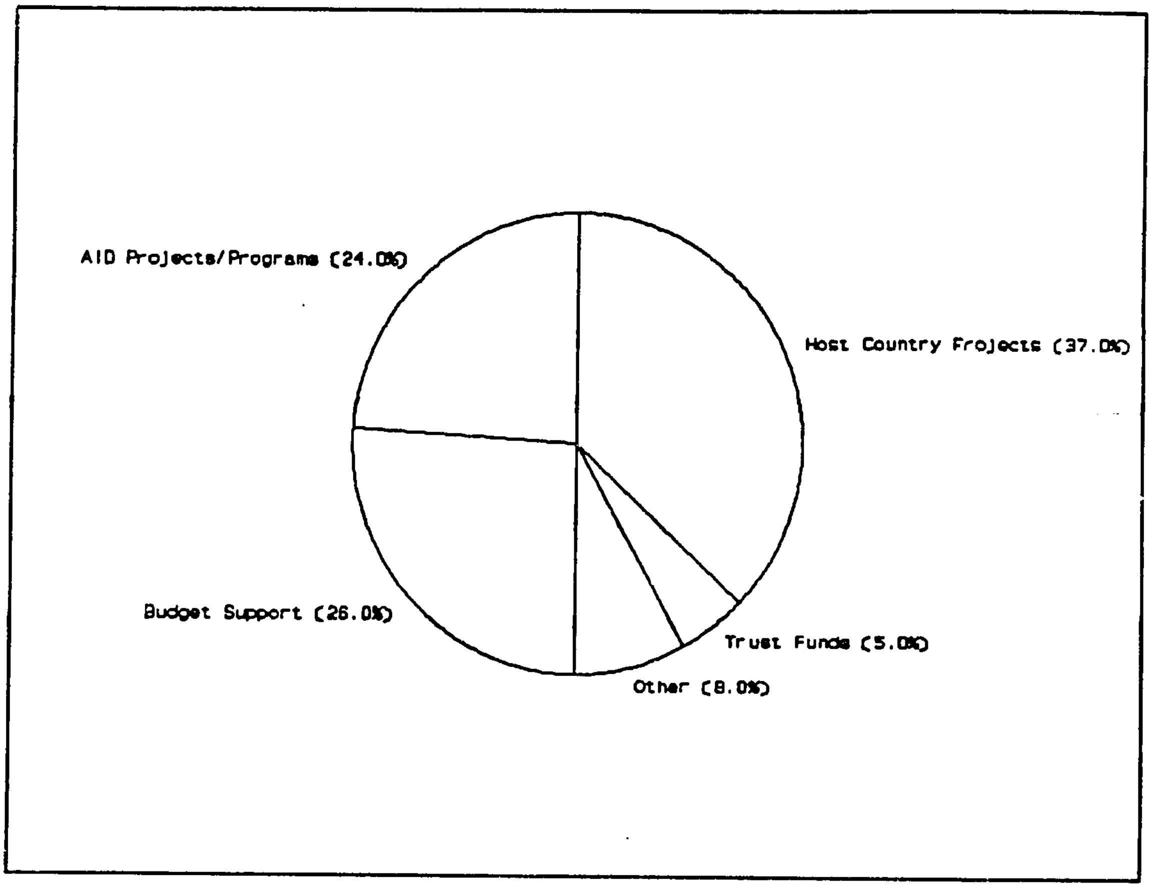
[22] General Accounting Office, Briefing Report to the Chairman, Committee on Foreign Affairs, House of Representatives, Use of Host-Country Owned Local Currencies, 14.

USAID missions surveyed were found lacking in administrative controls over their local currency programs.

b. Programming

The programming of local currencies evolved into a broad set of categories during this period. USAID missions and the host country governments jointly program funds which are available to support host country general budgets or development budgets of particular ministries or sectors. In some cases, some of the funds are held in a trust fund for mission operating expenses and in other cases local currencies are released for general budget support after the host country implements agreed-upon policy reform measures. A breakdown of funds by use is contained in Figure 3.

FIGURE 3
WORLD WIDE LOCAL CURRENCY USE IN 1989[23]



E. Current Developments

1. Recent Legislation

In November 1990, Congress enacted the Farm Bill of 1990, amending PL 480. This recent legislation reintroduces the flexibility of generating U.S.-owned, host country-owned or, in appropriate situations, no local currencies. In addition, it divides the responsibility for the administration of the U.S. food aid program between A.I.D. and USDA which now has management responsibility for PL 480 Title I generations.

Section 2 of the new food for peace law delineates U.S. policy in this regard as:

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[23] Ibid., 19.

It is the policy of the United States to use its abundant agricultural productivity to promote the foreign policy of the United States by enhancing the food security of the developing world through the use of agricultural commodities and local currencies accruing under this act to -

(1) combat world hunger and malnutrition and their causes;
(2) promote broad-based equitable, and sustainable development, including agricultural development;
(3) expand international trade;
(4) develop and expand export markets for United States agricultural commodities; and
(5) foster and encourage the development of private enterprise and democratic participation in developing countries.

To achieve these objectives, Congress has permitted the A.I.D. Administrator flexibility in making local currency deposits in special accounts and determining whether local currency funds are owned by the host country or the U.S. Government. Section 305 of Title II which reads as follows:

Sec. 305. LOCAL CURRENCY ACCOUNT

(a) Retention of Proceeds - ...The Administrator may determine not to deposit such revenues in a separate account if-

(1) local currencies are to be programmed for specific economic development purposes listed in section 306(a); and
(2) the recipient country programs an equivalent amount of money for such purposes as specified in an agreement entered into by the Administrator and the recipient country.

(b) Ownership and Programming of Accounts - The proceeds of sales pursuant to section 304(2) shall be the property of the recipient country or the United States, as specified in the applicable agreement. Such proceeds shall be jointly programmed by the Administrator and the government of the recipient country in accordance with local currency agreements between the Administrator and that government.

2. Recent A.I.D. Policies

In order to increase the effectiveness of managing local currency proceeds and to meet the challenges of recent legislation, A.I.D. has developed draft guidelines for the policy and financial management of host country-owned local currency resources.

This draft guidance sets forth the regulations that will require USAID missions to review and monitor more closely the financial management systems of host countries.

IV. REVIEW OF ISSUES AFFECTING THE MANAGEMENT OF U.S.-OWNED AND HOST COUNTRY LOCAL CURRENCY RESOURCES

A. Introduction

1. Definitions of Host Country Local Currency and U.S.-owned Local Currency Resources

a. Counterpart or Host Country Local Currencies

Counterpart or host country local currency resources are local currency generations or deposits under CIP, sector assistance or ESF cash transfer programs and non-project assistance. This includes funds that are generated by these sources but are held by PVOs and NGOs and funds that are held under trust fund agreements.

The definition of counterpart funds varies widely. The term can be used to refer to any local currencies generated by commodity sales based on the concept that these funds are counterpart of the provision of real resources by donors.[24] The other definition refers to local currency proceeds held in special accounts established by recipient countries for the proceeds of sales of U.S. commodities or cash transfers. In any event, these funds are owned by the recipient government to be spent with the approval of the USAID mission.

Host country funds are deposited in special accounts or otherwise segregated as a result of agreements signed with the U.S. to be used for purposes agreed upon by the USAID missions and the recipient country. Generation is usually in connection with CIP programs and in some cases, ESF cash transfers, the most efficient means of achieving one of the objectives of foreign assistance, balance of payment support.

b. U.S.-Owned Local Currency Resources

U.S.-owned funds are generally generated from conversion of dollars to fund local costs through a central bank or a U.S. Treasury Disbursing Officer or obtained through the repayment of loans or other legal obligations owed to the U.S. by host country governments.

[24] U.S. Congress, The Availability and Use of Local Currencies in U.S. and Foreign Aid Programs, 5.

Funds received from the repayments in local currency for U.S. agricultural commodities sold abroad are considered to be U.S.-owned local currency resources. Under agreements between the U.S. and the recipient government, some of these funds are used for official purposes in the country (U.S.-use) and others are used in the recipient country in the form of grants or loans. These funds are owned by the U.S. and are included in the accounts of the U.S. Treasury and other U.S. government agencies. The majority of these funds, provided under P.L. 480 and the Foreign Assistance Act, are for country use.

U.S.-owned foreign currencies require appropriations action because they are U.S.-owned and controlled by the U.S. Treasury under section 612 of the Foreign Assistance Act. Host country funds do not require similar treatment. Under Section 108 of PL 480, U.S.-owned local currency resources are loaned out to indigenous intermediate financial institutions (IFIs) for private enterprise development purposes. In this case, Congress has waived the procurement and other contracting requirements normally applicable to appropriated dollars. U.S. procurement and contracting requirements are not applicable to host country funds.

Local currencies generated by commodity transfers under U.S. foreign assistance programs are not "real resources" in themselves, but represent claims on real resources in recipient countries.[25] Commodity transfers can be in the form of grants of commodities, exchanges of dollars for local currencies, long-term dollar credit loans or dollar repayments. In the first case, the U.S. is providing real resources for nothing tangible in return; in the second case, it is providing real resources for potential claims on real resources of the country; in the third case, it is providing real resources for future claims on the real resources of the country; and in the final case, exchanging real current resources for real current resources of the country.[26] There is only one transfer of real resources into the host country which is the commodity. There are no <u>economic</u> benefits beyond this transfer, although <u>financial</u> resources spent can generate other benefits. Furthermore, local currencies owed to the U.S. are considered to be future or potential claims on the recipient country's real resources, requiring the economy to generate real resources to meet them.

A breakdown of active U.S.-owned accounts as of Spring 1990 is contained in Exhibit 1.

[25] <u>Ibid</u>., 6.

[26] <u>Ibid</u>., 7.

Exhibit 1

Active U.S. Owned Accounts

As of Spring 1990

Active U.S. Owned Accounts \ Countries	Nepal	India	Poland	Egypt	Costa Rica	Dominican Republic	Jamaica	Sri Lanka	Morroco	Tunisia	Pakistan
FT520 Purchase of Commodities for Other Countries, P.L. 83-480	-										
FT535, Great Program Assistance Section 614(a) and 612(b)		+									
FT555, Zablocki Memorial Out-Patient Facility P.L. 98-266			0								
FT565, United States-India Fund for Cultural, Educational and Scientific Cooperation, P.L. 98-164, Sec. 902(a)		+									
FT566, United States-India Fund for Cultural, Educational and Scientific Cooperation, P.L. 100-204		+									
FT720, Sale of Surplus Agricultural Commodities, Sec. 402, Mutual Securities Act of 1954		+									0
FT745, Grants for Economic Assistance, P.L. 83-480				+							
FT750, Loans and Grants for Economic Assistance (Special Account) P.L. 83-480		0									
FT760, Loans to Private Enterprise P.L. 83-480											+
FT785, Loans to Intermediary Financial Institutions, P.L. 99-198					+	+	+	+	+	+	
FT786, Grants for Establishment of Intermediate Financial Institutions P.L. 99-198 Sec. 108											

+: Positive Balance
-: Negative Balance
0: Zero Balance

2. Determining Local Currency Generation

Generating local currency has potentially significant impacts on the macroeconomic environment of the recipient country. The decision to generate must be based on careful consideration of a number of factors including existing or future macroeconomic policies entailing the effects on host country balance of payments and on the domestic money supply.

