101st Congress
1st Session

COMMITTEE PRINT

THE PRIVATE ENTERPRISE INITIATIVE OF THE AGENCY FOR INTERNATIONAL DEVELOPMENT

REPORT

PREPARED FOR THE

COMMITTEE ON FOREIGN AFFAIRS
U.S. HOUSE OF REPRESENTATIVES

BY THE

CONGRESSIONAL RESEARCH SERVICE
LIBRARY OF CONGRESS

SEPTEMBER 1989

Printed for the use of the Committee on Foreign Affairs

U.S. GOVERNMENT PRINTING OFFICE

20-656 ⇆

WASHINGTON : 1989

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FOREWORD

House of Representatives,
Committee on Foreign Affairs,
Washington, D.C., September 5, 1989.

In January 1988 I appointed a Task Force, headed by Hon. Lee H. Hamilton and Hon. Benjamin A. Gilman, to conduct a comprehensive bipartisan review of the U.S. foreign assistance program. This was the first major review of foreign assistance since 1973.

The Task Force issued a report in February, 1989. The recommendations of the report were drafted into legislation. The final bill was reported by the Committee on Foreign Affairs on June 16 and passed by the House on June 29 as H.R. 2655.

The work of the Task Force was ably assisted by several studies by the Congressional Research Service on reporting requirements and on the development of U.S. foreign assistance programs. The attached study makes a further contribution to the Committee in its efforts to carry out its oversight responsibilities for U.S. foreign assistance.

Authored by Curt Tarnoff, this study of AID's Private Sector Initiative, which was developed during the 1980's by AID Administrator Peter McPherson, is a concise exploration of the evolution and elements of AID's Private Sector Initiative. While U.S. assistance programs have for years worked through and promoted private sector activities, this initiative brought considerably greater focus and a more concerted approach to market economics and promotion of the private sector. This Initiative coincided with a growing disenchantment during the 1980's in many developing countries with state directed economies and a redirection toward market-oriented policies.

The analyses and findings contained in this report are those of the Foreign Affairs and National Defense Division of the Congressional Research Service and, as such, they do not necessarily reflect the views of the Committee on Foreign Affairs or its members.

Dante B. Fascell, *Chairman,*
Committee on Foreign Affairs.

LETTER OF SUBMITTAL

CONGRESSIONAL RESEARCH SERVICE,
THE LIBRARY OF CONGRESS,
Washington, DC, August 23, 1989.

Hon. Dante B. Fascell,
Chairman, Committee on Foreign Affairs, House of Representatives, Washington, DC.

DEAR MR. CHAIRMAN: I am pleased to submit "The Private Enterprise Initiative of the Agency for International Development." The study addresses an important aspect of the U.S. foreign economic aid program. It examines the formulation of the Initiative, the range of private enterprise activities conducted by AID, and a number of issues which might be considered by policymakers in the Congress and the executive branch.

The report was authored by Curt Tarnoff, Analyst in Foreign Affairs in the Foreign Affairs and National Defense Division.

Sincerely,

JOSEPH E. ROSS,
Director.

EXECUTIVE SUMMARY

The Private Enterprise Initiative, introduced by the Reagan Administration in 1981, has been an effort to shift the development strategy of the Agency for International Development (AID) from a "predominantly public sector, or government-to-government, focus to one that emphasizes market forces and active private indigenous productive sectors."

In its belief that the key to economic growth is private enterprise, the Initiative was partly an adaptation of the Reagan Administration's domestic program to its foreign aid program. It also reflected a widespread belief that previous development strategies were not adequate. The evidence for their failure was to be found in the onset of severe economic stagnation in much of the developing world during the early 1980's.

In the view of Initiative proponents, developing countries have been characterized by two features: the dominance of the state in the economy and the weakness of the private sector. The Initiative has sought, therefore, to encourage developing country governments "to open their economies to a greater reliance on competitive markets and private enterprise", and "to foster the growth of productive, self-sustaining income and job producing private enterprises in developing countries."

Policy Formation. The basic outlines of the Private Enterprise Initiative were developed during the first year of the Reagan Administration and private enterprise became the first of AID's "Four Pillars" through which, according to AID Administrator Peter McPherson, the U.S. could achieve the President's foreign assistance objectives.

The new policy was bolstered by the actions of a variety of outside sources. Several major foreign policy study groups, including the Carlucci, Kissinger, and Andreas Commissions, recommended steps to encourage private sector growth in their findings. The World Bank and other donor entities began to integrate private enterprise projects into their overall development programs. The U.S. Congress enacted several modest pieces of legislation which authorized new programs or added new language supportive of AID private enterprise activities. Among these were the establishment of the Private Sector Revolving Fund in 1983, the Food for Progess Program in 1985, and the earmarking of appropriations for microenterprise projects in FY 1988 and FY 1989.

