FOREIGN ASSISTANCE MANAGEMENT PRACTICES AS THEY RELATE TO THE EMPLOYMENT PROBLEMS OF THE RECIPIENT COUNTRIES

Foreign Assistance Management Practices as They Relate...
309.223072 Agency for International Development.
A265 Foreign Assistance Management Practices as They Relate to the Employment Problems of the Recipient Countries. Mar. 1973.
25 p.

;NV ab isn = 18095 ✓
local = PC630

1.Program management - Manpower development.2.Manpower development.3.Employment.4.Development assistance methodology.I.Title.

United States Agency for International Development

March 27, 1973

Table of Contents

FOREIGN ASSISTANCE MANAGEMENT PRACTICES AS THEY RELATE TO THE EMPLOYMENT PROBLEMS OF THE RECIPIENT COUNTRIES

Introduction

1. Recognizing that our efforts to help the developing countries address their unemployment and underemployment problems have not been as systematic as they might be in concept and implementation, The Agency for International Development (A.I.D.) is now engaged in examining ways in which employment considerations can better be incorporated into every step of our program planning and implementation process. Our purpose is not to concentrate exclusive attention to this one objective but to try to make sure employment considerations are given the full weight they merit along with other high priority objectives in our assistance strategy for each of our aid recipients. We want to make sure that employment considerations are taken into account in: (a) our advice to aid recipients on overall development strategy; (b) the selection of the development goals on which A.I.D. resources are to be concentrated; (c) the choice of the program and project activities our assistance will finance; (d) determining the appropriate technique for their financing; (e) the project design; (f) the project implementation, (g) our training programs for citizens of developing countries, and (e) our research and evaluation activities.

2. The re-examination of our program management procedures from this point of view is still in process. We expect that some of the solutions will become apparent only through experience and experimentation. This paper is designed only to inform other lenders of our current thinking about these problems -- not to present conclusions. Our purpose is as much to solicit ideas of others as to offer suggestions.

Influence of Lenders on Policies Affecting Employment in Developing Countries

3. The ability of the lender countries to affect through the management of their foreign aid programs the employment situation in developing countries is likely to be marginal at best unless the governments concerned also attribute great importance to the same objective. The individual receiving country must address its employment problems within the framework of a sound development strategy supported by its general economic policies and implementation practices. For this reason, the lenders cannot expect to achieve much of an impact on the employment problems of a developing country, if they limit their attention to the isolated activity or project proposal. The lenders need also to concern themselves with the place of that activity in the country's overall program.

4. The lenders may be able to make an important contribution toward alleviation of employment problems by devoting greater attention to employment among other goals in their discussions with LDC leaders about their general development policies and programs. The lenders may expect to have greatest influence with countries which are themselves committed to improvement of the employment prospects of their citizens, but their efforts may also serve to increase recognition of the seriousness of employment aspects of development among all the aid receiving countries. This influence may be enhanced if the lenders convey to them the understanding that judgments about their own self-help efforts, and hence lender willingness to help finance their development activities, include among indices of progress an assessment of their employment policies and implementation efforts.

5. Meetings of consultative groups of lenders with high-level representatives of a developing country present the best occasion to raise issues related to employment within the context of the LDC's overall development program. Individual lenders, aware of the sensitivities of many of the developing countries to any semblance of interference in their domestic affairs, may be reluctant to offer suggestions bilaterally on some of the broad policy issues which affect employment, whereas international groups tend to be less vulnerable to suspicions of their motives.

6. The primary point of attention in these multilateral conversations should be on the ways in which employment can be adversely affected by distortions in foreign exchange and interest rates, tariff, tax, wage, and other general economic policies, leaving discussion of separate projects, sector or other program activities as they pertain to the employment situation to bilateral talks. Such advice by a group of lender countries may be instrumental in strengthening the position of a developing government striving to implement reforms in these directions in the face of strong domestic political opposition.

<u>Importance of Considering Employment at the First Stage of Planning Process</u>

7. Our experience in planning and implementing of foreign assistance activities with developing countries leads us to the conviction that considerations relative to employment creation (and other high priority goals) must be introduced at the earliest stage of selection of activities for our financial support. In this way project and program proposals can be examined in the light of macroeconomic policy aspects before irreversible commitments to LDC governments are made. There is limited usefulness in trying to estimate the employment created by any particular activity considered by itself. It is quite possible that the direct employment effects of a specific project may be negligible and yet that

project can represent a key element in the nation's overall development plan which as a whole may be expected to have great impact on the employment picture.

8. In 1972, a review was conducted by the Administrator of A.I.D. and his top level policy advisors of the adequacy of our contribution to helping the developing countrues solve their employment problems. It was concluded that our Agency needed to intensify its efforts to make sure employment considerations were taken into account at every stage of the planning and execution of our programs. As the first step in translating this policy directive into action, our field missions were instructed to analyze with representatives of the host government during their periodic discussions of overall program strategy the changes needed in order to add employment generation to specific goals of A.I.D.-financed activities. It is still too early to judge to what extent this new policy directive will induce aid recipients to propose shifts in their development strategy in order to give greater weight to employment considerations. In any event, the overall direction of a country program cannot be shifted abruptly.

9. At the same time, we also instructed our field missions to include in their evaluation of LDC proposals for U.S. aid financed investments an analysis of how those proposals relate to employment considerations of the particular countries. We have asked them to explore how different socio-economic groups are affected both favorably and adversely in terms of their access to new or more remunerative employment opportunities. In collaboration with host governments, explicit consideration will be given to the implications for employment generation of different techniques of implementation of each program activity. When factor prices are distorted, missions are asked to consider shadow prices, especially for foreign exchange, capital, and labor in the design and appraisal of projects.

10. The A.I.D. program in Colombia provides a good illustration of this approach. Two major sector loans support development policies and programs oriented toward employment generation. Discussion between A.I.D. and Colombian officials resulted in agreement to support the following activities: (1) agriculture: credit to small farmers and local currency financing for labor-intensive construction of farm-to-market feeder roads, (2) urban-regional: credit for small and medium scale industry in small and medium cities and financing basic infrastructure for low income urban housing. These were all activities in which the Colombian Government planned to commit a significant amount of its own resources.