The decision to generate is based on the economic environment in the recipient country. USAID missions are encouraged to generate local currency only in situations where it is appropriate relative of other macroeconomic programs and, where it will not have a negative impact on economic stability. Generation is not encouraged in situations where it would have a negative impact on inflation, where the accountability requirements imposed by new guidelines cannot be implemented because of staff constraints and where there are other situations which discourage the generation of funds.[27] However, there are situations where generation cannot be avoided, where sales are made to the private sector as in the cases where the private sector purchases commodities and local currency from A.I.D, such as food aid under PL 480 Title I program, fertilizer under the CIP program or cash auctioned under the Cash Transfer Program. In situations that involve the sale of commodities to the private sector, local currency would be generated if resources to make the purchase were included in the government budget. This would require the government to make adjustments in other budget expenditures, increase revenues through increased taxes or borrowings and/or print money.

Policy being currently drafted by A.I.D. introduces more flexibility into the issue of local currency generation. USAID missions are not required to generate local currency in all cases, except when it is required by law or it makes sense in advancing A.I.D.'s developmental objectives. This in turn, will:

- Reduce the need for missions to maintain the amount of staff necessary to monitor and maintain records for the administration of the program. This is consistent with A.I.D. policies for maintaining smaller staffs in the missions and reducing A.I.D. budgets.

- Reduce the potential problems in the administration of the programs and the use of local currency funds that

[27] John Blackton, Memo regarding: A.I.D. Local Currency Policy, October 5, 1990.

have arisen in the past with the A.I.D. Inspector General, the GAO and the U.S. Congress.

- Simplify the management of A.I.D. Development programs

- Reduce the potential for conflict between A.I.D. and host country governments who charge that the U.S. is intervening in its affairs

- Bring U.S. policy more in line with the policies of other international donor agencies.[28] By having an external agreement only and not being required to negotiate an additional internal agreement, A.I.D. will probably have more impact in terms of development. This may focus its area of involvement on objectives more similar to that of the European donors, the World Bank and the International Monetary Fund where the focus is on strengthening and supporting host country budgetary processes and the monitoring of public expenditures rather than negotiating the spending of counterpart funds.

Local currency counterpart funds are not generated when funds are used by the recipient government to service external debt or in situations where the interest of the U.S. is primarily foreign policy as opposed to economic in such countries as Israel, Portugal and Turkey.

There has been considerable debate concerning the potentially inflationary nature of local currency programs. It is argued that injecting commodities or foreign exchange into an economy for counterpart funds is at first deflationary and later inflationary when counterpart funds are utilized. Although there is a tendency for this dynamic to occur, there is no direct and constant correlation between local currency generation or disbursement and inflation or deflation. However, in a recent A.I.D.- supported study, Dr. Henry Bruton determined that:

> The aid plus counterpart funds will be most "deflationary" when imports increase, increasing supply and avoiding an increase in the monetary base as a result of increased international reserves, and when government spending and taxes remain unchanged, leading

[28] See section I.A for discussion of other donor agency.

to a smaller increase in Central Bank credit to the government than otherwise.[29]

Bruton argues, however, that the final effect of aid and local currency generating programs on the money supply depends on what happens to the balance of payments as well as the government budget in response to the aid.[30] Moreover, Dr. Bruton's research revealed that the risk of inflation as a result of local currency programs varies from country to country but has historically been a risk in only a few countries.[31]

3. Overview of Issues

The issues that will be addressed in this study cannot be taken individually. They are so closely connected that requirements under one area have created obstacles in others. An example is the relationship between ownership and accountability. Traditionally, the USAID missions have come under criticism from the GAO and A.I.D.'s IG for their failures to monitor more closely the deposits and withdrawals of local currencies as well as their use by the host country governments. In return, the USAID missions have argued that it is difficult to effectively monitor resources over which the U.S. has no ownership rights. The same is true of programming. USAID Missions have found it difficult to convince host country governments to agree on programming objectives since the ownership of the funds belongs to the host country. Countries such as Egypt, Pakistan and Kenya have, in the past, resisted USAID attempts to program their local currency resources and, in some cases, implement monitoring and control requirements.

The treatment of these issues will reflect the changes that have occurred in A.I.D.'s approach to each issue over the course of the U.S. foreign assistance program. In the 1970s, A.I.D's involvement in programming local currency resources was minimal unlike today when USAID missions are being encouraged to participate more fully in programming local currency resources with host country governments. A similar situation exists in

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[29] Agency for International Development, Bureau for Private Enterprise, Office of Food for Peace, Bruton, Henry J., and Hill, Catherine B., "The Development Impact of Counterpart Funds," Department of Economics, Williams College, Williamstown, MA, (Washington, D.C., Agency for International Development, Bureau for Private Enterprise, Office of Food for Peace, August, 1990).

[30] Ibid., 45.

[31] Ibid., 46.

regard to the accountability and control of host country resources. This has increased over time so that under the current legislation host country local resources are expected to be accounted for and controlled as if they were appropriated funds. Over time, food aid, ESF and CIP programs have become important, not only as sources of valuable local currency resources for development, but also for USAID mission operating expenses.

B. Accountability

1. Historical Perspective

The U.S. approach to accountability for local currencies has undergone several changes since the establishment of the foreign assistance program. In 1972, A.I.D. policy discouraged participation in programming local currency. However, beginning in 1973, A.I.D. policies changed and USAID missions became more actively involved in programming. This active involvement required greater accountability on the part of the USAID missions and is still required today by the A.I.D. IG and the GAO in countries where they maintain active participation. Recent A.I.D. guidance reaffirms the responsibility of USAID missions to account for the generation, accumulation and use of local currency resources especially with the recent emphasis on the missions' active participation in the programming of these resources.

The issue of accountability is closely linked to the issue of ownership. The monitoring of the use of local currency resources has traditionally been a source of some confusion and disagreement between A.I.D. Management, its IG and the GAO. A.I.D. has argued that since funds are owned by host country governments, the burden of management should be placed on the recipient government and not on the Agency. It has argued further that it is difficult to control a resource that is not owned by the U.S., especially when the Agency is faced with decreasing budgets and staffing levels. USAID missions have felt that increases in staffing would be required if they were expected to meet the same level of accountability required for appropriated funds. In El Salvador, the USAID mission has estimated that another 108 employees would be needed. The response to this argument has been that the level of accountability required by the USAID mission is the same, regardless of whether the funds are owned by the host country government or the U.S.

2. Current Procedures

In an attempt to put an end to the chronic management problems associated with local currency generation, A.I.D. is developing new policy and financial management guidelines which will require the missions to adhere to more rigorous standards. This should alleviate concerns that the generation and management of local currency may not be decided by the development needs of the host country as it should be, but by the administrative constraints of the USAID mission.

Under these new standards, approaches to managing and programming local currencies, as they belong to host country governments have been defined. This guidance requires that the funds be deposited into special accounts under the Foreign Operations, Export Financing and Related Programs Appropriations Act of 1990 and requires that agreements with the government be established, stating the amount of the generation and the terms and conditions under which the currencies are to be utilized. This should include agreement on the established responsibilities of A.I.D. to monitor and account for deposits and disbursements from the special accounts. Furthermore, A.I.D. has the responsibility to see that the local currencies in the account are disbursed for the purposes agreed upon and that at the termination of the assistance any unencumbered balances are disposed of for agreed purposes, as established by the host country government and the U.S. government. A.I.D. must jointly program local currency to achieve development objectives in keeping with mission and host country development objectives provided that "an acceptable level of accountability for local currencies can be assured".[32] Furthermore, the guidance encourages integration with external assistance sources to increase developmental impact. The new policies also address situations where government financial management systems are weak since this presents special programming and accountability problems and may require more staff time to identify and review the pros and cons of generating local currency.

3. Applying Procedures to Host Country Local Currency Funds: Appropriated vs. Unappropriated Funds.

The controversy surrounding the determination of the appropriate levels of accountability relate to the issue of ownership. Since

[32] Agency for International Development, Office of Financial Management, Supplemental Guidance on Programming and Managing Host Country-Owned Local Currency (Washington, D.C.: Agency for International Development, October 11, 1990), 3.

host country local currency resources are owned by the recipient country, there is a belief that they are not subject to the same accountability requirements as appropriated dollar funds. In addition, the reluctance to enforce accountability requirements on host country funds is based on concern about the creation of friction between the host country and the USAID mission, which has been a valid fear. In several countries such as Egypt and Pakistan, the missions have shared this reluctance. In Pakistan, the mission has regarded assistance as inter-governmental transfers rather than "sales", not requiring any local currency generations. Furthermore, it regarded the monitoring of currencies generated as the responsibility of the host country, preferring to use staff time to monitor dollar expenditures. In these situations, programming involvement was limited. In other countries such as Zambia and Zaire, where local currency resources were more critical in the achievement of development objectives, the USAID missions were actively involved in programming and the management of local currency which achieved a higher level of accountability.

Even though host country local currency resources are not U.S.-owned, certain levels of accountability are required. The issue of ownership should not determine the level of accountability but rather the source of the funds. Host country local currency funds are generated by foreign assistance programs and thus, there is a degree of accountability implicit in the management of these funds. This is reflected in the guidance drafted by A.I.D. in October 1990 to manage host country local currency resources.

C. Programming

1. Historical Perspective

A.I.D.'s involvement in the programming of local currencies has varied considerably over time. In the nineteen fifties and early nineteen sixties A.I.D. enjoyed a considerable amount of control over local currency programming. As previously discussed in Section III, U.S. programming priorities changed considerably during this period. Under the Marshall Plan, the U.S. focused on providing Europe with support by sterilizing the money supply and retiring debt. Later, under the PL 480 program, emphasis was placed on project and budget support.

By the 1970s, A.I.D. had changed its policy regarding country owned local currency generated through Title I sales, and moved away from project programming. This change was designed to reduce direct U.S. involvement in the affairs of A.I.D. recipient countries and simplify program administration. It also was sought to lessen a perceived monitoring burden on A.I.D. missions administering the programs. Therefore, recipient governments were no longer required to deposit the sales proceeds into special accounts, nor participate in programming choices except in special cases.[33]

A 1974 paper delineating A.I.D. policy on this issue explained A.I.D.'s responsibilities in programming Title I proceeds as follows:

> Title I legislation does not require formal A.I.D. involvement in programming the expenditure of these proceeds, nor does it require recipient countries to deposit sales proceeds into special accounts. Nevertheless, it contemplates some degree of A.I.D. involvement, since A.I.D. must monitor the use of the sales proceeds and assure that they are allocated to support economic development objectives.[34]

Therefore A.I.D. policy stated that the Agency was not only technically bound to program funds specifically for projects, but also responsible to ensure that they were allocated in an appropriate manner. Beginning in 1983, A.I.D. policy required more active participation in local currency programming. However, greater A.I.D. involvement has led to greater A.I.D. accountability responsibilities.[35]

Programming directions have had several emphases over time. In the 1980s, USAID missions were encouraged to use local currencies for funding private sector activities. USAID missions were encouraged to program for private sector development with the ultimate recipient being private sector entities and individuals. They were also encouraged to utilize private sector organizations thereby strengthening private sector institutions and promoting market-based financial development. In Tunis and Bolivia, P.L. 480 local currency proceeds were used to finance private sector projects such as credit programs and pre-investment studies.