The Institutionalization of the Initiative in AID. Within the Agency for International Development, the Private Enterprise Initiative was granted a prominence which has led to its successful integration into the bureaucracy. Although the most visible aspect of the Initiative, the Private Enterprise Bureau, due to limited funding, small staff, and difficulties encountered in working with other parts of the Agency, has played only a modest role in development of the Initiative. It has managed the Private Sector Revolving Fund and provided technical assistance to missions in the areas of privatization, policy reform, financial markets, and other subjects.

As an "agency-wide" initiative, private enterprise has been promoted by all other bureaus and the AID missions. The regional bureaus have each established special private enterprise offices which support mission activities with technical assistance. Many AID missions now possess a designated private enterprise officer who takes the lead in establishing contacts with the developing country private sector and reviews project proposals initiated by other offices in the mission to insure that private enterprise options are fully taken into account during the project design process.

The Private Enterprise Activities of AID. The most accurate data available indicate that private enterprise programs have represented roughly 12–13% of total Development Assistance and ESF funding from FY 1986 to the present. In FY 1988 AID obligated $630 million of DA and ESF in support of the Initiative. In addition, a large proportion of projects funded with ESF-generated local currency have had a private enterprise element.

There have been three kinds of private enterprise programs:

- those that sought to change government policies which bear on private enterprise;
- those that sought to assist private enterprises directly, through credit schemes, training and technical assistance; and
- those that sought to utilize private enterprise to carry out AID's traditional social service activities.

1. *Policy Reform.* Through its "policy dialogue" with developing country governments, AID has sought the elimination of policy constraints on private enterprise and the adoption of policies which would stimulate its growth. For instance, under the Africa Economic Policy Reform Program, African countries were variously encouraged to increase private sector roles in agricultural marketing, contract rural road construction to private contractors, or liberalize import and export licensing.

One of AID's more common policy reform objectives has been the privatization of government-owned enterprises and of government services. AID funded the establishment of a Center for Privatization in order to develop a pool of consultant expertise on the process and techniques of privatization. AID has provided technical experts to conduct studies on the feasibility of privatization and assist government in carrying them out, conditioned ESF cash transfers on privatization of parastatals, and used ESF local currency to eliminate parastatal debt in order to facilitate their sale to the private sector. In Honduras, for example, AID is currently assisting the privatization of a holding company with 65 firms.

2. *Assisting Private Enterprise.* AID has directly met business needs for trained personnel, capital for start-up, operations and expansion, and technology by funding a wide variety of credit, training and technical assistance projects. Among the more distinctive private enterprise activities conducted by AID during the 1980s are:

- Business associations. AID has helped establish and promote institutional development of business and trade associations which provide leadership in advocating policy reforms on behalf of its business membership and implement AID credit, training, and business information service programs aimed at the particular membership they represent.
- Microenterprise programs. Microenterprises are the smallest size businesses, defined as having 10 or fewer employees. It is estimated that they comprise between 30% and 70% of the labor force in developing countries. At present AID is conducting 87 microenterprise projects funded at $290 million over their project-life. These projects provide various mixes of credit, training, and/or technical assistance.
- The Private Sector Revolving Fund. The Fund provides credit assistance to businesses mostly via loans and loan guarantees to banks which then on-lend the funds. Up to the end of 1988, the Fund's portfolio consisted of $67 million in projects.
- Export Development/Investment Promotion projects. AID projects have assisted indigenous exporters, largely emphasizing development of non-traditional products, while others have sought to attract foreign investors through creation of export processing zones and creating a policy climate conducive to investment. Twenty-eight of 105 active AID-funded projects in the Latin American private sector as of June 1988 had an export-related component.

3. *Using Private Enterprise to Implement AID Objectives.* In order to encourage expansion of the private sector, AID has utilized the private sector as much as possible to implement development activities and convince governments to use them in the provision of services. Anticipated benefits are greater cost-efficiency, greater financial sustainability, and decreased burden on government budgets.

For example, in the population sector, AID is helping developing country private employers to initiate family planning services within the context of their existing employee-based health programs. AID's contraceptive social marketing projects use market techniques, such as advertising campaigns, market research, and retail distribution and sales, to achieve greater contraceptive use at low program cost.

Issues Raised by the Private Enterprise Initiative. In its challenge to existing policy, its emphasis on the private sector, and concurrent deemphasis of the public sector, the Initiative has been a departure from the past. A variety of issues have been raised during the eight year implementation of the Initiative:

- Does the Initiative run contrary to basic human needs?
- What has the Initiative meant for developing country governments?
- Is financial sustainability best attained through the private sector?
- Which private sector components should AID assist?
- What institutional obstacles does Initiative implementation face?

1. *Basic Human Needs and the Private Enterprise Initiative.* Since the introduction of the Initiative, many have wondered

whether the new program was not in some way incompatible with the objectives of the 1973 New Directions legislation which requires the U.S. aid program to support the "poor majority" in developing countries. It has been asserted that the Initiative might be a return to the pre-New Directions indirect approach to development in which the poor were expected to receive benefits via a "trickle down" process.