<u>Flexibility in the Choice of Assistance Instruments and Methods</u>

11. Lenders wishing to shift the focus of their aid programs from individual investment projects to cross-sectoral problems, such as unemployment, need

to consider with particular care whether their capabilities for helping aid recipients deal with these problems will be improved by greater use of loans not tied to the direct foreign exchange components of projects. For individual developing countries, there is not a necessary relationship between the total amount of foreign aid that can be efficiently used and the direct foreign exchange components of large-scale projects. If lenders restrict use of their aid to the foreign costs of capital projects and if the developing country's urgent needs for foreign aid exceed the foreign cost components of its investment projects, a clear bias toward selection of sectors and projects with a high foreign cost will be introduced. The result will be distortions of the system of priorities for projects designed to achieve national objectives, including expansion of employment. By providing incentives to buy abroad when local procurement may cost less to their economies, the choice of projects, their design, and their execution may be biased against local employment.

12. When an aid receiving country is taking action to mobilize its domestic resources to the full extent reasonable and it is utilizing these savings efficiently, a requirement on the part of the foreign lender that that country finance all local costs of development projects may not be in the best interests of the developing country. The result can be reduction of other worthwhile development investments or inflation or some combination of both. The need for local currency financing is often particularly acute in the very poor countries where it is not possible to raise taxes without reducing the already low levels of consumption of its citizens and the priority demands on the available tax resources are tremendous.

13. The lender's ability to contribute to solution of employment problems may be enhanced by selective use of various forms of aid not tied to the foreign exchange component of specific projects. However, while this should result in greater employment generation (other things being equal), the effect will not be as great as it might if other biases and limitations result in inappropriately capital-intensive project design and selection. Moreover, even if foreign lenders finance some local costs, the foreign exchange converted into local currency would still tend to be used to import excessively capital-intensive technology if the economic policies (exchange rate, tariff policy, interest rates, etc.) of the developing country subsidize capital relative to labor. Thus, while increased financing of local costs would be a helpful step, it is by no means sufficient to ensure substantially greater employment generation from foreign aid. If the lender does limit

aid to financing foreign exchange costs, then care must be taken to see that the borrower does not try to include imports which are available locally in order to make maximum use of concessional assistance.

14. Lending techniques which directly or indirectly provide resources for local costs of development investments include the following:

(a) financing with foreign currency a portion of the local currency costs of a project or sector;

(b) financing with foreign currency the indirect import requirements attributable to project expenditures in addition to direct import components of the project (this is the preferred technique for A.I.D. programs);

(c) financing the foreign costs of a number of projects (related or unrelated) or a sector of the economy instead of restricting use of aid to the foreign costs of a single large project in order to reduce incentives of the borrower to enlarge unnecessarily the import component of that one project;

(d) financing general commodity import requirements to generate local currency for meeting domestic costs of the project, sector, or overall development programs;

(e) providing food aid;

(f) providing commodities for food-for-work public works projects;

(g) debt relief.

15. These techniques can influence employment in the recipient countries in different ways. The choice between them depends not only on the needs of the individual country but also on the concerns of the lender with respect to (a) identifying the aid loans with exports of its own goods and services, and (b) for lenders with international payments problems, the need to minimize the impact of the aid program on the balance of payments.

<u>Advantages of the Different Techniques of Providing Aid from the Point of View of Employment and Direct Foreign Financing of Local Costs</u>

16. The simplest aid device for financing local costs is by direct conversion of the lender's currency into the borrower's currency. For some donors, this presents a problem because public support of their aid programs may be dependent on identification of aid loans with export of their own goods and services. Other donors prefer to provide their aid in exports

rather than free foreign exchange because they believe this form of aid best protects their balance of payments. For this reason, a number of donors prefer some form of aid giving which links the local currency financing with their exports. The extent to which such links reduce the value of the aid to the recipient depends in large measure on the limitations imposed on the use of the foreign currency spent to acquire local currency. This problem is discussed in a subsequent section on aid tying. The local currency generated by the imports of aid-financed goods and services can be budgeted for specific sectors or projects depending on: (1) extent to which the lender believes that this will help improve sectoral performance by improving analysis of problems, increasing internal resource mobilization, facilitating institution building and policy changes, etc., (2) whether the lender wishes its aid resources to be associated with readily identifiable projects, and (3) the extent to which the lender wishes to monitor the expenditure of its aid funds.

17. An important concern that lenders have about permitting their aid to be used for local currency relates to the fundamental problem of fungibility. While this problem applies to any kind of development assistance, it applies with special force to local cost financing. Local cost financing will not result in a net increase in employment if it simply substitutes for resources which would have otherwise been raised domestically or if it fosters unproductive, low priority activities which otherwise might be cut back in order to carry out the project. Therefore, lenders need to consider carefully whether the particular developing country has taken reasonable action to increase domestic savings and to utilize them efficiently before agreeing to finance local costs of investments. They will also want to examine the overall pattern of foreign exchange use in order to judge whether the foreign exchange made available or freed by local cost financing will also contribute to development objectives. The role of such multilateral fora as consultative groups in discussing patterns and trends in government expenditures, public savings, and foreign exchange use takes on special significance as the share of local financing increases.

18. For some lenders and some developing countries, direct purchases of the borrower's currency may be the only practical way to finance local costs. Such a situation may arise when the donor is not an economic source of the imports needed by the LDC because of the geographic location of the aid receiving country or its traditional pattern of imports.