2. <u>Current Alternatives under 1990 Farm Bill</u>

Under the 1990 Farm Bill, Congress has made several significant changes that may effect the programming of local currencies. The

[33] A.I.D., "Policy Determination; Programming PL 480 Local Currency Generations," (Washington, D.C., Agency for International Development, February 22, 1983), 1.

[34] <u>Ibid</u>.

[35] <u>Ibid</u>., 2.

new legislation vests in the Department of Agriculture full authority over Title I sales proceeds. The law also allows for debt forgiveness, and opens the door for generations of U.S.-owned local currencies. Moreover, it is the intent of this law to avoid using local currency funds for monetary sterilization purposes.

Section 104 of the new food aid law allows Title I generations to be used for purposes which are generally consistent with programming policy in the 1980s. Section 104 authorizes the following activities under the new law:

- Trade Development
- Agricultural Development
- Agricultural Business Development Loans
- Trade Promotion
- Private Sector Agricultural Trade Development
- Research
- United States Obligations

With control of Title I proceeds passing to the Department of Agriculture, the emphasis on agricultural marketing activities allowed under Title I will be expected to increase.

In addition to this legislation passed by Congress, A.I.D. is in the process of drafting new guidance for programming local currency. Under the new guidance, there are two principal types of local currency programs that can be funded from the special account: budget support (including general budget, general sector and specific sector assistance) and extra-budgetary activities which are project specific.

The relationship between programming and accountability and control are important in any analysis of this issue. Accountability is predicated on the assumption that the host country government's financial management systems are adequate and that once the funds reach the right agency, they will be used for the intended purposes. These include a rational budgetary allocation and expenditure system which contains the controls to detect fraud or diversion and adequate reporting systems to track expenditures. If there is any indication that these systems are unable to provide the necessary support, the type of programming being considered should not be used. The guidance establishes guidelines for the use of types of programming in situations where the decision to a type of programming is taken even though host country systems are unable to support the necessary monitoring requirements. Adherence to these guidelines will be considered as meeting the reasonable assurance concerns of the GAO.

The levels of monitoring and accountability are directly related to programming. If general budget support assistance is provided, the mission must have a high degree of confidence in the budget allocation and expenditure systems of the host country. The monitoring requirements as they relate to types of programming are further described in Exhibit 2.

3. Maximizing Development Impacts

In 1988, the GAO found that in USAID mission budgets requests for FY 91, 84 percent of local currencies generated under food aid programs were budgeted for public development activities, 12 percent for private sector programs and 4 percent for budget support and other purposes.[36] Only a small percentage of Title I local currency was for non-development budget support and only 3.5 percent of local currencies from food aid were used for public sector recurrent costs. Over 26 percent of local currencies generated from ESF were used for public sector recurrent costs.

This breakdown is illustrative of the various uses to which local currency resources are put. In some cases, these uses have been creative, such as programs implemented under PL 480 Section 108 which permits generations under P.L. 480, Title I to be loaned out to Intermediate Financial Institutions (IFIs) for on-lending to support private sector activities, similar in objectives to the Cooley Loan Program of the 1950s. In countries such as Jamaica, this program has provided substantial assistance to the private sector funds projects in agriculture (10 percent), tourism (25 percent), manufacturing (37 percent), transportation (14 percent) and housing and construction (12 percent).[37] However, this type of programming has substantial monitoring responsibilities as USAID mission are expected to monitor the financial viability of the IFIs with outstanding loans even though current agreements do not contain any provisions for the borrower to supply audited financial statements to assist in this process.

[36] General Accounting Office, Uses of Local Currency Generated by U.S. Food Aid for Development Purposes. Statement of Harold J. Johnson, Director Foreign Economic Assistance Issues. Before the Committee on Foreign Affairs Subcommittee on International Economic Policy and Trade, 8.

[37] Agency for International Development, Black, Dorothy, The First Auction of PL-480 Section 108 Funds, A Jamaican Experience, (Kingston, Jamaica: Agency for International Development, March 15, 1990), 10.

Exhibit 2

PROGRAMMING AND ACCOUNTABILITY FOR HOST COUNTRY LOCAL CURRENCY RESOURCES

	PROGRAMMING OPTIONS			EXTRA-BUDGETARY ACTIVITIES
	Budgetary Support	General Sector Support	Specific Sector Support	
MONITORING				
HIGH	●			
MEDIUM - HIGH		●	●	●
CONFIDENCE IN HOST COUNTRY AGENCY FM SYSTEMS				
HIGH	●			
MEDIUM - HIGH		●	●	●
VERIFICATION				
HIGH	●			
MEDIUM - HIGH		●	●	●

There is considerable debate over the maximization of the development impact of local currency resources and opinions fall into two categories. One category believes that the only way to insure the efficient, incorrupt and wise application of host country currency resources is for the U.S. to have complete control over the programming the funds and track expenditures closely. This approach, it is argued, prevents corruption and opens the door for policy dialogue with the recipient country.

The other category asserts that such a strategy defeats the long-term development objective of creating self-sustaining governments. Proponents of this view argue that programming for specific projects is also condescending to the recipient country and will possibly result in friction between the donor and recipient.

Under the draft policy there are three basic programming choices available to the missions. The local currency may be programmed to support more than one of these three options, even though it was generated from a single assistance source. Each program choice is associated with a specific set of accountability requirements set forth in operational guidelines. Under current draft program policy guidelines being reviewed by the Agency, the three programming choices are:

- o Developmentally sound projects
- o Specific sector support
- o Budget deficit support[38]

Sterilization or demonetization, once a programming use for local currency funds, is no longer within the realm of options available to USAID missions.

Within these categories, the USAID missions are given some latitude in determining how local currencies will be used. A 1988 A.I.D. policy document from the General Counsel's office outlines some specific circumstances where local currency generations are prohibited. According to this report, mission operating expenses are a prohibited use for local currency proceeds of the PL 480 program. The report stresses that Section 106(b) of P.L. 480 requires that Title I sales be used for economic development purposes which do not include A.I.D. operating expenses.[39]

[38] A.I.D., Local Currency Policy, 3.

[39] A.I.D., Memorandum: "Local Currency Generation Under Food Sales Program." To: GC, Howard M. Fry, From: GC/CP, Stephen Tisa. Washington, D.C., 03/7/88, 1.

Although the debate concerning which type of assistance continues, there seems to be a consensus on which broad category of programming is necessary under different circumstances (see Exhibit 2). When strong financial management systems are in place within a host country government and confidence in the systems is high and verification procedures are sound, general budget support is generally an appropriate type of programming to pursue. General budget support is favored under these circumstances because the funds are not likely to be diverted and it is in keeping with A.I.D. objectives of improving the government's capacity to develop a self-sustaining economy. In addition, general budget support sends a clear message to the recipient country that the donor is supportive of its economic development priorities and this dynamic strengthens political ties between the countries.

However, it is rare to find strong systems in developing countries capable of meeting the monitoring requirements for budgetary support programs. There may be cases where host country monitoring, financial management and verification procedures are less than adequate to insure appropriate utilization of local currency resources. In these cases, USAID missions may be required to choose between general sector support, specific sector support and extra-budgetary activities. Although these options are open, it is important to note that this progression from budget support programs to specific sector support programs is sometimes viewed as simply a transfer of responsibility from the host country government to the mission. The argument can be made that missions are ill-equipped to handle this administrative burden. The situation arises, similar to others in the 1950s after the passage of Section 1415 (See Section III), in which missions may decide that the bureaucratic costs of funding projects through local currency accounts are higher than the cumulative benefits.

A.I.D. policy on programming explicitly states that the Mission and the host government should agree on the appropriate degree of A.I.D. involvement in programming local currency before any agreement is signed. A.I.D. policy also encourages USAID missions to participate in the programming of host country-owned local currency.[40] Within this framework, the mission and the recipient must agree on which type or types of programming are best in the host country context.

[40] A.I.D. "Supplemental Guidance on Programming Local Currency," HB 1, Part IV, 10/21/87, 2.

D. Ownership

1. Historical Perspective

The ownership of local currency funds is one of the key determinants of host country and U.S.-owned local currency resources. Prior to the Marshall Plan, Congress established a 5 percent deposit requirement of local currency generation which was later increased to 10 percent. These funds were transferred to special accounts under the control of a U.S. Disbursing Officer. Amounts remaining in these accounts were transferred to the U.S. Treasury for use by other Government Agencies.

The U.S. ownership of local currency generations created several problems under the Marshall Plan when the U.S. foreign assistance program expanded and the amounts of U.S. commodities distributed as part of the program increased significantly. Restrictions placed on the use of these funds required that agencies use the funds to finance projects that were of sufficient but not equal or greater importance than projects to be funded by appropriated dollars. This requirement discouraged the use of counterpart funds and encouraged the excessive accumulation of U.S.-owned local currency resources in recipient countries, threatening the economic stability of those countries. This discouraged the generation of U.S.-owned local currency resources for the next two decades.

These occurrences were not limited only to the Marshall Plan era. In the 1970s, large amounts of local currency resources were generated in countries such as India, creating potential threats to the economic stability of the economy and to the relationship between the two countries. The generation and accumulation of local currency funds exceeded their use which was hampered by bureaucratic requirements. In addition, the requirement that these funds be appropriated further discouraged their use.

2. Current Provisions Under the 1990 Farm Bill

Under this legislation, the responsibility for the administration of the food aid programs under PL 480 is divided between A.I.D. and USDA with concessional credit sales programs under Title I to be implemented by USDA. Title III programs have been replaced by a donation program which will be administered by A.I.D. and a donation program for public and private agencies under Title II for A.I.D. This division is an attempt on the part of Congress to clearly delineate responsibility and to reduce the amount of interagency involvement in the day-to-day operational decisions. In addition, the A.I.D. Administrator and the Secretary of Agriculture are permitted to determine whether funds generated can be host country-owned or U.S.-owned.

3. Ownership Implications for Planning and Budgeting

Ownership implies control and for this reason the issue of ownership in the management of local currency resources is important. The assumption can be made that U.S.-ownership of funds implies greater A.I.D. leverage over project activities implemented in recipient countries. This is not always the case. Through effective management of its CIP/cash transfer program in the Dominican Republic, the USAID mission found that control could be exercised for balance of payment support depending on project disbursements. Control over how the funds were spent gave the mission important leverage over the achievement of development objectives. The mission had persuaded the government to reduce the budget deficit, maintain its stabilization efforts and allow a market-determined interest rate to function. It established performance benchmarks for stabilization and structural reform components which were easy to measure. In addition, the mission created a Local Currency Coordinating Division as a counterpart to the Local Currency Coordinating Unit created by the Government within the Presidency.[41]

Furthermore, historical experience has shown that the ownership of local currency generations has created severe problems for A.I.D. in the past. In India, the U.S. owned a significant amount of the country's money supply during the 1970s until 1974 when the U.S. returned some $3 billion to the Indian Government. The build-up of excess funds in recipient countries threaten the country's economic stability and has significant implications for future relations between the recipient country and the U.S.

Moreover, U.S.-owned local currency resources must be appropriated, except for certain programs such as those administered under Section 108. This discourages its use, especially when host country local currency resources are an available option outside of the appropriation process. Appropriation restrictions are not the only restrictions that decrease the attractiveness of U.S.-owned local currencies. Because U.S.-owned local currencies are considered appropriated funds, their use is subject to Federal contract and procurement requirements which are difficult to meet in other countries. This is unlike host country local resources which are not subject to these requirements.