Although AID admitted to re-examining its strategy, the Administrator noted that the needs of the poor majority would continue to be addressed, if somewhat differently than earlier. AID has pointed out that the Initiative specifically helps the poor by emphasizing employment generation and raising incomes, thereby increasing the purchasing power of the poor and enabling "them to meet basic human needs by their own efforts and choices".

Specific private enterprise programs, the use of the private sector as a delivery mechanism, and the emphasis on using AID resources to encourage national economic growth have been challenged on the utility and effectiveness of their particular approach to meeting the needs of the poor majority.

a. *Private Enterprise Programs.* In many cases, programs such as assistance to business associations, policy reform assistance, and credit supplied to medium-sized business, do not appear to help the poor directly but have the purpose of strengthening national economic growth in order to create job opportunities and help governments afford sustainable social programs.

- Policy Reform. World Bank structural adjustment reforms supported by AID have been criticized for having an adverse affect on the poor. Many believe that AID should stress incorporation of poverty-alleviation measures in its own policy reform programs. AID, however, refutes the notion that the consequences for the poor are mostly negative. They argue that sectoral reforms supporting decontrol of agriculture prices, for instance, have benefited the small farmer. In addition, the apparent negative impact of policy reforms must be weighed against the far greater negative impact that would ensue if government policies had remained on their original course.
- Assistance to Business. Although AID provides assistance to a wide range of businesses, the extent to which the poor have been served directly by these projects has been questioned. To some, there is a stark policy choice to be made between the objectives of poverty alleviation and business development. To others, helping business develop is the best way to alleviate poverty.

  Critics perceive a tendency for many AID business assistance projects to ignore the poor. Export promotion projects tend to help neither small nor micro enterprise, because they are viewed by AID as having little potential for developing quality products in quantities necessary to be competitive exporters. Small-scale enterprise beneficiaries of the Private Sector Revolving Fund are enterprises with fixed assets under $250,000, a definition of small-scale viewed skeptically by some. Proponents of microenterprise legislation in 1987 were similarly critical of AID efforts to adopt a definition of microenterprise which, in their view, would prevent funds from reaching the very poorest of entrepreneurs. On this latter point, one group of Representatives accused AID of ignoring bottom-up growth. AID has countered that directly targeting credit to those at the lower end of the per capita income spectrum may make it more difficult to achieve sustainable results, because businesses with higher skill levels benefit more from credit and technical assistance programs and sustain more new employment opportunities. Supporters of the poverty-alleviation approach, however, suggest that the immediate social benefits of business assistance programs should be taken into account in weighing who should be targeted for direct assistance.

b. *Use of Private Sector as Delivery Mechanism.* The effort to utilize the private for-profit sector and for-profit market mechanisms to provide project services formerly delivered through governments has not been fully exploited as yet. However, there is reason to believe that use of private enterprise methods and organizations to serve the poor has significant limitations.

For example, many believe that use of private enterprise is unlikely to make significant inroads outside of urban areas, because transport and other costs are too high and potential client incomes to low to make service profitable. Furthermore, charging for services may deter the poor from utilizing available services. In the health sector, service charges seem to channel use to curative care rather than than toward the preventative care which AID programs in child survival and nutrition have sought to foster. On the other hand, some suggest that although private enterprise may not totally replace existing service practices, where they do succeed, limited government resources could target those poor groups less likely to be served by private enterprise.

c. *National Growth vs. Targeted Growth.* Some believe that a major premise of the Initiative—that basic human needs may be met by stimulating broad-based economic growth—is inaccurate. They assert any benefits the poor receive from the presumed "trickle down" effect of increased job opportunities are uncertain and only direct targeting of assistance to the poor will have a strong positive impact. Proponents of the Initiative, however, argue that the poor have benefited in those countries which have experienced relatively rapid rates of growth. The number of absolute poor in middle income countries is significantly lower than in slow-developing countries. And any growth at this stage is important in order to free government budgets from the debt burden and allow them to support social programs which satisfy basic human needs.

2. *AID and the LDC Government Role in the Private Sector.* Initiative proponents take the view that developing country governments have largely played a negative role in their economies. In stressing divestiture of government enterprise, privatization of government services, and the transfer of project funding from government to the private sector, AID appears to support an LDC government role substantially different from what it had previously. This approach may cause some friction with LDC governments. In Jamaica, for example, explicit conditions made by AID in 1984 and 1985 listing firms to be privatized led to a deterioration of relations between AID and the Jamaican government.

Changing priorities from support for government to support for the private sector are reflected as well in a shift of resource transfers. Although most assistance is still directed through governments, in the Latin America region in 1985, almost half was run through non-governmental groups, half of these for-profit organizations. Further, AID no longer funds projects to assist parastatal development.

AID has recognized the political problems that its private enterprise approach could engender. Its support for privatization, for instance, has been characterized by activities designed to build public support. Some believe AID has been too cautious. Strategic considerations, they say, have prevented it from pursuing a harder line in support of policy reform in both Egypt and Honduras.