19. In the past, A.I.D. has associated its assistance with U.S. exports by opening up special letters of credit in American banks for use by importers of the aid recipient countries in purchasing a broad list of American products. There is no assurance, of course, that such exports are additional to those which would have taken place if the aid had been made available as free dollars. However, in order to relate loan disbursement more closely to implementation requirements of the particular

loan supported development activity, A.I.D. often purchases the local currency required directly with dollars. A.I.D. expects to authorize during the fiscal year ending June 30, 1973, roughly $150 million out of a total development loan program of about $600 million for the direct purchases of local currencies. Perhaps four-fifths of this $150 million will be for Latin American programs and the remainder will be in Africa and the Middle East. The high concentration of such financing in Latin America is the result of (1) the high concentration on A.I.D. lending in that continent for agricultral, education, and urban development projects in which local costs exceed the foreign exchange components, (2) considerations relating to U.S. balance of payments; a much larger portion of the free dollars spent for acquisition of Latin American currency may be expected to be respent for U.S. goods and services, and (3) the special political relationship between Latin America and the United States.

Non-Project Aid Financing General Import Requirements of the Developing Country

20. A developing country may be unable to undertake substantial public works projects (such as feeder roads, irrigation ditches, or low-cost housing) which will utilize idle workers and abundant domestic resources because of severely limited budgetary revenues and concern that deficit financing for such projects will result in inflation and indirect pressure on the balance of payments.

21. General commodity import programs, food aid, or debt relief (which frees foreign exchange which otherwise would have to be spent on debt service payments) all serve to cushion the impact of such expenditures on the balance of payments. The local currency proceeds of the general commodity imports on the surplus agriculture commodities can be budgeted for these public expenditures. PL 480 commodities which are mainly foodstuffs can be especially valuable in keeping down food prices.

22. A greater impact on employment may be achieved by financing the flow of imports to permit existing plants to operate nearer capacity rather than imports to finance expansion of productive capacity. Utilization of existing capacity, particularly industrial, may be held back by a shortage of foreign exchange for raw material imports in countries that have reached a stage where they are able to provide domestically capital goods and other requirements for new investment while an increasing volume of imports is needed to sustain economic growth. The same situation may be brought about when raw material imports might have to be restricted because the country is confronted with substantial and inescapable claims on available foreign exchange, such as a critical need for food imports following a major crop failure or the necessity to meet substantial foreign debt service requirements. The role of debt relief operations

in supporting development and employment objectives is apparent in this last situation.

23. Assurance of adequate assistance not tied to the foreign costs of projects can help a developing country to adjust to devaluation of its foreign exchange rate and liberalization of its import control system. The provision of non-project aid in such situations can be an extremely important contribution to employment to the degree that it helps the developing country establish more realistic factor pricing which reduces the bias toward capital intensive investments.

Package of Mixed Aid Resources for Interrelated Projects

24. A.I.D. is striving to shift its focus away from isolated projects at one extreme and program loans at the other extreme toward so called sector loans directed at solution of problems which are obstructing the developmental process of the country concerned. (A.I.D. is continuing to provide project and program as well as sector loans. See Appendix for pertinent data.) The problems on which we are placing emphasis are those affecting human welfare, among which employment is given a priority position. Our aim is to concentrate all of our aid resources -- technical assistance, capital resources, surplus agricultural commodities, training and research -- on an integrated attack on a limited number of problems. To help the receiving country identify its most critical problems and to develop a sensible strategy for addressing them, we are encouraging recipient countries to undertake comprehensive analyses of the few selected problem areas, with the help of U.S. technical advisors if desired. Not all the problems selected for such study require the same scope or depth of analysis. Nor are the interest and capabilities of the different LDCs for conducting such analyses uniform. However, we try to persuade them to make the analyses comprehensive enough to encompass to the extent feasible, the resource requirements, manpower, institutional and policy components. We hope that through such analysis the individual receiving country will develop an improved strategy for addressing its more serious development problems. This strategy should serve as a guide to decisions on allocations of domestic, as well as foreign aid resource allocations. By providing a package of U.S. aid resources to finance a group of interrelated projects which implement the agreed upon strategy, we hope to develop an aid technique which will be an appropriate and effective means for:

-- bringing policy issues pertaining to a particular problem area to the attention of decision makers;

-- identifying interrelated institutional problems within a sector of the economy or those affecting a number of sectors;

-- evaluating consistency of investment programs.

23. A.I.D. package loans for interrelated projects (sector loans) often contain a sizeable local cost component. The dollars provided for local cost financing may or may not be tied to purchase of U.S. and LDC goods and services, depending on the individual country considerations.

Intermediate Credit Institutions

24. The most practical technique for lenders to channel their foreign assistance resources to small enterprises, which we postulate tend to employ more labor-intensive than large businesses, is through local Intermediate Credit Institutions (ICIs). For administrative reasons, it is not feasible for foreign assistance agencies to invest directly in private enterprises unless they are large scale businesses. Although investing in the establishment of a local credit institution *per se* will not guarantee improvement of employment, lenders can help such institutions achieve this result (1) by cooperating with them in establishing the criteria for their operations which will ensure a broad geographic distribution of credit resources, and (2) by encouraging lending to small enterprises, such as by stipulating ceilings on the size of productive units eligible for subloans.

25. The types of intermediate credit institutions which have been the beneficiaries of A.I.D. resources are numerous. They include national, regional, and urban development banks, sublending for a number of different sectors (industry, mining, agriculture, fisheries, home construction, rural electrification, and tourism, *inter alia*), institutions to improve capital markets, and international banks to promote regional economic integration of neighboring countries.

26. Most of A.I.D. loans to ICIs are made under a two-step arrangement whereby loans are extended by A.I.D. to the government concerned and that government transfers the resources to a domestic credit institution for relending on harder terms to the end-user in accordance with an agreement with A.I.D.

27. In the Spring of 1969, A.I.D. undertook a comprehensive review of the effectiveness of intermediate credit institutions, most of which were designed to meet the needs of industry, to evaluate their effectiveness. Findings relevant to the current discussion are summarized in the following paragraphs.

28. One major deficiency of industrial ICI operations arises from frequent distortions in the structure of prices in the markets in which they operate.