[41] Agency for International Development, Haris, Jafri, et al, "The Effectiveness and Economic Development Impact of Policy-Based Cash Transfer Programs: The Case of the Dominican Republic," (Washington, D.C., A.I.D. Working Paper No. 123, Robert R. Nathan Associates, May, 1989).

Besides the additional administrative requirements placed on mission and A.I.D. staff by the appropriation process necessary to obtain these funds, there are the additional accountability and control requirements imposed by the U.S. Treasury since these funds are required to be treated as appropriated funds. In recent times, Congress has placed constraints on A.I.D., by reducing its budget and limiting its staff. This trend has served to make the option of using U.S.-owned local currency funds less attractive.

E. Control

1. USAID Mission Control and Monitoring of Local Currency Accounts

The control and monitoring of local currency accounts has been a source of controversy for A.I.D. The Agency has come under severe criticism, both internally and externally, for its inability to effectively control and monitor its local currency generations. The Agency has defended itself arguing that administrative requirements for implementing such systems are demanding, and that implementation of these systems are difficult especially when it involves recipient country governments who are owners of the funds.

In general, increased control or ownership would imply greater administrative burdens for USAID mission staff. A reading of the current draft guidance places a significant administrative burden on mission staff to ensure that host country local resources are being managed effectively. In an audit of the Sahel program, A.I.D. found that the USAID missions were overburdened and unable to find the time to analyze and monitor all the transactions as required.[42]

However, in Egypt the USAID mission found that by creating a trust fund to improve the administration of its Local Development Project for the counterpart CIP/cash transfer generations, it could maintain control over the timing and distribution of the funds and increase A.I.D. leverage to influence sector-wide reforms in the country. Furthermore, it found that this could be

[42] Area Auditor General, A.I.D., Problems in Host Country Accounting for Utilization of A.I.D. Funds in the Sahel, (Washington, D.C., January 29, 1981, Audit report 81-35), 16.

accomplished without increasing the administrative burden on the mission staff.[43]

In June, 1989, A.I.D/FM/FPD conducted a Special Account Survey for the purpose of gaining a general sense of the resources required to effectively monitor special account activity. The survey concluded that although it may appear to be less costly for USAID missions to perform their own financial assessments, more U.S. appropriated dollars would be required. A detailed breakdown of these costs is contained in Exhibit 3.

2. Analysis of Approaches Advocated By

a. The A.I.D. Inspector General

There are disagreements between A.I.D. Management and its IG on the appropriate level of management for local currency resources. A.I.D. maintains that the monies belong to the host country and that they should manage them. Increasing accountability demands create problems for the relationship between A.I.D. and the host country who regard those funds as their own. On the other hand, the IG believes that A.I.D. should exercise more control over these funds because they are generated from U.S. assistance.[44]

b. The General Accounting Office

The GAO has found that in general, A.I.D. monitoring of local currency programs is characterized by agreements that are not clear or specific, inadequate accountability, weaknesses in host country compliance, and reporting and limited mission monitoring which has encouraged the belief that full host country compliance is not necessary. However, the absence of strong monitoring systems and other management weaknesses may have resulted in lost development opportunities and diminished the impact of programs in encouraging policy reforms.

The concept that ownership is necessary for effective management is not accepted by the GAO. It believes that accountability and control requirements are the same regardless of whether the funds are owned by the host country or by the U.S. In testimony before

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[43] From ANE/MENA, Vivikka Molldrem, To: The Assistant Administrator, Bureau for Asia, Near East and Europe. RE: Establishment of Trust Fund Account for Local Development II Project (263-0182), August 17, 1990, 2.

[44] General Accounting Office, Briefing Report to the Chairman, Committee on Foreign Affairs, House of Representatives, Use of Host-Country Owned Local Currencies, 31.

MONITORING LOCAL CURRENCY SPECIAL ACCOUNTS
COST ANALYSIS
NOVEMBER 1989

Exhibit 3

Local Currency Special Accounts			ASSESSMENTS - CONTRACT			ASSESSMENT - DH		AUDITS - CONTRACT				OVERALL MONITORING	
Mission	Number of Units	Assessmants Conducted	Contract Cost	USAID Monitoring WYs	USAID Monitoring Cost	Direct Hire Costs WYs	Direct Hire Costs Cost	Audits Conduted	Contract Cost	USAID Monitoring WYs	USAID Monitoring Cost	USAID Monitoring WYs	USAID Monitoring Cost
Cameroon	1	Yes						No	50.0	0.08	12.5	0.25	37.5
Lesotho	1	No	40.0	0.08	12.5	0.17	25.0	Yes				0.25	37.5
Zambia	3	Yes						Yes				0.75	112.5
Malawi	2	No	80.0	0.17	25.0	0.33	50.0	Planned	100.0	0.17	25.0	0.50	75.0
Mozambique	2	Yes						Planned	100.0	0.17	25.0	0.50	75.0
Cape Verde	1	Yes						Planned	100.0	0.17	25.0	0.25	37.5
Kenya	2	No	80.0	0.17	25.0	0.33	50.0	No	100.0	0.17	25.0	0.50	75.0
Gambia	1	No	40.0	0.08	12.5	0.17	25.0	No	50.0	0.08	12.5	0.25	37.5
Zimbabwe	2	No	80.0	0.17	25.0	0.33	50.0	No	100.0	0.17	25.0	0.50	75.0
Liberia	2	No	80.0	0.17	25.0	0.33	50.0	Yes				0.50	75.0
Somalia	2	Yes						Planned	100.0	0.17	25.0	0.50	75.0
Mali	2	No	80.0	0.17	25.0	0.33	50.0	Yes				0.50	75.0
Zaire	2	No	80.0	0.17	25.0	0.33	50.0	Yes				0.50	75.0
Burundi	2	No	80.0	0.17	25.0	0.33	50.0	Yes				0.50	75.0
Chad	2	Yes						No	100.0	0.17	25.0	0.50	75.0
Sudan	2	No	80.0	0.17	25.0	0.33	50.0	Requested	100.0	0.17	25.0	0.50	75.0
Ivory Coast	1	No	40.0	0.08	12.5	0.17	25.0	No	50.0	0.08	12.5	0.25	37.5
Seychelles	1	No	40.0	0.08	12.5	0.17	25.0	Yes				0.25	37.5
Mauritius	3	Yes						Yes				0.75	112.5
Senegal	1	No	40.0	0.08	12.5	0.17	25.0	No	50.0	0.08	12.5	0.25	37.5
Ghana	1	No	40.0	0.08	12.5	0.17	25.0	No	50.0	0.08	12.5	0.25	37.5
Burkina Faso	1	Yes						No	50.0	0.08	12.5	0.25	37.5
Rwanda	2	No	80.0	0.17	25.0	0.33	50.0	Planned	100.0	0.17	25.0	0.50	75.0
Uganda	2	No	80.0	0.17	25.0	0.33	50.0	Yes				0.50	75.0
Tanzania	2	Yes						Planned	100.0	0.17	25.0	0.50	75.0
Niger	1	Yes						Yes				0.25	37.5
Swaziland	1	Yes						Planned	50.0	0.08	12.5	0.25	37.5

MONITORING LOCAL CURRENCY SPECIAL ACCOUNTS
COST ANALYSIS
NOVEMBER 1989

Exhibit 3

Local Currency Special Accounts			ASSESSMENTS - CONTRACT			ASSESSMENT - DH		AUDITS - CONTRACT				OVERALL MONITORING	
				USAID Monitoring		Direct Hire Costs				USAID Monitoring		USAID Monitoring	
Mission	Number of Units	Assessments Conducted	Contract Cost	WYs	Cost	WYs	Cost	Audits Conduted	Contract Cost	WYs	Cost	WYs	Cost
Tunisia	2	No	80.0	0.17	25.0	0.33	50.0	Yes				0.50	75.0
Nepal	1	No	40.0	0.08	12.5	0.17	25.0	Planned	50.0	0.08	12.5	0.25	37.5
Jordan	1	No	40.0	0.08	12.5	0.17	25.0	Yes				0.25	37.5
Egypt	2	No	80.0	0.17	25.0	0.33	50.0	No	100.0	0.17	25.0	0.50	75.0
Pakistan	2	No	80.0	0.17	25.0	0.33	50.0	Yes				0.50	75.0
Philippines	2	No	80.0	0.17	25.0	0.33	50.0	Yes				0.50	75.0
Yemen	1	No	40.0	0.08	12.5	0.17	25.0	No	50.0	0.08	12.5	0.25	37.5
Bangladesh	1	No	40.0	0.08	12.5	0.17	25.0	No	50.0	0.08	12.5	0.25	37.5
Indonesia	1	Yes						Planned	50.0	0.08	12.5	0.25	37.5
Jamaica	1	No	40.0	0.08	12.5	0.17	25.0	Yes				0.25	37.5
Barbados	3	Yes						No	150.0	0.25	37.5	0.75	112.5
El Salvador	3	No	120.0	0.25	37.5	0.50	75.0	Yes				0.75	112.5
Bolivia	3	No	120.0	0.25	37.5	0.50	75.0	Yes				0.75	112.5
Honduras	3	No	120.0	0.25	37.5	0.50	75.0	No	150.0	0.25	37.5	0.75	112.5
Peru	1	Yes						Yes				0.25	37.5
Costa Rica	2	No	80.0	0.17	25.0	0.33	50.0	Yes				0.50	75.0
Dom. Rep.	3	Yes						Yes				0.75	112.5
Belize	2	Yes						No	100.0	0.17	25.0	0.50	75.0
Ecuador	3	No	120.0	0.25	37.5	0.50	75.0	Yes				0.75	112.5
Haiti	2	No	80.0	0.17	25.0	0.33	50.0	Yes-PL480	50.0	0.08	12.5	0.50	75.0
Guatemala	3	Yes						Yes				0.75	112.5
Cost to Complete			2,200.0	4.58	687.5	9.17	1,375.0		2,100.0	3.50	525.0	21.75	3,262.5
Completed			1,280.0	2.67	400.5	5.33	799.5		2,250.0	3.75	562.5		
Total Cost			3,480.0	7.25	1,088.0	14.50	2,174.5		4,350.0	7.25	1,087.5	21.75	3,262.5

Source: AID/FM/FPD Special Account Survey, June 1989.

MONITORING LOCAL CURRENCY SPECIAL ACCOUNTS
COST ANALYSIS
NOVEMBER 1989

Exhibit 3

Assumptions

1. Number of units is based on an assumption that one host country agency will be responsible for each local currency source.

2. U.S. Direct Hire (USDH) Workyear (WY) is based on a standard cost of $150,000, excluding USAID mission overhead.

3. Assessment - Contract is based on a standard cost of $40,000 and a standard time of 1 month per USDH employee to manage a contract.

4. Financial Assessments are based on the assumption that all host country agencies involved in the management of local currency resources will be formally assessed by USAID mission staff. The standard time assumed for a USDH employee is 2 months.

5. Audit - Contract assumes that all audits will be performed by contractors at a standard cost of $50,000 for 1 multi-year audit of each agency The further assumption is made that annual audits are not being performed. USDH time for managing each contract is 1 month.