3. *Financial Sustainability.* One of the major benefits that was predicted to flow from the Private Enterprise Initiative approach to development has been that it would insure greater project sustainability. Previous approaches to development had established the basis for government to provide new services without covering the necessary recurrent costs, such as salaries for doctors and teachers, to keep them going once donor funding had ended. Utilizing market forces, on the other hand, promised to help projects become sustainable in several ways. For one, projects run by the private sector would be more efficient and respond to market forces to determine resource allocation. Further, they would recoup costs by charging for services.

There has been some success in fostering greater financial sustainability in AID projects using private sector methods. By charging fees, a number of training programs have become more self-sustaining. Credit programs charging real positive interest rates have recovered most of their costs. Drawbacks to greater sustainability exist, however. In contraceptive social marketing projects, for example, there appears to be a trade-off between the objective of widespread contraceptive use at prices affordable by the poor majority and that of project self-sufficiency.

4. *AID and Private Sector Components.* Funds for private enterprise are limited, and decisions must be made regarding which components of the private sector should be targeted for assistance. Each segment of the private sector has its supporters and detractors.

For example, those who believe that microentrepreneurs in the "informal" part of the private sector should be the chief beneficiaries of private enterprise assistance tend to contest that portion of aid which assists larger businesses. On the other hand, proponents of aid to small business argue that it generates more employment than other businesses. Medium and large businesses, still others argue, are more viable candidates for export activities and linkages to foreign technology and investment.

5. *Obstacles to Implementation of the Private Enterprise Initiative.* During the past eight years, efforts to implement the Initiative have run into a number of institutional and policy obstacles.

- There has been a shortage of AID professionals qualified to implement the Initiative. In order to meet a need for people with an understanding of the business environment, AID has recruited more staff with business experience and has established a training course.

- Some contend congressional oversight hinders AID's ability to deal with business by discouraging risk taking, such as equity investments, and by frightening off businessmen due to the detailed financial reporting requirements of government.
- Procurement regulations which place severe limitations on salary levels payable for provision of contract technical services have distracted from the Agency's ability to obtain skilled consultants in banking, investment, and other specialties.
- Foreign aid financial resource limitations have slowed growth of private sector programs. Some believe that congressional allocations of funds to specific functional accounts and congressional earmarks for specific programs, greatly limited funds which might have been dedicated to private enterprise development.

Assessing the Private Enterprise Initiative. It is difficult to measure the impact of the Initiative on the development of private enterprise and on the national growth of developing countries. In view of the small size of the AID role in many countries and the relatively small size of the private sector program within AID, some believe one should not expect too much.

Nevertheless, the Initiative can claim two concrete accomplishments as a result of the past eight years. For one, it has brought the problems of private enterprise in the developing world into the mainstream of the U.S. foreign aid program. Secondly, the Initiative has revitalized some old areas of AID activity and moved AID into new areas.

CONTENTS

I. INTRODUCTION [1]

The Private Enterprise Initiative is, perhaps, the chief legacy of the Reagan Administration to the foreign economic assistance program of the United States. Asserting that "increased reliance on private enterprise, individual initiative and entrepreneurship, the encouragement of competition, and reliance on market forces to guide economic progress is essential for sustained, equitable growth," the Private Enterprise Initiative has sought to shift development strategies of the Agency for International Development (AID) "from a predominantly public sector, or government-to-government, focus to one that emphasizes market forces and active private indigenous productive sectors." [2]

The Initiative has had three components:[3]

- *Policy reform.* AID has encouraged governments to establish policies which promote free market principles and end government intervention in the economy. Such activities are intended to create a climate compatible with private enterprise growth.
- *Private enterprise development.* AID has expanded and initiated a variety of activities aimed at assisting the growth of micro, small, and medium-scale indigenous private enterprises.
- *Utilization of the private sector as a delivery mechanism.* AID increasingly has used private, rather than public, sector organizations, including private enterprises, to implement its traditional programs in such areas as population and health.

Although the Initiative represents only one element of an extensive and complex U.S. foreign aid program of the 1980s, it has had a significant impact on the program, on the Agency for International Development. Its ultimate impact on the developing coun-

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[1] Note: This report is based upon a close review of the written public record of debates, hearings, government studies and project evaluations on the subject discussed herein. It is also based on over 70 interviews and discussions with administration, congressional, development specialist, AID, and developing country participants with first-hand knowledge of the subject.

[2] AID Congressional Presentation, FY 1988, p. 205A, and AID Congressional Presentation, FY 1989, p. 202.

Defined in AID policy papers and often reiterated in congressional testimony, "private enterprise" is "profit-oriented economic units producing goods and services for the market in which the means of production are privately owned." AID includes "business associations (e.g. chambers of commerce) that promote private enterprise, and profit-oriented, privately-owned cooperatives" as a related concern. (AID Policy Paper, *Private Enterprise Development*, May 1982, revised March 1985).