Since ICIs in making their individual loan decisions necessarily depend considerably on expected commercial profitability of the borrower as determined by market prices, distortion of those prices by government policies of excessive protection, over-valued currency, etc., will distort the allocation of ICI resources. There was general agreement that these distortions were often a serious problem and that the preferred way of dealing with them, where practicable, was through correcting government economic policies.

29. Beyond this general agreement, a definite dichotomy emerged. One view held that ICIs should be guided by market price signals. This view appeared to be applied particularly to private ICIs, which were established to be profit-making institutions. The opposing view was that where changes in government economic policies to eliminate price distortions were not practicable, this situation should not rule out more direct efforts at offsetting policies or practices by the ICIs to correct for excessive protection, over-valued exchange rates, etc. This might be as formal as the general use of shadow prices or might simply provide some kind of priority ranking for certain subsectors.

30. The interest rate was widely agreed to be a frequently distorted price. Interest rates held down by laws or regulations were generally thought to be lower than is warranted in many, if not most, LDC's, and rates charged by ICIs are often at the low end of the scale. A closely related finding was that the availability of funds for medium- and long-term loans is generally of much greater importance to the potential borrower than is the interest rate -- the prospect of obtaining credit on medium-term greatly outweighs a few percentage points on the interest charged.

31. The interest rates charged to ICIs supported by A.I.D. generally include a subsidy -- and sometimes a large one -- to the ICI and/or its sub-borrower. It was generally agreed that a "lower than market" rate to ICIs might be justified to subsidize certain kinds of performance. There was also, however, a widely held view that the amount of subsidy, its rationale, and who were its beneficiaries, all appeared to be less fully understood than they should be, and that the providers of such subsidies should know and approve of the purposes served.

32. Medium- and long-term lending to the smaller borrowers was found to be particularly scarce. Few regular ICIs make many really small loans, and there are very few specialized small loan ICIs. This appears to be explained by the high costs, administrative requirements, and needed geographic dispersion which make very small-scale lending inappropriate for most existing ICIs, particularly private ones. Higher interest rates

are appropriate to cover the higher risks and higher costs, but charging such rates is likely to be politically difficult because they may appear to discriminate against the small borrowers relative to larger ones.

33. A.I.D. has made both dollar loans and local currency loans for ICIs.* Experience indicates that loans in dollars are often not well suited to the central purposes of the ICI. While it is true that many of these institutions may need foreign exchange as well as local currency, special availabilities of commercial dollars can place the ICI in a position of being a rationer of scarce foreign exchange -- as well as a rationer of scarce long-term credit. A further complication applicable to A.I.D. dollar loans is that ICIs and the sub-borrowers must deal with the problems of tied procurement item-by-item.

34. A similar review of small farmer credit programs will be held this year. Certain of the tentative conclusions from the various papers already prepared for this review are relevant to this discussion.

35. Several interest rate patterns are evident. The rates are usually low, generally in the range of 4 to 12% per year. There are instances of lower rates and even cases of zero rates of interest. Because of inflation, the real rates of interest have often been negative. In the majority of cases, the rates of interest charged are lower than usual commercial bank rates; they are even lower on credit specifically directed at small farmers in many cases. On the other hand, in several instances the rates effectively charged are higher than the nominal rates quoted because of various loan fees.

36. The generally low rates of interest have often been justified on the grounds that small farmers have been exploited by lenders who charge exorbitant rates of interest, pay low prices for products purchased, and ask high prices for inputs sold. It has also been argued that traditional farmers need special inducements to use highly productive inputs.

37. By and large, such views are being challenged both on empirical grounds and as guides to policy. Recent research has shown that farmers will respond to technological changes that result in positive returns. Even where a subsidy is needed, there is a question whether low credit is the most efficient delivery method. If low rates of interest induce credit institutions to favor large farmers, or if the lower rates reduce the amount of private funds available for loans, they are not working to the advantage of small farmers. It appears that this is often the case.

---

*Most often from the proceeds of the sale of U.S. agriculture commodities.

38. If rates of interest were increased: (1) larger farmers might release funds from their less productive uses which would become available for small farmers; (2) lending institutions might find the higher rates adequate compensation for the higher cost of servicing small farmers; (3) informal lenders might be forced to behave more competitively; and (4) a more realistic price of capital might encourage selection of more labor-intensive crops and methods.

Food for Wages - Work Projects

39. During fiscal year 1972 the United States provided food as partial or full payment of wages to approximately 15 million workers and their families. All of the workers were engaged in self-help projects designed to contribute to overall economic, community and social development. The value of the commodities shipped was $65 million. These projects are administered by the recipient government in accordance with bilateral government-to-government agreements or by U.S. private voluntary agencies in cooperation with the host government. Typically, about sixty developing countries participate in this program.

40. Public works constructed under this program include: roads, flood control, irrigation systems, reforestation, soil conservation and reclamation, rural electrification, and schools.

41. One of the main limitations of food-for-wages public works as an employment-creating program is that economically useful projects require effective, careful supervision. The more labor-intensive the project, the greater the need for additional, careful supervision. Another shortcoming of this technique is that the host government must provide sizeable local currency outlays to cover the costs of administration and distribution, which may even exceed the value of goods received. For administrative and substantive reasons, A.I.D. restricts the portions of the food which may be sold to obtain local currency to the tools needed on specific projects. We recognize, however, that in some cases, sale of the foodstuffs on the local market to permit payment of wages all in cash would be preferable from the workers' point of view.

42. Food-for-wages public works projects are a relatively short-lived source of employment. Hopefully, through on-the-job training and economic multiplier effects on the rest of the economy, as well as the creation of productive infrastructure, these projects will provide additional, lasting job opportunities. They also provide "breathing room" for additional employment and self-employment to be created in small-scale industry and

agriculture with the help of domestic and foreign private and public investment and aid.

Untying of Development Assistance

43. The primary argument for untying aid funds is to increase the volume of goods and services which may be purchased by permitting the recipient to use the aid credits for procurement from the lowest cost source. If an assistance program has a positive effect on employment in the recipient country, then untying will enhance this effect since more real resources will be transferred for the purposes of the programs for a given dollar amount of assistance. If an assistance program is biased against employment generation, then the benefits with respect to this objective may be minimal.