6. Program Monitoring assumes 3 months of USDH time per year for each host country unit, including 1 month for each financial management officer, a program officer and appropriate technical office representative to review host country reports, verify reports, conduct site visits, and meet and negotiate with host country officials.

the House of Representatives, the GAO pointed out that the local currencies generated from Title I and Title II, government-to-government food aid programs, belong to the host country government and that the issue of ownership of the monies does not determine whether they are properly or effectively used.[45] Accountability and financial management requirements are the same regardless of the ownership of the funds.

Joint programming relates to the use of the funds for appropriate development purposes and accountability ensures that these purposes are met. The GAO further testified that it did not support making local currencies U.S.-owned even though the argument was made that it is easier to monitor and account for funds over which the missions has ownership. The GAO sees the opportunities to improve the financial management capabilities of the host government as part of developmental assistance to the government.

It is also concerned that U.S.-ownership of large volumes of local currency could lead to the kinds of problems experienced in the 1970s, as in the case of India. More recently, local currency funds have accumulated faster than they have been used because of numerous constraints, threatening the economic stability of the host country. In some countries, these funds are near or exceed 9 percent and in Costa Rica, they were 12 percent in 1988. If these were U.S-owned, a potential for political problems would be created. In addition, U.S.-owned local currency resources impose additional accountability requirements.

Furthermore, the GAO believes that allowing for changing the ownership of funds proposed under the Farm Bill of 1990 is contrary to the development goal of allowing recipient countries management of their own resources through the improvement of their financial management systems, since the accountability requirements are the same for host country local currency resources. This has the potential of giving rise to concerns on the part of recipient governments, that their sovereignty is being infringed.

c. The U.S. Congress

The belief that the local currency resources generated under U.S. foreign assistance programs are real and represent funds on deposit in accounts for use to finance development project is one that is held strongly by some members of Congress. For this

[45] General Accounting Office, Using Local Currency Generated By U.S. Food Aid for Development Purposes, 2.

reason, Congress has passed legislation in the past to ensure that these resources are accounted for and controlled. However, recognition that this has been difficult to accomplish in the past has encouraged Congress to institute the changes it has in the 1990 Farm Bill.

Under the Farm Bill, the administration of the foreign assistance programs is divided between A.I.D. and the USDA, reducing A.I.D's responsibility for the overall management of the program. The legislation also provides the Secretary with the option of requiring repayment on loans in dollars and to not generate local currency funds unless needed. Furthermore, the legislation permits flexibility in programming and on ownership issues as well as determining deposits. Under the current legislation, the amounts deposited can be "equivalent" amounts of local currency resources and not the actual amounts of the sale proceeds. These changes will provide the two agencies with greater flexibility in managing their local currency programs.

3. Analysis of recent A.I.D control policies

In October 1990, A.I.D. issued draft guidelines for the financial management of host country local resources. Under this guidance, local currency resources are to be deposited in special accounts, regular reports on their deposit, withdrawal and use are to be issued, audits are to be conducted monitoring systems for the implementation of activities funded by local currency resources are to be established. As uses become more specific, monitoring responsibilities increase. Individual projects will require more monitoring than local currency programmed for general sector support or of a Ministry. If an acceptable level of accountability cannot be assured for an anticipated type of programming, then that type should not be approved.[46] Therefore, the mission must be sure that it chooses the form of programming that would be most appropriate for the economic environment and will support better accountability.

The draft guidance identifies three levels of accountability:

- **Monitoring the special account to ensure that deposits and withdrawals are made in accordance with agreements**

Under the guidance, funds from different U.S. assistance sources should not be co-mingled in the same account. ESF cash transfer local currency generations should not be co-mingled with local

[46] Agency for International Development, Office of Financial Management, Supplemental Guidance, 9.

currencies generated under a CIP program.[47] USAID missions are also required to ensure that the host country government is carrying out its management functions since the degree of mission involvement in oversight is determined by the management capabilities of the host country government. In cases where local currency is to be generated, the program assistance approval document (PAAD) must specify the government agency or specific unit responsible for the administration of the account, and a conclusion as to the capability of the host government agency to effectively manage the account including the ability of the agency to arrange for or perform financial assessments or audits of recipient organizations if funds were used to support local currency project costs.

Efforts should also be made to provide for appropriate reporting by the host government on the management of the funds and report on the status of the special account. The format of the report should be outlined as soon after the agreement is signed as possible, and should cover information on deposits to, withdrawals from and use of local currency from the special account. In addition, it should also outline the required documentation that has to be submitted by the government and the mission should also receive copies of the statements directly from the bank. Missions will also be expected to develop a plan to verify accuracy of reports and at least one report should be verified on an annual basis. The frequency and scope of verification of reports should be based on the capabilities of the host government as determined in the financial assessment.

The conclusion as to the ability of the host country government to manage these funds can be determined by an independent review of the financial systems of the agency, past mission experience, or a formal financial assessment if the agency has not managed an account before or has done a poor job previously. This involves a review of the financial systems to determine whether sufficient personnel, systems and internal controls exist to manage the account and can be performed by an independent contractor or mission personnel and funded by program development and support funds (PD&S) (See Exhibit 3). Either dollar or local currency funding can be used and technical assistance to strengthen an agency's capabilities can be considered.

Missions must also ensure that the special accounts are audited periodically and these auditing requirements should be laid out in the agreement. The audits may be performed by a local firm,

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[47] However, once the disbursement takes place, the funds may be commingled and could be considered an "equivalent" of local currencies. Ibid., 4.

government central audit agency or another acceptable audit entity. The agreement should contain a discussion as to how this will be performed and whether it will be a private or public entity. If it is the government, efforts should be made to discuss in the agreement the agency's ability to perform an independent and fair audit.

- **Ensuring that the currencies are used for the established agreed upon purposes once they have been disbursed from the special accounts.**

Missions will also be required to conduct general assessments of the accountability environment of the host country, probably a minimum of once every five years, or in the case of substantial changes in the country such as a change in the administration. This assessment should include an overview of the host country's budgeting and financial management systems, an analysis of financial systems and other factors such as the quality of accounting and financial management capabilities, personnel, expenditure and allocation systems and mission prior experience. In cases where a general assessment was conducted and resulted in a decision against budget support but an individual mission wants to use this type of programming, it must develop a description of how the monitoring will take place to ensure that accountability requirements are met or in the case of general budget support that the funds were deposited in the general fund. The PAAD should also contain a specific assessment of the appropriate programming alternatives available to the mission based on the general assessment.

- **Evaluating the impact of the local currency programs.**

The USAID missions are also expected to develop performance indicators which are specific measures of project outputs. They are expected to evaluate the impact of program activities funded by local currency generations to determine whether the performance criteria has been fulfilled.

F. Congressional Appropriation

1. Analysis of Congressional Participation in Programming Local Currencies

Within the U.S. context, the provision of foreign assistance involves a demand for real resources which entails the appropriation of funds from Congress and taxation to finance the expenditure. To the U.S. Congress, any payments made or budgeted under the Foreign Assistance Act or P.L. 480 represent an outflow from the U.S. Treasury. Any inflows to offset these transactions, whether they are in local currency (inconvertible or not) or dollars are important, especially when the issue of spending them arises.

In 1953, Congress passed Section 1415 of the Supplemental Appropriations Act of 1953 which required that all expenditures of U.S.-use local currencies be appropriated by Congress. This legislation was intended to provide greater Congressional control over U.S.-use local currencies. However, this created programming problems for the agencies because they had to trade-off priority programs that were funded by dollar appropriations and projects that were not as important to be funded in local currencies, even though the actual expenditures themselves would be occurring in local currencies. With Section 1415, agencies with programs that could have been funded entirely by local currencies at no cost to their dollar appropriations now had to use dollar appropriated funds to purchase local currencies from the Treasury.

Under the special foreign currency program (SFC) which began in 1961, a system was established for submitting appropriation requests to Congress for programs to be financed out of excess local currencies. Programs were expected to be important enough to be included in the agency's regular dollar budget but of less importance than those actually in the budget. These requests were denominated in U.S. dollars and the dollars appropriated for SFC programs were used to purchase local currencies from the U.S. Treasury. If the local currency used for the purchase originally came from P.L. 480, then the dollar amount of the appropriation would be charged to the Commodity Credit Corporation (CCC) lowering the overall appropriation dollar requests of the CCC to Congress in the next year.

The appropriation process discouraged missions from making as effective use as they could of the SFC and local currency funding was utilized much less often than it could have been.[48] The reasons cited were based on the fact that the appropriations were dollar appropriations and that in some cases, the foreign currency programs were in direct competition with the dollar-funded programs.

With the passage of the Food for Peace Act of 1966, host country local currencies generated by food aid programs were explicitly exempted from the appropriations process. In addition, this legislation limited the use of local currencies for anything but "economic development purposes." Sections 103(b) and 104(b) of P.L. 480 demonstrated that Congress intended a different method

[48] U.S. Congress, The Availability and Use of Local Currencies, 23, Appendix II-g.

of raising local currency needed to cover the operating expenses of the USAID missions instead of using country-owned local currency resources which were restricted for "economic development purposes." Section 103 provides that the President should "determine the amount of foreign currencies needed for the uses specified in subsections...(b)...of section 104 [payment of United States obligations]..., and the agreements for credit sales shall provide for payment of such amounts...in foreign currencies upon delivery of the agricultural commodities..." [49] Because the agreements for credit sales were tied to the appropriations process, the funds for Mission operating expenses were therefore appropriated.

Congress appears to have intended to use the appropriations process to assist it in maintaining control over USAID mission budgetary activities, while freeing local currency resources for "development purposes" from bureaucratic restrictions as much as possible. Whether this approach was the result of concerns over excess local currency balances that developed in some countries as a result of Section 1415 is uncertain. However, it is clear that the intention of Congress was to develop a two-tiered resource allocation system to serve its management and development objectives simultaneously.

Under the new P.L. 480 Congress has taken an active interest in programming certain kinds of assistance. Permissible programming uses include:

- Trade Development
- Agricultural Development
- Agricultural Business Development Loans
- Agricultural Facilities Loans
- Trade Promotion
- Private Sector Agricultural Trade Development
- Research
- Payment of U.S. Obligations

According to the Conference Report, the Congress intends to exempt from the appropriation requirement local currencies used for any of these purposes except for the payment of U.S. obligations. Paying U.S. obligations with local currencies

[49] A.I.D., "Local Currency Generated Under Food Sales Programs," Memorandum To: GC, Howard M. Fry From: GC/CP, Stephen Tisa, 03/07/88, 5.

requires that the host country enter into special agreements with the United States.[50]

The conference managers intended that this exemption from the appropriation requirement will apply to uses of these local currencies by A.I.D. for agricultural development and other activities relating to A.I.D. programs in developing countries. The Congress seems to be developing a system through which it can maintain some control without taking over the burden of the Executive Branch to execute the law. This seems to be consistent with the public statements of Senator Leahy and other members of the various committees involved with foreign aid programs.[51]

2. The Role of Earmarks

Earmarks have played an increasingly important role in foreign assistance allocation in the past fifteen years. Congressional earmarks legally bind A.I.D. to direct certain resources to usually very specific projects or sectors. Although there does not seem to be a great deal of congressional earmarking of local currency funds, there may be if U.S.-owned local currency generations become significant under the new legislation.