Organizations, such as private and voluntary organizations (PVOs) and parastatals, which "tend to respond to motives in addition to, or in place of, the profit motive, and thus are less influenced by the operation of free and competitive markets" are excluded from this definition. Farmers might properly be considered private entrepreneurs where their operations are commercial, not subsistence.

Following AID's usage, this paper employs the term "private sector" interchangeably with private enterprise, except where the context clearly indicates its usage to include PVOs, cooperatives, universities and other non-governmental entities.

[3] A fourth, privatization, was added in the FY 1989 Congressional Presentation. This report, however, treats privatization as AID did previously and subsumes it under components one and three.

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tries which receive foreign assistance is, as with most other economic assistance efforts, not easy to identify.

In the past, AID had conducted projects which benefit the private sector. The activities encompassed by the Initiative, however, have been of a different order of magnitude than those of the previous decade. There has been more private enterprise project activity and a wider range of private enterprise project-types. The Initiative gives much greater priority to the development and growth of private enterprise as a way of achieving AID objectives than had been the case earlier. The shift in approach, qualitative as well as quantitative, can be seen in the new emphasis on policy environment and greatly increased contacts with private for-profit organizations and representatives.

To the extent that it has appeared to be a departure from previous policy and practice, the Initiative has stirred a degree of controversy. A number of issues have been raised by the Initiative:

Conflict with Basic Human Needs. The Initiative seemed to signify a shift in approach to the priorities established by the 1973 "New Directions" legislation which had called for direct targeting of assistance to the poor majority in order to fulfill a country's basic human needs. To critics the Initiative was an indirect, long-term macroeconomic growth approach to development in which the poor would only benefit through a "trickle down" of wealth. Proponents of the Initiative asserted that it was "a more efficient, cost-effective" way of meeting the New Directions mandate and that the poor would benefit through increased employment opportunities and more financially sustainable social programs.

The Role of Government. The Initiative proposed a change in the U.S. aid relationship with governments and in the role of developing country governments in their economies. Instead of supporting the implementation of government programs, the Initiative suggested that aid programs be used to assist the private sector directly. It would also use foreign aid to encourage a diminishing role for governments in both the economy and the delivery of social services. These new approaches, some believe, may raise political problems with LDC governments sensitive to any challenge to their role.

Financial Sustainability. One of the problems associated with development projects was the dependence on continued donor or government funding they created. Initiative proponents contended that adoption of private sector methods would greatly enhance the ability of projects to become financially sustainable.

Private Sector Strategies and Options. By expanding the range of foreign assistance programs to include private enterprise, the focus of discussion has moved away from the question of whether or not to assist the private sector. Rather, with limited financial resources available, the question arises as to which components of the private sector should receive assistance and what are the best strategies for assisting private enterprise development.

Obstacles to Implementation. The Initiative was in many ways a departure from previous practices in the Agency for International Development. In order to provide appropriate assistance to private enterprise, policymakers had to overcome a number of institutional and financial obstacles—and today many still remain.

As the policy was translated into actual programs and projects in the field, its more dramatic and controversial aspects were reduced. Some early alarms, for instance, that the entire economic assistance program would be "privatized" as a result of the Initiative have not been realized. But the Initiative, nonetheless, has had a substantial impact on the foreign assistance program. Activities to strengthen private enterprise in developing countries have increased in number and variety. New approaches and methods to development are being explored. To foster these programs, new institutions have been established within the Agency for International Development. New modes of behavior have been sanctioned allowing AID to communicate and work directly with the private sector. There has been as well a shift in the priorities which determine the direction of assistance, from the public to the private sector. There has been a new emphasis on non-project assistance used to induce policy reform. The Private Enterprise Initiative has certainly changed the U.S. economic aid program, but the extent, durability and implications of that change are still open to question.

Eight years into the Initiative, it is an appropriate time to review the ramifications of this approach. The report that follows describes the philosophy that drives the Initiative, the historical and economic context in which it was created, and its institutional and legislative implementation. The variety and scope of private enterprise activities undertaken by AID are then examined. Finally, the key issues raised during AID's encounter with private enterprise are discussed.

II. THE PRIVATE ENTERPRISE INITIATIVE

A. Policy Formation

The Private Enterprise Initiative has been both a continuation of and a departure from previous U.S. foreign economic aid programs. The United States has long used its economic assistance program to support the development of private enterprise in developing countries.[4] Nevertheless, the Private Enterprise Initiative has often been characterized as a departure from the past. The recent history of the U.S. foreign economic aid program is generally described in terms of several phases: the period from 1957–1973 when aid emphasized infrastructure and industrial projects; the period from 1973–1980 when the "New Directions" legislation targeted aid on the poorest populations in an effort to meet their basic human needs; and the period from 1981 to the present when "New Directions" approaches were supplemented by a wave of private enterprise programs. Although many private enterprise-related activities continued to be conducted throughout the 1970s, studies suggest that, with the exception of training programs, the level of such activity had dropped off significantly with the introduction of the "New Directions" policy. The difference in magnitude reflected the change in emphasis away from industrial and other projects "whose benefits for the poor were indirect, and hence difficult to quantify or demonstrate conclusively." [5]

The Reagan Administration's new program was derived from a belief that previous approaches to development had not been adequate. The Administration's arrival in office coincided with the onset of severe economic stagnation in much of the developing world. With growing debt, developing country governments were increasingly unable to maintain social and economic programs in health, education and agriculture of the sort which had been initiated with U.S. support. In a view shared by many in the Administration and the World Bank, the only answer for developing countries was to grow their way out of debt and recession through greater production, foreign investment, and increased exports. The poor could best be helped through such growth.