44. The opening up of a wide range of procurement sources may permit selection of capital equipment better adapted to labor-intensive technology than that available from the donor country. Benefits to the recipient country will obviously be greater if aid is untied for procurement among developed as well as developing countries. Untying which limits eligible sources to the lender country and developing countries will help employment in the LDC's to the extent they participate as source countries. The employment effects will be greater if procurement is from labor-intensive industries.

45. The significance of aid-tying as a means of promoting increased exports from the donor country may be partly illusory. The aid-financed exports from the donor to the recipient may substitute for normal commercial imports, thus freeing an equivalent amount of these foreign exchange resources of the developing country to use as it sees fit. To the extent that such substitution does take place, the adverse consequences of aid-tying for the recipient country is reduced. The breadth of choices among goods produced in the donor country eligible for procurement with tied credits also affects the degree to which tying decreases the quality of aid. The greater the selection of goods, the smaller the risk that the developing country may buy with tied aid resources more costly goods in order to fully utilize aid credits.

46. The type of foreign aid tied also has some bearing on the extent to which tying adversely affects employment. The tying of loans for capital projects to procurement in the donor country probably limits the choice among different technologies more than the tying of loans for general commodity imports (assuming the selection of goods which may be purchased with the credit is not severely limited). Loans for general

commodity imports probably permit a higher degree of substitution for commercial imports than project loans and thus the LDC is less restricted in its search for the most suitable goods from the cheapest sources.

47. The extent to which tied aid distorts normal import patterns also depends on the number of countries providing credits to the individual receiving country. The more sources of foreign credits available to the LDC, the greater will be the possibilities for matching procurement with the most economic source and the most appropriate technology.

48. The United States attributes great importance to untying as a means of improving the effectiveness of foreign aid. As DAC has been informed, A.I.D. untied its development loans to permit procurement in developing countries in the fall of 1970. We believe even this limited degree of untying will favorably influence employment, as the LDC producers of capital goods should be able to supply equipment more appropriate to the resources endowments of other LDC's than that available from the industrially advanced countries. Thus far, however, the volume of such procurement has been relatively small and the capital goods component insignificant. The effect on employment in source countries has also probably been fairly modest since the bulk of procurement has been for such relatively capital-intensive commodities as fertilizer and copper. Total procurement in LDC's has reached the level of about $20 million per year. We expect this procurement to continue on an upward trend as the recipients become more familiar with suppliers in other LDC's. In the appendix is a table showing the commodity composition, the sources, and the destination of this procurement.

49. In addition to untying all development loans with respect to LDC procurement, about 30 percent of our development loans are used for purchases of local currencies to finance program activities within the recipient countries. There are no restrictions on the subsequent use of these dollars. (See previous section on local currency financing for further discussion.)

50. A.I.D. developmental grant funds may be spent only for purchase of U.S. goods and services.

51. Under our Supporting Assistance programs, cash grants, which are totally untied in effect, are made in exceptional circumstances. Procurement of goods and services in both developed and developing countries is also permitted with Supporting Assistance funds when justified on a case-by-case basis for reasons of expediency.

Project Execution Procedures and Related Considerations

52. Lenders make several kinds of decisions under the heading of project execution procedures which have possible implications for employment generation. These include choices with respect to (1) nationality of design consultant, (2) nationality of construction contractor, (3) size of contractor, and (4) type of local contractor (public or private). The following discussion applies mainly to public construction activities although many of the observations apply to other sectors as well.

53. One of the main conclusions of the discussion is that the implications for employment generation of several of the above-mentioned choices are by no means clear, and that, in any event, a more important determinant of employment generation than the nationality of a contractor, whether he is from the private or public sector, or perhaps even his size, is the preparation by the lender of instructions for design or scope-of-work.

(1) Nationality of design consultant.

54. It has been argued that local consultants may be more familiar with and recommend labor-intensive approaches while foreign consultants may not only recommend capital-intensive methods but may apply unnecessarily rigorous standards, requiring capital-intensive approaches. But this relationship may be difficult to verify in practice. In the first place, local design firms are still rare, if not completely absent, in many developing countries. Second, it may be difficult to identify what is "foreign" and what is "local". Many "local" design as well as construction firms are local branches of international firms where all but a few top managers may be indigenous personnel. Finally, if the professional and technical personnel of "local" design firms have training and experience in developed countries (as is likely), their recommendations may lean toward capital-intensive approaches in any event.

55. Thus, the distinction between "foreign" and "local" - particularly in the case of design firms - may be of limited usefulness. It would seem

more important that the lender and/or recipient government agency make sure that a labor-intensive approach be incorporated in the scope of work for the design firm to assure use of such an approach during the implementation stage. At the same time there may be instances where use of local engineering talent could have an important impact on employment generation. This is likely where a country has built up indigenous expertise over some period of time. An example would be rice land irrigation engineers in rice producing countries such as VietNam, Korea, etc. Lenders should consider tapping this kind of talent for other developing countries on a prime or subcontracted basis depending on project requirements.

56. Although A.I.D. has no regulation against the use of local consultants, there is a tendency, for the reasons mentioned above, to use U.S. firms. But the agency is beginning to ask design firms to deliberately develop labor-intensive design features (in road construction in Central America, and possibly in Indonesia).

(2) Nationality of construction contractor

57. The distinction between design and construction is important. Once the design for a project has been determined, the range of construction methods which a construction contractor can use may be limited. For example, a highway built to handle loaded 50-ton trucks may require a certain design which, in turn, can be built only in relatively capital-intensive ways. It is probably generally true that the higher the design standards, albeit established for quality objectives, the lesser the range of feasible construction methods. Thus, it is most important from an employment point of view to ensure that a project is not designed for standards which are not warranted in the engineering stage. If appropriate design standards are set, then the construction stages may permit considerable scope for application of labor-intensive methods.