Key members of Congress have repeatedly renounced the excessive use of earmarks in foreign aid programming. In the 1970s and 1980s Congress used earmarks to keep tight checks on the executive branch. However, Senator Leahy, among others, has expressed an interest in limiting the use of earmarks to give the Executive Branch greater flexibility over foreign affairs in the current dynamic global setting. In fact, Congress seems to be moving away from the excessive use of earmarks characteristic of the mid-1980s, but remains reticent in its position that it has the authority to guide foreign aid allocation to a significant degree - a point of significant contention between the State Department and Congress.

[50] U.S. Congress: "Title XV - Agricultural Trade; Committee Report," Washington, D.C., 1990, Section 13

[51] Ibid.

G. Procurement Policy

1. Application of Federal Acquisition Regulations (FARs) to Local Currency Uses

The application of Federal Acquisition Regulations (FARs) to local currency is in part determined by ownership rights. The U.S. ownership of local currency funds requires that the use of these funds be managed under the same requirements as appropriated dollar funds. This means that the FARs apply to the use of U.S.-owned local currency resources even though the application of these regulations may not be appropriately applied in overseas situations. Furthermore, the FARs are not applicable to host country-owned local currencies since these funds are subject to the regulations of the host country government.

In addition to the appropriation requirements placed on U.S.-owned local currency resources which requires that they be treated as appropriated dollar funds, the contracting and procurement requirements increase the administrative burden imposed on mission staff and in some cases, can discourage the use of U.S.-owned funds, especially when the option of using host country funds exists.

2. Analysis of Alternative Approaches to the Application of FARs

Although U.S.-owned local currency resources are treated as appropriated dollar funds and are subject to federal contracting and procurement requirements, there have been situations in which these requirements have been waived. Under PL 480's Section 108, U.S.-owned local currencies generated under Title I are maintained in the recipient country for ten years during which time, the funds are on-lent to indigenous IFIs to further A.I.D.'s private sector objectives in that country. Such programs have existed in Morocco, Jamaica and the Dominican Republic. The appropriation requirements were waived for these programs as were the federal contracting and procurement requirements.

H. Operating Expenses

1. Historical Perspective

As previously discussed, USAID mission operating expenses are not considered a legal use of P.L. 480-generated host country-owned funds per Title I, Section 106 (b), Title II, Section 206 and Section 416 (b). According to these pieces of legislation host-country owned local currency funds are to be used to cover economic development costs which may include the administrative costs of the local currency generating programs. However, Section 104 of P.L. 480 allows for U.S.-owned currency proceeds expenditure for the payment of U.S. obligations, which is a broad term that could include USAID Mission operating expenses. U.S.-owned currencies generated under Section 103 (b) for payment of U.S. obligations under Section 104 (b) requires an appropriation by Congress.

In the 1970s Congress emphasized the use of host-country funds for agricultural development assistance, nutrition programs, rural development, population planning and, to some degree, Mission operating expenses. In 1973, A.I.D. financed about $170 million of Mission operating expenses of which $57 millions was from an administrative expenses appropriation and the balance from program accounts. This practice was criticized by Congress since it intended that operating costs to be covered from a distinct and separate appropriation account. Country-owned monies were restricted for use for "economic development purposes" and U.S.-owned funds for operating expenses were bound by the appropriation process.

2. Trust Funds

Under the Foreign Assistance Act of 1961, A.I.D. can enter into agreements with recipient governments to share the operating costs of Missions through trust funds. Local currency trust funds generated by assistance programs are expected to be used in the same manner consistent with any existing restrictions in the legislation authorizing the program which generated the funds.

Reduced budgets have stimulated the utilization of local currency trust fund arrangements authorized by ESF. ESF assistance exceeded $2 billion in the early 1980s and was responsible for generating substantial local currency resources for operating expenses. As of September 1987, trust fund agreements between A.I.D. and 27 counties accounted for $55 million of the total $177.7 million obligated in 1987 for mission operating expenses worldwide.[52]

In addition, research has shown that in some cases, the amount of appropriated dollars for operating expenses covered under trust

[52] General Accounting Office, Foreign Assistance, Briefing Report to the Honorable Lee H. Hamilton, Committee on Foreign Affairs, House of Representatives - Problems and Issues Affecting Economic Assistance, (Washington, D.C., General Accounting Office, Foreign Assistance, December 1988), 8.

funds had decreased.[53] However, it is difficult in some countries to jointly program monies or negotiate large trust funds with recipient governments. In some countries, they account for a substantial amount of the local currency resources. At one time in Costa Rica, for example, the USAID mission trust fund accounted for 90 percent of the mission's local operating costs, or about 9 percent of the total ESF program.[54] A similar situation exists in Jamaica where the USAID mission has a strong working relationship with the Government of Jamaica. As a result of this relationship, the USAID mission has been able to access host country local currency resources for operating expenses trust funds with a high degree of success. A significant amount (almost 70%) of mission operating expenses are funded by trust funds, with about 30% being supplied by host country local currency resources generated by ESF programs.[55]

Trust funds can also be useful in the case of reverse accommodation exchange where local funds are used to purchase dollars for dollar operating costs. In Honduras, the mission estimated that it could save $525,000 in appropriated fund operating expenses in FY89 by using local currency in trust funds to purchase dollars to cover dollar costs. In Egypt, the mission identified about $907,000 that could be saved by the Mission in future years through the use of reverse exchange accommodation transactions.

I. Experience of Other Donor Agencies

The approaches adopted by other international donors and donor countries to the management of counterpart funds differ, although there are areas of similarity with the approaches utilized in the U.S. foreign assistance program. One of the most significant difference lies in the programming of these funds. Within the EEC, some countries earmark their funds while others leave the programming of the funds entirely to the discretion of the recipient government. In the case of other international donor agencies such as the World Bank and the International Monetary Fund (IMF), the generation and use of counterpart funds is

[53] _Ibid_., 13.

[54] _Ibid_., 17-18.

[55] In an interview with Marjorie Lewis, the Comptroller at the USAID mission in Jamaica, she stressed the importance of the relationship between the USAID mission and the Government of Jamaica and the importance of trust funds in the financing of mission operating expenses.

closely tied to structural adjustment and stabilization programs implemented by the two organizations.

The impacts of counterpart funds on the economy of a recipient country is dependent on the type of assistance that is provided. When goods are sold to the private sector, the effect is deflationary, a decrease in the money supply and an increase in government deposits from the creation and accumulation of counterpart funds. If the government deposits the funds in the central bank or in commercial banks, the effect on the money supply is neutral.

When the assistance takes the form of a loan in foreign exchange or a grant, net foreign assets are increased and net credit to the government is decreased. However, if the counterpart funds are generated from the purchase of foreign exchange by the private sector, the effects on the money supply differ depending on where the deposits are made. If the deposits are made in commercial banks, the effect on the money supply is neutral. If the deposits are made in the central bank, the ability of the commercial banks to provide credit is increased.[56] In these situations, the generation and accumulation of counterpart funds could be managed to reinforce other macroeconomic policies intended to reduce inflationary pressures and balance of payments deficits.

The generation and accumulation of counterpart funds in themselves do not threaten the stability of the recipient country's economy. The real problems develop with the use of these accumulated funds, especially in relation to the timing of the use of these funds. If the recipient country uses its funds to repay its debt to the central bank, the effect on the money supply is neutral. However, if the funds are used to repay maturing debt to the public and the source of the counterpart funds is the sale of commodities and the counterpart funds are deposited in the central bank, the money supply increases. The effect is similar if the funds are used to fund an expenditure that may have otherwise not been undertaken.[57]

International donor agencies, such as the World Bank (the Bank) and the IMF believe that these effects can be controlled through the use of counterpart funds that are an integrated part of a well-designed macroeconomic program and budgetary process,

[56] International Monetary Fund, Jean A.P. Clement, "The Macroeconomic Impacts of Counterpart Funds," IMF Working Paper, [Washington D.C., August 18, 1989], 6-9.

[57] Ibid, 10.

especially in conjunction with the Bank's and the IMF's structural adjustment and stabilization programs. In fact, foreign assistance programs and the counterpart funds generated by them can be managed and utilized in such a fashion as to reinforce and support macroeconomic programs that promote economic stabilization in the recipient country.

1. International Donors

a. The World Bank Group

The approach of the World Bank to the generation of local currency has undergone several changes since the establishment of the Bank. In its Articles of Agreement (Article III, Section 4 (vii)), the Bank states that

> Loans made or guaranteed by the Bank shall, except in special circumstances, be for the purpose of specific projects of reconstruction or development.

The Articles go on further to state that loans made by the Bank are intended only to cover the direct foreign exchange costs of a project since Bank's policy prohibits it from covering the whole cost associated with a project. Therefore, until the 1960s, Bank loans did not generate counterpart funds and recipient governments were expected to find their own sources of counterpart funding.

Since the 1960s, Bank policy has changed to permit the generation of counterpart funds. In the case of loans related to projects, counterpart funds are generated when recipient governments on-lend the proceeds to sub-borrowers with faster repayment schedules than the Bank's. In the cases of program loans and credits, counterpart funds are generated from the payments for the foreign proceeds of the loan that the recipient government makes available to the public.

Based on agreements with the recipient government, the Bank assigns these funds to the government's development budget and a special account to finance expenditures related to the government's development plans. However, in some cases with government agreement, these funds have been allocated to more specific, high-priority development projects such as the local costs of investment projects including those funded by the Bank. In none of these cases does the Bank require prior approval for counterpart expenditures.

For the Bank, this issue of accountability is minor since the funds are projectized and expenditures are made under the structural adjustment operations. According to the Bank, when the approval of the donor agency is required to spend funds, the chances of these funds being spent in timing with their generation and accumulation decreases and the funds accumulate, throwing the timing off and creating potential inflationary pressures when they are used because the lag between the generation and use increases. Since the Bank monitors public expenditure programs as part of its structural adjustment programs, it maintains that with a review of program supervision and an understanding of the structure and level of public spending, there is no need for earmarking.[58]

b. International Monetary Fund

Unlike the World Bank, funds provided to developing countries by the IMF are provided primarily for balance of payment and not budgetary support. IMF assistance does not generate counterpart funds because funds provided to the government are not treated as loans but as a change in reserves. The IMF purchases of local currency increases the country's holdings within the Fund and increases the country's dollar holdings. The opposite occurs when the country purchases local currency with dollars. In this situation, the IMF sterilizes the local counterpart.

The IMF views the primary objective of food assistance to be in support of the country's balance of Payments and not of the budget. This leads to the conclusion that counterpart funds should not be generated as this is not the objective of the aid. Furthermore, the proliferation of special accounts, outside of the budget, creates an additional administrative burden on the host country government to monitor these accounts and increases the probability of corruption in countries that have weak financial management systems. In addition, the creation of special accounts outside of the budgetary process threatens the integrity of the process and causes it to degenerate which is contrary to the objectives of the IMF and World Bank stabilization programs.