For the Administration, the key to economic growth was private enterprise and reliance on market forces. The President himself was a strong proponent of the private sector's importance for the domestic economy, and these beliefs appear to have been translated to the developing world. In a speech to the World Bank and IMF in September 1981, President Reagan noted that "the societies which

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[4] See Deborah M. Orsini, *AID Private Sector Initiatives: Past, Present and Lessons Learned*, report for the President's Task Force on International Private Enterprise. November 1983.

[5] Robert Nathan Associates, Inc. *A Review of AID's Experience in Private Sector Development*. AID Program Evaluation Report No. 14. April 1985, p. 23.

have achieved the most spectacular broad-based economic progress in the shortest period of time" are united by "their willingness to believe in the magic of the marketplace." [6]

Private Enterprise in the Developing Countries. Generally, two complementary tendencies exist in many developing countries with regard to private enterprise: the dominance of the state and the weakness of the private sector. The former was partly a result of the supremacy of the colonial government inherited by most developing countries, the lack of capital available to the private sector in the early years of independence, and the enormous social needs of developing country populations, which many believed, could only be met by a strong central government. Governments came to play a powerful role in national economic policy.

Proponents of the Initiative often highlight two related points. One, that foreign assistance programs, largely channeled through developing country governments, accepted and encouraged the broad government role in provision of services. Institution-building projects were aimed at making government more effective and able to play a leadership role. Secondly, governments had become increasingly embroiled in the functioning of their nations' economies. Because these leaders thought it would make their economies grow faster, they played a more active role in resource mobilization. This led to the imposition of a variety of regulations. To encourage industrialization and urbanization, price controls and subsidies were established on foodstuffs. To promote import substitution schemes, exchange rates were overvalued and tariffs raised. In the end, these fiscal and monetary policies discouraged private sector growth. Government-owned business—parastatals—often intended to fill gaps in the economy or keep a failing private business from collapse, multiplied.

At the same time, the private sector in developing countries was handicapped by small and inefficient labor and capital markets, lack of access to technology, poor or unavailable training in management, accounting and other skills, and onerous government regulations and excessive government participation in the economy. Business associations and chambers of commerce either did not exist or had undeveloped capabilities for provision of information and marketing support services or for exercising influence over the government policies which affected its members.

The Policy. [7] It was the view of the Administration that a "private enterprise economy" was the most efficient means of achieving broad-based economic development. In order to build such an economy, AID targeted its Private Enterprise Initiative on the two impediments to private enterprise development noted above. Its goals, therefore, were:

- to encourage developing country governments "to open their economies to a greater reliance on competitive markets and private enterprise", and

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[6] Remarks at the annual meeting of the Boards of Governors of the World Bank Group and International Monetary Fund, September 29, 1981.

[7] The following discussion is largely based on AID policy papers, *Private Enterprise Development,* May 1982, and the revised version of March 1985.

- "to foster the growth of productive, self-sustaining income and job producing private enterprises in developing countries."

AID policy acknowledged the possibility of a positive role for the public sector in the achievement of economic growth. That role was believed to be the establishment of a favorable climate for private investment. Mission directors were instructed to identify government policy constraints to private enterprise development and seek to address these through both its ongoing dialogue with governments regarding its foreign assistance programs and in the course of project design.

Specifically, the AID effort to encourage governments to create a climate amenable to private sector development had a number of objectives:

- *Economic policy reform.* AID sought to encourage government economic policies regarding levels of taxation, exchange rates, tariffs, subsidies and price-fixing which are conducive to private sector growth. Where countries have followed an import substitution strategy, AID sought to encourage a shift to more export-oriented policies.
- *Legal and regulatory changes.* AID sought to encourage private sector growth through government policies regarding labor, including minimum wage and employment rules; licensing of business and the establishment of corporations; banking restrictions, including limits on lending rates; and investment incentives.
- *Privatization of government services and parastatals.* AID sought to encourage governments to privatize parastatals as well as to open up traditional government-dominated programs in such social sectors as education, health, and agriculture to private sector participation.
- *Improved infrastructure in power, transport, and communications.* Since AID only rarely provided capital costs of infrastructure, its role was to provide assistance to ensure business-like management of services. Although infrastructure was widely viewed as the responsibility of government, AID encouraged private ownership.