58. Construction contractors are undoubtedly more plentiful locally than consultants. Such firms are likely, although not necessarily (for the reasons mentioned above), to use a greater proportion of local materials as well as more labor-intensive methods than foreign construction firms.

59. Lenders might want to consider extending preferences to local construction firms although this raises certain administrative problems.

The IBRD extends a 15% preference to local contractors. This rule, while simple to administer, ignores the wide difference existing in some countries between official exchange rates, on the one hand, and domestic-world price ratios, on the other. Owing to new regulations in 1970 which permit procurement from developing countries, procurement of engineering and construction services under borrower contracts financed by A.I.D. is permitted from any eligible developing country source, including the borrowing country.

(3) Size of contractor

60. Larger contractors in any sector may be more capital-intensive than smaller ones (statistical evidence for manufacturing and agriculture supports this). Large firms tend to be in the most favored positions to obtain subsidies on capital (import privileges, subsidized interest rates, etc.) and they are probably more subject to enforcement of wage laws and other labor legislation as well. There may also be aversion to managing large groups of labor, which of course would be more likely in the case of labor-intensive large firms, particularly in public construction.

61. For several reasons, therefore, use of small contractors is likely to lead to greater employment generation on a project than use of one large contractor. Lenders should explore various techniques for employing small contractors. It might be feasible to contract various stages or even tasks in the construction process to smaller firms (for example, in road construction: digging, earth moving, grading, ditching, etc.) or to contract subcomponents of a project to smaller contractors (such as, segments of a road, bridges, walkways, etc.) Use of small contractors on a large project would require the general or prime contractor to coordinate and manage the entire project. This kind of expertise may be difficult to find in some countries.

62. Use of small contractors will not guarantee significantly more labor-intensive methods. Accordingly, it is important that those features of the project which can be constructed effectively in a labor-intensive way (such as, ditching, laying culverts, and other tasks in road construction) be specified to be so constructed in the design instructions.

63. A.I.D. has no formal limitation on minimum size of contractor, but agency practice based on prequalification tests tends to favor large firms. International construction firms naturally tend to be large and it is easier to deal with large local contractors rather than small ones. The latter factor also suggests consideration of the prime contractor approach.

(4) Type of local contractor (private or public)

64. A related question concerns the use of public force account (temporary expansion of public works departments) vs. use of private contractors for public construction projects. It is not clear whether one approach is more labor-intensive than another. Small private contractors, for the reasons mentioned above, may be more labor-intensive than a large public works department.

65. One possibility might be to have the public works department serve as the prime or management contractor and for smaller subcontractors to come from the private sector (this has been tried with some success in the United States -- in the General Services Administration of the Federal Government and in the State of New York). In some countries the supply of private contractors for some kinds of projects will be so limited as to require use of public force account. Mobilization costs and availability of labor for work in outlying areas may also preclude private contracting. Moreover, in some cases, considerable capital and technical assistance on the part of lenders has developed competent public works departments which may be able to effectively mount labor-intensive projects.

Conclusion

66. Lenders may wish to give more attention to the above-mentioned aspects of project execution procedures which may result in greater employment generation. But, as indicated at the outset of this section, the probable key factor is the scope of work set by the lender for the design consultant which, in turn, will have important implications for the methods adopted by the construction contractor. Also, recognizing the objective and subjective obstacles to more labor-intensive approaches (discussed above), it is important to try to modify the system of incentives affecting contractors. These incentives are both direct and indirect, positive and negative, and affect both lender agency personnel and contractors. For example, setting unnecessarily short time limits on the construction period for a project will encourage more capital-intensive approaches. Conversely, basing evaluations on the extent to which labor-intensive alternatives were

explored or limiting the foreign exchange provided for a certain project will encourage more labor-intensive approaches.

Project and Program Appraisal, Review, Evaluation and Feedback

67. Part of the programming and implementation cycle of A.I.D. consists of a sequence of project or program design followed by appraisal and review in the field and Washington, monitoring of implementation, and evaluation of results. Although it is much more difficult to affect an already designed project at a later stage, this possibility should not be overlooked, and, in any event, project review and evaluation can and should affect the design of future projects.

68. At A.I.D., employment considerations are now raised during reviews of proposed projects and programs in Washington. This has led to changes in existing design in some cases (for example, increased attention to the requirements of small and medium scale firms for a program of assistance to technological institutes in Brazil) and to a commitment to study or introduce labor-intensive approaches into the design of future projects (for example, road construction in Central America or Indonesia).

69. A.I.D. has devoted substantial efforts to developing methodologies for evaluating its projects and programs but the task of putting these concepts into practice is just beginning. A limited number of completed projects is now being selected for an evaluation of their benefit incidence in terms of employment and access to resources and opportunities. It is hoped that such evaluations will become a regular process and that local social scientists will participate in the design and implementation of such evaluations. It is also essential that the results of such evaluations be systematically fed back into the implementation and design stages.

70. Meaningful evaluation is impossible without base-line data against which to judge the impact of a project on employment and incomes. Thus, project design should include as integral parts: (1) gathering of basic information on the employment and income status of target and related non-target groups and (2) formulation of realistic employment and income goals, by target group, as an aid to evaluation and possible modification of the project or design of new projects.

Research

71. Research is an important tool which a lender has to improve the employment impact of its assistance. This includes analytical research at a general level, but of equal and perhaps, at the current state of

knowledge, more important, experimental research in the form of pilot projects. Universities and a wide range of governmental, international and private organizations are carrying out analytical research on employment and development, but lender agencies - and particularly those engaged in capital as well as technical assistance - are in a unique position to test operationally the possibilities suggested by theoretical research.

72. A.I.D. is supporting analytical research on employment and development at several major U.S. universities as well as through the U.S. National Academy of Sciences. These projects are identified in the background paper provided by the U.S. Delegation to the D.A.C. Meeting on the Employment Problem in the Less Developed Countries, December 6-7, 1972.* In addition to the projects mentioned there, a new research project on "Income Distribution, Growth, and Public Policy", to be carried out by a group of researchers at Princeton University and the Brookings Institution, will address several important employment-related questions by examining distributional implications of land reform, public works, labor and other policies and programs.