Funds provided by the IMF for balance of payment support are generally shown as part of net foreign assets of the monetary authorities and is regarded as domestic financing from the local banking system, not resulting in local counterpart funds. IMF policy on the counterpart funds requires that the timing of the use of counterpart funds be kept as close as possible to the original transactions that generated the funds, provided that this is appropriate in the economic environment. The monitoring

[58] Commission of the European Communities, Bernard Petit, "Discussion Paper on Counterpart Funds," (Directorate General, Commission of the European Communities, Brussels, October, 1990).

of these funds through a special account does not take into account the fact that money is fungible and that directing funds toward "narrowly defined expenditures" can be offset by changes in other parts of the budget, causing the financial resources to be used for other purposes while counterpart funds accumulate. Furthermore, the stricter the conditions placed on use placed by the donor, the greater the likelihood that the funds will increase over time, increasing the possibility of inflationary pressures at a later time. In some countries, the amounts that have been accumulated are large. According to Fund estimates, around the middle of 1989, counterpart funds were equivalent to 20 percent of the M2 in Guinea and 22 percent in Malawi, 49 percent in Madagascar and 91 percent in Guinea-Bissau.[59]

For these reasons, the IMF favors not earmarking counterpart funds specially in countries that are implementing World Bank or IMF adjustment programs and maintaining the pace at which the funds are used, in keeping with the other macroeconomic conditions and policies that are in place. If the creation and use of counterpart funds are simultaneous, then the effect on the money supply depends on the type of use made of the funds. Strict control often leads to the creation of special accounts outside of the budget and the proliferation of these accounts, makes it more difficult to monitor counterpart funds, creating the likelihood of conflicts between the generation and use of the funds and other macroeconomic policies. In these cases, the use of untied funds makes more sense in recipient countries where the adjustment programs funded by the Bank and the Fund are being implemented since sound public investment programs and close monitoring of government expenditures are part of the programs.

There have been occasions in which attempts have been made by A.I.D. to program its local currency funds in conjunction with the objectives of IMF/World Bank programs. In an analysis of the Cash Transfer Program in the Dominican Republic, Nathan and Associates cite five elements that contributed to the success of the program. These were the size of the cash transfers, the terms of the resource transfer, the timing of the disbursements, the use of sanctions to enforce conditions precedent and covenants, and policy dialogue. To lessen the impacts of policy reform, USAID/Dominican Republic tailored the size of the cash transfers to reduce the impacts of the adjustment efforts required by the Government. Furthermore, because of the compatibility between the objectives of the cash transfer program objectives and those of the IMF, there has been coordination

[59] Ibid, 5.

between the two institutions since 1974 and the implementation of mutually supportive programs.[60]

2. Other Donor Agencies

a. Canadian Industrial Development Agency (CIDA)

For the most part, the policies adopted by CIDA are in keeping with the approaches advocated by the World Bank and the IMF, although they differ from geographic region to region. In general, however, foreign assistance programs that generate counterpart funds are owned by the recipient governments and are generally included in general government funds in situations where CIDA is comfortable with the government's policies. In extreme situations, where there are concerns about corruption and other policies considered to be unacceptable, CIDA requires that the funds be placed in a special account, usually outside of the central bank. Between these two situations, there is a "grey area" in which a variety of controls can be implemented. In some cases, agreements may stipulate that CIDA control 20 percent of the funds and any funds in excess would go to the government's general revenues. In others, agreements may require that funds be programmed for the local currency costs of Canadian projects. Use has been made of counterpart funds to finance the local currency operating costs of the aid programs but this is not a standard practice. In general, local currency funds are not earmarked although there have been situations where CIDA has had problems negotiating support for private sector institutions and NGOs with recipient governments.

There are no current mandatory requirements for the control, monitoring and programming of counterpart funds although this may change in the future. The administration of the programs are left to the discretion of the local CIDA Mission Administrator who determines whether the control and monitoring procedures of the host country government are appropriate. In cases where the government is corrupt such as Zaire, stronger controls and greater monitoring is required. The option of generating Canadian-owned local currency funds does not exist. This is based on the belief that the administrative burden for monitoring and controlling these funds would be heavy. Furthermore, the monitoring requirements imposed on counterpart funds is much less

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[60] Agency for International Development, "The Effectiveness and Economic Development Impact of Policy-Based Cash Transfer Programs: The Case of the Dominican Republic." Prepared by Haris Jafri, et al. (Robert Nathan Associates, Washington D.C: May, 1989).

than those imposed on Canadian dollar funds. CIDA does not have the responsibility for auditing the funds held by the recipient government and rely on reports from the governments. However, Canadian government auditors are beginning to look more closely at the management of these funds.

As mentioned previously, the approaches to the generation and use of counterpart funds differ within CIDA. In the Africa Region, counterpart funds programming is accomplished at the policy level, within the context of structural adjustment programs and the public expenditure process, rather than at the project level to initiate long-term change in government policies. If recipient governments are not capable of handling the funds, changes are made in the type of assistance provided to emphasize assistance that does not generate counterpart funds. However, in the Americas Region, the use and generation of counterpart funds is encouraged to alleviate poverty within the context of structural adjustment programs funded by the World Bank and the IMF. Not only are there differences in programming, but also in the level of monitoring which differs from country to country. In Bolivia and Peru, the monies are included in general funds. In the case of Guyana, these funds are projectized and targeted to Canadian NGOs.

b. European Economic Community

Foreign assistance from the European Community to developing countries has traditionally taken the form of grants that generate counterpart funds. However, starting in 1991, under Lome IV, adjustment assistance will increase with the introduction of structural adjustment grants. Overall community policy has supported the use of counterpart funds for financing specific projects and programs. Under the new Convention, greater emphasis will be placed on a macroeconomic approach and counterpart funds generated can be used for "targeted budgetary support" to avoid the termination of essential services such as health and education.

Individually, the practices of the European Community differ from member to member and are discussed below for selected countries.

i. Netherlands

Counterpart funds are generated from grants of which 75 percent in 1989 were used for BOP support and 20 percent for food aid. The use of the funds are left to the discretion of the recipient government as long as the country's social and economic policies are sound. In situations where this is not the case, use is made of it as general sectoral assistance such as in the development budget or in health or education sectors. Earmarking is an exception rather than a rule.

ii. United Kingdom

As in the case of the Netherlands, almost all assistance generating counterpart funds is in the form of grants. The policy of the Overseas Development Agency (ODA) is to use counterpart funds to support public expenditures that are part of a structural adjustment program.

iii. Spain

Most of the assistance that generates counterpart funds comes from grants of food aid. Commodities are sold at market prices and the proceeds have to be deposited within 6 months in commercial banks in special accounts. These are earmarked for specific projects and programs or targeted budget items. Counterpart use is reviewed every two years in joint meetings.

iv. France

Counterpart funds generated from food aid and import programs are used to finance bilateral projects, providing general budgetary support or supporting structural adjustment programs. These could include the reduction of government debt or the recapitalization of public enterprises or development banks.

v. Germany

Assistance provided by Germany is provided in the form of grants and counterpart funds generated by food aid programs and are generally earmarked for specific budget items. The use of counterpart funds generated from import programs are generally left up to the recipient governments. However, there have been cases of earmarking in the past. These uses have been the products of bilateral negotiations and have been specifically used to finance local costs of projects for which Germany is providing the foreign currency funding. However, there is a tendency to try to avoid earmarking.

V. CONCLUSIONS AND RECOMMENDATIONS

A. Introduction

Before discussing the conclusions drawn from the research conducted for this study, it is necessary to develop a framework in which this conclusions are valid. The principal element of this framework relates to the experiences of the USAID missions. USAID mission experiences differ from one country to another. Since the management of local currency programs cannot be divorced from the economic, political and social environments in which they are developed, it is difficult to develop programs that will respond to every situation. Programming decisions have to be made in the context of other macroeconomic programs as does the decision to generate U.S.-owned or host country local currency resources.

Furthermore, these decisions are based on broader issues such as U.S. development objectives which may differ from year to year or unexpected changes in the political or economic structures of the host country governments. Historical evidence of this exists. In the past, A.I.D. has put emphasis on the programming and generation of U.S.-owned local currency resources and then changed its programming focus to host country resources. The decision to generate U.S.-owned or host country local currency resources is also linked to other broad policy decisions such as the kind of foreign assistance program the U.S. government would like to promote; whether its objectives would be to direct and control aid to recipient countries in order to ensure that the desired development goals are achieved or to encourage recipient countries to manage their own resources or, on a more specific basis, whether its objective would be to provide balance of payment support, in which case no local currency should be generated, or to provide budget assistance. These objectives determine the nature of programming, control, ownership, monitoring and accountability levels.

B. Conclusions

The research conducted for this study has led to the following key conclusions:

- <u>Effective accountability and control of local currency resources do not require U.S.-ownership.</u>

According to the GAO, the ownership of local currency generations does not determine the degree of management over the deposit, withdrawal and use of these funds. The level of accountability is determined by the source of those funds which are, in these situations, U.S. foreign assistance (appropriated) programs. Although host country-owned local currencies do not require the same level of accountability as U.S.-owned local currency and dollar funds, if USAID missions elect to generate local currency funds, they are also responsible for the effective and efficient utilization of these funds.

- <u>Control over programming and the achievement of development objectives can be effective regardless of ownership rights over local currency resources.</u>

A major concern in providing assistance to foreign countries is ensuring that the development objectives of that country are valid and that they are in keeping with U.S. development objectives for that region. One of the best means of ensuring that these objectives are met is to use local currency funds which are controlled and administered by the U.S.

However, USAID mission experiences have proven that control can still be exercised over host country local currency funds to achieve desired development objectives. This has been the case in Egypt where a trust fund has been set up by the mission to control the flow of counterpart funds for a project; in the Dominican Republic where the USAID mission's management of its CIP/cash transfer program enabled the Government to achieve its economic stabilization goals and in Jamaica where local currency resources have increased the USAID mission's leverage with the Government of Jamaica in implementing economic reforms.

- <u>Accountability and control requirements for local currency resources are labor intensive.</u>

One of the chief reasons for the inability of USAID missions to effectively manage their local currency resources has been the amount of staff time required to monitor and control these funds. Due to reductions in mission operating budgets and restrictions on the hiring of personnel, additional management requirements for local currency management increases administrative burdens of the existing mission staff.

While it depends on the programming use to which the local currency resources are put, this burden can be reduced. If local currency funds were used to finance the local currency component of projects with are within the USAID mission's DA portfolio, the administrative burden on the mission staff would not increase significantly. On the other hand, if these funds continue to be used to fund activities outside of the USAID mission's specific development program in support of a "shadow program", the administrative burden would be increased. This is especially important in assessing the administrative impact of generating and programming U.S.-owned local currency funds.

- <u>Technical assistance is required to strengthen host country financial systems to meet A.I.D. monitoring requirements.</u>

With the emphasis shifting to host country financial systems, it has become crucial that the weaknesses that have existed in these systems and will continue to exist, have to be addressed if the host countries are to assume, or even share, monitoring and control responsibilities. This will require further technical assistance to these institutions to enable them to fulfill this role and to comply with the requirements set out in the new guidance.

- <u>A balance between management requirements and development impact should be key in making programming decisions.</u>

Programming decisions are influenced by a number of factors but the most significant appear to be those of accountability and development impact. The GAO has noted that significant development opportunities have been lost as well as leverage over the achievement of economic reforms in host countries because of weaknesses in accountability systems. It is therefore crucial that program decisions include accountability considerations. If these systems are in place and functioning effectively, the impacts of the development programs and of the local currencies used to fund them will be greater.