Changes in government policies and programs were not the only aim of AID policy. The private enterprises themselves were a target of assistance. In order to assist the expansion of private enterprise in developing countries, AID had several objectives:

- *Access to credit.* AID intended to use its financial resources to increase availability of credit and its technical assistance to create credit institutions.
- *Creation of a trained labor force.* AID would support training programs to fill gaps in the private sector labor force.
- *Availability of technology.* Using technical experts and training programs, AID would promote capital saving technologies.

A key objective of the Initiative was project sustainability. Whereas projects run by governments had faltered when donor assistance ended, projects implemented through the private sector would seek to become self-sustaining as soon as possible. It was argued that private enterprise projects would charge a market price for services, they would be more efficient in their operations, and more responsive to the public served. Furthermore, they could mobilize private sector financial resources with which to expand and develop their activities.[8]

The Public Policy. The basic outlines of the Initiative were developed over the first year of the Administration. Within weeks of President Reagan's inauguration, a private sector approach to foreign aid was being formulated by AID Administrator, Peter McPherson. In its first budget submission, the amended FY 1982 Carter budget, McPherson noted the Administration's commitment to increased opportunities for private sector participation in AID programs. By July 1981, in an act heralding the Initiative, a Bureau for Private Enterprise was established within AID. Subsequently, in the fiscal year 1983 budget submission (presented in January 1982) and in a series of policy papers that followed, AID outlined the essential points describing the Initiative.

Private enterprise support had been the first of the Agency's "Four Pillars", through which, according to McPherson, the U.S. could achieve the President's foreign assistance objectives.[9] In addition to being an Agency priority, institutionally promoted by its own Bureau, the Initiative was supported in principle by a number of outside sources. Both the Kissinger (1984) and Carlucci (1983) Commissions, on Central America and Security and Economic Assistance respectively, recommended that steps be taken to encourage private sector growth.[10]

In May 1983, the President appointed a Task Force, headed by Dwayne O. Andreas, to examine how U.S. foreign aid could be used to stimulate private enterprise development. The President's Task Force on International Private Enterprise eventually reported over 80 recommendations; many of those aimed at AID activities were adopted by the Agency. Another task force, focused on privatization issues in both the United States and abroad, was established in September 1987. Its report in March 1988 called on AID to increase its privatization activities by directing funds to the private sector and encouraging privatization of state-owned enterprises.[11]

World events during the 1980s also helped to reinforce the policy. Partly as a result of the debt crisis and government responses to the prescriptions of the World Bank and International Monetary Fund, many developing countries indicated an interest in moving

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[8] Another feature of the Initiative when first introduced was the prominent role given to U.S. private enterprise. The first AID policy paper on the subject stressed U.S. investment in developing country economies, U.S. business role in technology transfer, and the provision of AID information services to U.S. business firms in order to assist their investment and trade with developing countries. The revised version of this policy, however, focuses entirely on the developing country private sector and greatly downplays the role of U.S. enterprise. While noting that a more market oriented LDC economy should benefit U.S. private enterprise through profitable business relationships with LDC entrepreneurs, the paper, referring to AID projects, notes that "the mere use of a U.S. private firm should not be construed to mean that the project is a private enterprise promotion project in the sense of meeting A.I.D.'s policy objectives." (*Private Enterprise Development*, March 1985, p. 11). Although there has been increased trade, technology transfer and investment activity utilizing the U.S. private sector as a result of the Initiative, this report will focus on AID activities to assist LDC private enterprise, not U.S. private enterprise.

[9] Testimony to House Foreign Affairs Committee, February 23, 1983, *Foreign Assistance Legislation for FY 1984–85 (Part I)*, p. 246.

[10] *Report of the National Bipartisan Commission on Central America*, January 1984, and *Commission on Security and Economic Assistance: A Report to the Secretary of State*, November 1983.

[11] *The President's Task Force on International Private Enterprise: Report to the President*, December 1984, and President's Commission on Privatization, *Privatization: Toward More Effective Government*, March 1988.

from inward to outward looking economic strategies and from statist to free market approaches. Developing country governments were more agreeable to the new private enterprise-related projects advanced by AID than they might have been at an earlier period. Other donors, notably the United Nations Development Program, also began efforts to integrate private enterprise projects into their overall development aid programs.