73. The Agency is supporting several employment-related research projects of a more operational nature. The first, being carried out by the Arthur D. Little Company, is examining ways of reducing cost in civil construction projects, including labor-intensive road construction in selected countries (Colombia, the Philippines, and one or two other countries). The second project is development of small-scale agricultural machinery and implement prototypes at the International Rice Research Institute suitable for commercial production by local small-scale manufacturers and feasible (in terms of cost and quality) for local small farmers. A third project planned to begin in 1973 is to expand and improve the capability of the Georgia Institute of Technology to extend its small-scale industry technical assistance experience in Georgia and Paraguay to other developing countries. This will include research and development linked to technical assistance. The Agency is also contemplating adding an experimental or pilot project component to several proposed road construction projects (in Central America and Indonesia). The plan is to ask a contractor to test out on a 10 to 20 mile stretch of road the range of intermediate technologies suggested by IBRD research on substitution of labor for capital equipment in road building. These suggestions include both substituting labor-intensive methods for capital-intensive methods and trying to increase the efficiency of inherently labor-intensive methods.

---

*DAC (72) 69, <u>AID Policy Background Paper on Employment and Income Distribution</u>, pp. 20-23, 42.

Training

74. While the implications of labor-intensive alternatives for skilled worker requirements is unclear, it is clear from research at the IBRD and elsewhere that the supervisory and management requirements of labor-intensive infrastructure construction and operation are greater than for capital-intensive alternatives. Training of these personnel has often been ignored in donor-financed projects, and serious operational problems have followed when expatriate personnel have departed. The incorporation of a training component to develop a full complement of domestic managerial and technical personnel will be even more essential for labor-intensive projects.

75. Donors also support developed country training of developing country professionals and technicians. Training in such fields as engineering, agriculture, administration and education is likely to reflect the capital-rich, labor-scarce economic environment of advanced countries in its curricula (texts, examples, exercises, etc.). A.I.D. is examining ways to introduce methods of design, introduction and appraisal of labor-intensive approaches in such training through short-term courses or modification of existing courses. It also intends to introduce employment considerations into the orientation of consultants and technical assistance experts.

FISCAL YEAR 1972 A.I.D. COMMITMENTS* - TYPE OF ASSISTANCE BY APPROPRIATION CATEGORY
(Thousands of Dollars)

	GRAND TOTAL	Near East and South Asia	Latin America	East Asia and Vietnam	Africa	Europe	Non Regional
GRAND TOTAL a/	2,071,550	450,834	338,060	675,860	175,205	9,965	421,624
PROGRAM ASSISTANCE TOTAL	697,723 b/	185,385	34,000	442,702	20,000 b/	9,532	6,104 b/
Development Loans	199,700	75,700	32,000	75,000	17,000	-	-
Supporting Assistance	457,702	90,000	-	367,702	-	-	-
Contingency Fund	32,839	19,685	2,000	-	3,000	9,532	1,621
SECTOR LOANS TOTAL	105,800	-	89,000	-	16,800	-	-
CAPITAL ASSISTANCE PROJECTS TOTAL	345,864 c/	44,588	123,550	81,126 c/	74,428 c/	433	21,737 c/
Development Loans	320,096	44,513	123,550	79,600	70,250	433	1,750
Technical Assistance	853	75	-	-	778	-	-
TECHNICAL ASSISTANCE PROJECTS TOTAL	506,975	26,439	91,511	152,032	63,977 f/	-	173,016
Development Loans	4,937	-	36	2,876	-	-	2,025
Technical Assistance	254,272	23,539	80,341	19,155	55,410	-	75,827
Supporting Assistance	127,499	-	-	115,555	300	-	11,644
Population Program	120,267	2,899	11,134	14,446	8,267	-	83,519
Multilateral Technical Assistance Administrative Expenses and Other	415,188	194,422 d/	-	-	-	-	220,764

* Development loans (including Alliance for Progress) authorized, plus obligations of other AID funds on a program basis, i.e., new obligational authority plus reobligations.

a/ Excludes $28,326 thousand for reimbursements to AID by Department of Defense for grants to Vietnam.

b/ Includes $4,483 thousand in TA funds for Ocean Freight, Voluntary Relief Agencies and $3,000 thousand for Population Program appropriated especially for that purpose, now shown separately.

c/ Total includes $19,987 thousand for American Schools and Hospitals Abroad, appropriated especially for that purpose, and $4,926 thousand Supporting Assistance (Vietnam $1,527 thousand and Nigeria $3,400 thousand) not shown separately.

d/ Refugee Relief Assistance (Bangladesh).

e/ Excludes Self-Help.

f/ Includes $300 thousand International Relief Effort.

TABLE 1

STATUS OF LOAN-FUNDED PROCUREMENT FROM LESS DEVELOPED COUNTRIES

AS OF DECEMBER 31, 1972: BY DESTINATION COUNTRY

($ Million)

Destination Country	Offshore Cumulative
India	4.0
Indonesia	9.1
Turkey	*
	13.1
Colombia	0.6
Costa Rica	0.1
Dominican Republic	*
El Salvador	0.1
Panama	*
Paraguay	0.3
Uruguay	1.3
	2.4
Ghana	0.7
Morocco	0.5
Nigeria	10.8
Tunisia	0.2
	12.2
TOTAL	27.7

*Transactions total less than $50,000

TABLE 2

INTERREGIONAL SUMMARY UNTIED PROCUREMENT

AS OF 12-31-72

($000)

Destination Region	Source Region: Asia	Latin America	Africa	Total
ASIA	10,515	271	2,354	13,140
LATIN AMERICA	-	2,426	-	2,426
AFRICA	11,492	355	339	12,186
	22,007	3,052	2,693	27,752

[illegible]
2/26/73

TABLE 3

ONSHORE-OFFSHORE PROCUREMENT RATIOS AS OF 12/31/72

($000)