- <u>Delays between generation and accumulation and use of local currency funds create problems in the economy and this is aggravated in situations where joint programming is necessary.</u>

The timing of use of counterpart funds, in the opinion of donor agencies such as the World Bank and the IMF, is crucial to the impact of these funds on the economy of the host country. The longer the lag time between generation and use, the greater the potential for counterpart funds to fuel inflationary pressures.

- <u>There is a need for greater cooperation among donor agencies to ensure that local currency plans are in accordance with other existing macroeconomic programs in the host country.</u>

Since counterpart funds are used to achieve certain development objectives within host countries, their use should be coordinated and conducted within the context of existing and future macroeconomic programs such as those being implemented by the World Bank and the IMF.

- o <u>Operating expenses can be funded from host country local currency resources placed in trust funds and do not required U.S.-owned local currency generations.</u>

One of the arguments in support of the generation of U.S.-owned local currencies could be its use to cover a greater share of operating expenses. It is unclear however, what the impact such usage would have on dollar appropriations for operating expenses. Experience has shown that in some cases, the funding of operating costs with local currencies have resulted in lower dollar funding for these costs. In others, the levels have remained the same.

In some cases, it is easier to fund operating costs through trust funds based on agreements with the recipient country government and this has been done by several USAID missions although in other USAID missions, the host country governments have been reluctant to support this practice.

- o <u>In some countries, funding of private sector activities is prohibited under government regulations and may required U.S.-owned sources of local currency.</u>

Perhaps the most persuasive argument for generating U.S.-owned local currency resources is the difficulty donor agencies have experienced programming local currency funds to support private and non-profit institutions in some donor countries. This has been the experience of USAID missions in the LAC region and of CIDA.

- o <u>In some situations, the determining factors for generating and programming local currency resources are staffing requirements and existing staff constraints.</u>

The importance of staffing constraints has taken precedence over development objectives in determining the programming of local currency resources and, in some situations, shaping the decision to generate local currency resources. Although this is recognized as a practice by A.I.D. Management, it raises some concerns that administrative, and not development considerations are determining local currency use.

- o <u>The generation of U.S.-owned currencies in the past has created excess local currency balances resulting in friction between U.S. and recipient countries.</u>

Historical experience has shown that the generation of U.S.-owned local currencies has created potential for friction between the host country and U.S. Governments. Restrictions placed on the use of these funds through the appropriation process reduced the rate at which these funds were spent, far below the rate at which they are generated. Large amounts of host country local currency resources are being generated today which, if they were host country-owned, would result in similar problems.

- <u>The effective use of local currency resources can result in significant development benefits for host countries.</u>

By developing effective "mixes" of types of foreign assistance programs and programming uses, local currency programs once they are integrated into the existing macroeconomic framework within the host country can reinforce programs being implemented either by the IMF, World Bank or the host country government itself and ensure that economic stabilization and structural adjustment objectives are achieved.

C. Recommendations

Based on conclusions drawn from this research, it is difficult to support the generation or use of U.S.-owned local currency funds. Although there are some instances in which joint programming with host country governments has proven to be difficult, USAID missions in general have accomplished their development goals through joint programming. The only exception appears to be in the use of host country funds for private sector purposes. In addition, USAID mission operating funds are adequately addressed through the use of host country resources placed in trust funds. U.S. ownership of local currency is not required to fund local mission operating expenses.

Management has always been a source of controversy and concern in every A.I.D. effort to improve the utilization of local currency resources. The administrative burden it places on mission staff is often cited as the principal reason for weaknesses in management systems. Under A.I.D.'s new financial management guidance, the monitoring responsibility for host country financial management systems placed on the missions is demanding and would be even more so if missions were also "saddled" with administrative responsibilities for managing U.S.-owned local currency resources in addition to its management responsibilities for dollar funds. In light of the restrictions being placed by Congress on A.I.D's operating budgets, these are difficult demands to place on USAID missions and will not improve the current situation. While the appropriate monitoring of host country resources does not entail the same level of responsibility as U.S.-owned local currency resources, proper administration cannot be ignored.

The issue of proper administration is related to the recognition of local currency resources as valuable resources that can contribute not only to the fulfillment of USAID mission development goals, but also to the more efficient and effective management of operations. Consideration should be given to the more active utilization of local currency generations from foreign assistance programs to meet local currency project costs currently covered by local currency proceeds from appropriated dollar conversions. The adoption of this approach is even more attractive at the present time when the Agency faces budget cuts in Congress.

Past experience has shown that U.S.-owned local currency resources which were not being used as fast as they were generated have resulted in excess currency balances, creating threats to the stability of the host country economy and to the relationship between the host country government and the U.S. Government. At that time, restrictions on the use of these funds including those imposed by the appropriation process and federal contracting and procurement requirements prevented the funds from being used in a timely fashion. The chance that similar situations can arise today from the generation of these funds is significant and should be avoided. Moreover, the inability to spend these funds within an appropriate timeframe after their generation can have inflationary impacts on host country economies.

One of the principal benefits of the emphasis placed on host country financial systems under A.I.D's draft financial management guidance is strengthening of these systems to meet the accountability and reporting standards set out in the guidelines for managing host country local currency resources.
The necessary improvement of systems that have traditionally been weak and neglected fulfills two A.I.D. objectives simultaneously. Improvements through technical assistance and increased A.I.D monitoring will strengthen government financial management systems as well as assist A.I.D. staff in the monitoring of local currency resources. The establishment of effective financial management systems and in turn, the development of efficient governments in the in developing countries are in themselves desirable development goals to be achieved.

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From: Listed A.I.D. Missions, To: AIDAC Mission Controller, RE: Special Accounts. E.O. 12356: N/A; Special Accounts Survey Responses: Babako 04632, Banjul 01677, Belize 03302, Bridge 05038, Bujumb 02986, Cairo 15378, Colomb 04528, Comora 21199, Dakar 08469, Dar Es 03728, Dhaka 05385, Djibou 21111, Gaboro 04436, Guatem 07945, Harare 03953, Islama 15288, Jakart 09887, Kampal 03026, Kathma 05386, Kharto 07894, Kigali 03175, Kingston: Facsimile: Leonard, Bob; 7-14-89, Kinsha 10787, La Paz 08545, Lagos 09825, Lilong 03542, Lima 09957, Lome 03867, Lusaka 02880, Manila 22110, Maputo 02409, Maseru 02001, Maseru 02001, Maurit 20762, Mbaban 04232, Mogadi 07833, Monrov 06822, Nairob 20166, Ndjame 03816, New De 15071, Niamey 06906, Ouagad 03843, Port Au Prince: State 257788, Praia 01658, Quito 09784, Rabat 06714, San Jo 08907, San Sa 08790, Sanaa 05150, Santia 06456, Santo 07522, Seyche 21197, Teguci 11826, Tunis 06472, Yaound 05635.

Audit Reports

Audit of Accountability for Local Currency in Bolivia. Audit Report No. 1-511-89-09. February 13, 1989

Audit of Selected U.S.A.I.D./Costa Rica Local Currency Activities. Audit Report No. 1-515-88-05. January 19, 1988

Audit of USAID/Dominican Republic, Public Law 480 Title I Program. Audit Report No. 1-517-88-17. August 28, 1988.

Audit of U.S.A.I.D./Dominican Republic ESF Programs and Related Local Currency Activities. Audit Report No. 1-517-88-16. April 28, 1988

Audit of U.S.A.I.D./Ecuador P.L. 480 Title I Local Currency Generations. Audit Report No. 1-518-87-36. July 27, 1987

Audit of U.S.A.I.D./Ecuador ESF Local Currency Generations, Project Number 1-518-87-35. July 27, 1987

Audit of Verification of Accountability for Dollars and Local Currency Associated with U.S.A.I.D./Haiti Programs. Audit Report No. 1-521-89-24. July 3, 1989

Audit of Jordan Commodity Import Program, Program No. 278-K-643. Audit Report No. 3-278-90-01. October 31, 1989

Audit of P.L. 480 Program in Liberia. Audit Report No. 7-669-89-12. September 28, 1989

Area Auditor General, AID. Problems in Host Country Accounting for Utilization of A.I.D. Funds in the Sahel. Audit Report 81-35, January 29, 1981

Audit of Local Currency Generated from Somalia's Commodity Import and P.L. 480 Programs. Audit Report No. 3-649-87-7

LIST OF INTERVIEWS

Agency for International Development

Robert Bonnafont, FM (202) 663-2333: 9:00am November 8, 1990

Curt Christiansen, USAID/Jakarta: 2:00pm December 27, 1990.

Phil Christiansen, FVA: 3:00 January 30, 1991.

John Competello, IG (202) 647-7845: 9:00am November 6, 1990.

James Durnil, RIG/Singapore: 10:00am December 19, 1990

Gary Eidet, FM (202) 663-2200: 2:45pm November 13, 1990.

Jeff Evans, LAC/DR (202) 647-9155: 11:00am November 7, 1990.

Don Harrison, PPC/PDPR/RP (202) 647-7028: 9:30am November 19, 1990.

Haridene Johnson, A/PRE (202) 647-9064: 1:00pm November 13, 1990.

Michael Kitay, A/PRE/GC (202) 647-8235: 4:30pm November 15, 1990.

Robert Kramer, PFM/FM/FP (202) 663-2245: 9:00am November 7, 1990.

Robert O'Leary, USAID/Santo Domingo: 9:00am January 1991.

Denton Larson, ENE (202) 647-7632: 11:00am November 8, 1990.

Robert Lester, GC (202) 647-8548: 9:30am November 15, 1990.

Marjorie Lewis, USAID/Jamaica: 10:00am January 1991.

Mark Matthews, FM (202) 663-2274: 3:00pm November 14, 1990.

Donald McClelland, AFR/DP (202): 9:30am November 8, 1990.

Vivekka Moldrem, ENE/MENE (202) 647-9001: 1:00pm November 6, 1990.

Herbert Morris, PPC/PDPR/RP (202) 647-6504: 10:45am November 9, 1990.

John O'Rourke, FVA/PPM (202) 647-0218: 10:00am November 6, 1990.

Robert Perkins, IG, (202) 647-7844: 8:30am November 15, 1990.

Mark Silverman, LAC/DR (202) 647-9155: 11:00am November 7, 1990.

Edward Sprigues, (202) 647-9218: 1:30pm, November 9, 1990.

Steve Tisa, GC, (202) 647-8416: 9:00am November 13, 1990.

Michael Usnick, FM, (202) 663-2468: 3:00pm November 15, 1990.

Eric Zallman, USAID/Nairobi: 11:00am January 25, 1991

The World Bank

Michael Payson: 10:30am December 10, 1990.

The International Monetary Fund

Jean Clément, (202) 623-7000: 10:00am December 19, 1990.

Canadian International Development Agency

Roger Erhard, (819) 997-0983: 9:30am December 18, 1990.

U.S. Treasury

Dan Niewarsky, (202) 566-8587: 2:00pm November 8, 1990.

U.S. Senate Committee on Agriculture

Anita Brown, (202) 244-3121: 2:00pm November 16, 1990.

U.S. Department of Agriculture

Mary Chambliss, (202) 447-3573: 10:00am November 16, 1990.

Office of Management and Budget

Rodney Bent, (202) 395-3974: 4:00pm November 14, 1990.

Other

Dr. Henry Bruton, Williams College, (413) 597-3131: 12:00pm November 9, 1990.