Commodity Code	Commodity Description	Total Cum. Expend.	Onshore	Offshore ($000)	Offshore (%)	Percent Onshore	Percent Offshore
65	Textile Yarn, Fabrics & Prods.	12,503	2,484	10,019	36.2	19.9	80.1
56	Fertilizers, Mfd.	7,339	753	6,586	23.7	10.3	89.7
71	Machinery Non-Electric	87,356	85,046	2,310	8.3	97.4	2.6
68	Non-Ferrous Metals	17,112	14,953	2,159	7.8	87.4	12.6
33	Petroleum & Petroleum Prods.	20,184	18,525	1,659	6.0	91.8	8.2
73	Transport Equipment	62,656	62,100	556	2.1	99.1	0.9
62	Rubber Mfg, n.e.c.	2,480	1,966	514	1.9	79.3	20.7
72	Electric Mach. & Appliances	21,289	20,837	452	1.6	97.9	2.1
51	Chemical Elements & Compounds	21,668	21,241	427	1.6	98.0	2.0
67	Iron & Steel	26,638	26,357	281	1.0	98.9	1.1
69	Manufactured Metals, n.e.c.	3,733	3,505	228	0.8	93.9	6.1
55	Essential Oils	706	501	205	0.7	71.0	29.0
59	Chemical Material & Prod.	8,003	7,798	205	0.7	97.4	2.6
66	Non-metallic Mineral Mfg.	2,354	2,207	147	0.5	93.8	6.2
27	Crude Fertilizer & Minerals	2,150	2,031	119	0.4	94.5	5.5
89	Misc. Mfd., Articles	651	562	89	0.3	86.3	13.7
64	Paper, Paperboard & Mfr.	10,119	10,068	51	0.2	99.5	0.5
58	Plastics, Celulois & Artificial Resins	6,989	6,941	48	0.2	99.3	0.7
81	Sanitation, Plumbing, Heating Lighting Fixtures	151	113	38	0.1	74.8	25.2
24	Wood, Lumber & Cork	90	53	37	0.1	58.9	41.1
28	Metal Ores & Scraps	2,173	2,136	37	0.1	98.2	1.8
86	Prof-Scientific Instruments	2,735	2,699	36	0.1	98.7	1.3
26	Textile Fibers Not Manufactured	917	898	19	0.1	97.9	2.1
04	Cereal Preparations	32,541	32,536	5	*	99.9	*
61	Leather Mfg. & Fur Skins	7	2	5	*	28.6	71.4
98	AID Administrative (Incl. Ship.)	24,984	23,464	1,520	5.5	93.9	6.1
	SUB-TOTALS	377,528	349,776	27,752	100.0	92.6	7.4
	ALL OTHER COMMODITIES	55,702	55,702	-	-		-
	TOTALS	433,230	405,478	27,752			

Source of Data: C/FRD, Commodity Information Systems

* Transactions total less than 0.1; not shown.

FRC/PRD/[illegible]
2/26/73

TABLE 3

ONSHORE-OFFSHORE PROCUREMENT RATIOS AS OF 12/31/72

($000)

Commodity Code	Commodity Description	Total Cum. Expend.	Onshore	Offshore ($000)	Offshore (%)	Percent Onshore	Percent Offshore
65	Textile Yarn, Fabrics & Prods.	12,503	2,484	10,019	36.2	19.9	80.1
56	Fertilizers, Mfd.	7,339	753	6,586	23.7	10.3	89.7
71	Machinery Non-Electric	87,356	85,046	2,310	8.3	97.4	2.6
68	Non-Ferrous Metals	17,112	14,953	2,159	7.8	87.4	12.6
33	Petroleum & Petroleum Prods.	20,184	18,525	1,659	6.0	91.8	8.2
73	Transport Equipment	62,656	62,100	556	2.1	99.1	0.9
62	Rubber Mfg, n.e.c.	2,480	1,966	514	1.9	79.3	20.7
72	Electric Mach. & Appliances	21,289	20,837	452	1.6	97.9	2.1
51	Chemical Elements & Compounds	21,668	21,241	427	1.6	98.0	2.0
67	Iron & Steel	26,638	26,357	281	1.0	98.9	1.1
69	Manufactured Metals, n.e.c.	3,733	3,505	228	0.8	93.9	6.1
55	Essential Oils	706	501	205	0.7	71.0	29.0
59	Chemical Material & Prod.	8,003	7,798	205	0.7	97.4	2.6
66	Non-metallic Mineral Mfg.	2,354	2,207	147	0.5	93.8	6.2
27	Crude Fertilizer & Minerals	2,150	2,031	119	0.4	94.5	5.5
89	Misc. Mfd., Articles	651	562	89	0.3	86.3	13.7
64	Paper, Paperboard & Mfr.	10,119	10,068	51	0.2	99.5	0.5
58	Plastics, Celulois & Artificial Resins	6,989	6,941	48	0.2	99.3	0.7
81	Sanitation, Plumbing, Heating Lighting Fixtures	151	113	38	0.1	74.8	25.2
24	Wood, Lumber & Cork	90	53	37	0.1	58.9	41.1
28	Metal Ores & Scraps	2,173	2,136	37	0.1	98.2	1.8
86	Prof-Scientific Instruments	2,735	2,699	36	0.1	98.7	1.3
26	Textile Fibers Not Manufactured	917	898	19	0.1	97.9	2.1
04	Cereal Preparations	32,541	32,536	5	*	99.9	*
61	Leather Mfg. & Fur Skins	7	2	5	*	28.6	71.4
98	AID Administrative (Incl. Ship.)	24,984	23,464	1,520	5.5	93.9	6.1
	SUB-TOTALS	377,528	349,776	27,752	100.0	92.6	7.4
	ALL OTHER COMMODITIES	55,702	55,702	-	-		-
	TOTALS	433,230	405,478	27,752			

Source of Data: C/FRD, Commodity Information Systems

* Transactions total less than 0.1; not shown.