In sum, private enterprise issues have now become integral to the U.S. foreign assistance program. As the Assistant Administrator of the Bureau for Private Enterprise pointed out in 1988:

> . . . the encouragement of market forces and active indigenous private sectors to stimulate growth is now pervasive in A.I.D. strategy formulation and programming. Starting in 1981 as a departure from the Agency's historical government-to-government approach, the Initiative today enjoys wide recognition in the field as a proven development tool that is especially well suited to the attainment of self-sustaining growth. This recognition extends beyond our own foreign assistance program to other donor nations. To multilateral donor organizations, and, most important, to many host country governments which make the laws and enforce the regulations under which their emerging entrepreneurial sectors must operate. Therefore, in contrast to the situation seven years ago when A.I.D.'s Initiative was begun, private enterprise has become part of the development mainstream and seems likely to persist as an essential tool of development into the future.[12]

B. Congressional Actions

Although most private enterprise-related activities have been conducted under the terms of pre-1981 legislation, the U.S. Congress did enact several pieces of legislation after 1981 which either authorized new programs or added new language supportive of AID private enterprise activities. At the request of the Reagan Administration, Congress established the Private Sector Revolving Fund in 1983.[13] Several other initiatives emanated from Congress. The Food Security Act of 1985 contained two initiatives—one (section 108) requiring a proportion of PL 480 Title I-generated local currency to be made available to financial institutions for on-lending to private enterprises, and another (the Food for Progress Program) providing food aid in return for government policy reforms promoting private enterprise involvement in the agriculture sector. In addition, the Foreign Operations Appropriations bills for fiscal years 1988 and 1989 earmarked $50 million and $75 million, respectively, from total Development Assistance (DA), Economic Support Funds (ESF), and local currency to support microenterprise projects.[14]

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[12] Neal Peden. Testimony to Senate Foreign Operations Subcommittee, Committee on Appropriations. May 12, 1988. *Foreign Assistance and Related Programs Appropriations for Fiscal Year 1989.* p. 258.

[13] As section 108 of the Foreign Assistance Act of 1961. For more on the Private Sector Revolving Fund, see page 33.

[14] There are several categories of economic assistance. Development Assistance funds emphasize long-term development objectives and are broken down into a number of functional ac-

Continued

Policy language was also added as a consequence of the Private Enterprise Initiative. In 1983, Congress amended the Foreign Assistance Act of 1961 (Public Law 87–195, section 108(a)) to include a finding that the development of private enterprise is a vital factor in the stable growth of developing countries and that it is in the best interests of the United States to assist this development. Section 102 of the Act, containing a list of principles on which implementation of bilateral development assistance programs should be based, was amended in 1985 to include the "four pillars" of the Reagan Administration's foreign aid program. One of the "pillars" supported the promotion of private sector activity as a fundamental objective of development assistance.[15] Both House and Senate reports on the amendment, however, noted that the intention of the legislation was simply to restate principles already embodied in other parts of the Act and that doing so did not in any way mean that the New Directions' basic human needs policy mandate had been supplanted.

Private enterprise legislation generated little discernable political controversy. The attitude of potential opponents to the Initiative might fairly be described as "laissez-faire". As one Foreign Affairs Committee member said of the most prominent private enterprise legislation—that creating the Private Sector Revolving Fund:

> We weren't really involved in the establishment of this program. It was a Reagan initiative, and we more or less went along with it. We felt that the greater stake the administration had in the foreign aid program, the more support there would be for the overall authorization.[16]

Another reason for congressional receptivity to the Administration's proposals, according to one committee staff member, was that "private enterprise is like apple pie. You can't attack it."

Furthermore, new legislation on private enterprise did not appear to threaten existing programs. As noted, the hearing record and committee reports exhibit congressional concern regarding possible conflict with New Directions policy. When Administration officials were asked if they intended to seek changes to reflect a greater private sector philosophy, they responded that any recommended changes would remain consistent with congressional objectives in establishing New Directions. For the most part, however, existing legislation authorizing foreign economic aid was sufficiently broad to permit most activities encompassed by the Initiative without any change.

C. The Institutionalization of the Initiative Within AID

If the Initiative was to be translated into actual projects in the field, it first had to be introduced successfully into the bureaucracy which designed and implemented those projects. In addition to the

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counts, such as agriculture and education, and one regional account, the Development Fund for Africa. ESF is provided to countries of special economic, political, or military significance. PL480 refers to the Food for Peace Program, which authorizes food aid activities.

For more on microenterprise, see page 31.

[15] The other three are encouragement of policy reforms, access to appropriate technology, and institution-building.

[16] Don Bonker, House Foreign Affairs Committee, *Oversight of the Private Sector Activities of OPIC and AID's Bureau for Private Enterprise*, September 10, 1986, p. 112.

release of directives and policy papers, the Administration sought to insure that institutional mechanisms were put in place to promulgate the Initiative on a long-term basis. To understand the outcome of the Initiative, it is useful to examine this process.

Within the Agency for International Development, the Private Enterprise Initiative was granted a prominence which suggested the beginning of a serious and comprehensive effort. In its early years, however, there was considerable resistance to the Initiative throughout the Agency. Some AID professionals perceived it as just another of the "development fads" which appear with regularity and are eventually forgotten. Others saw the Initiative as a temporary political phenomenon connected to the advent of the new Administration.

Because promotion of one policy often meant diminution of another, many viewed the Initiative as a threat to the type of programs which they, as AID professionals, had implemented during the preceding half dozen years. A 1982 memo from the Administrator noted that "The principal sources of funding for the Agency's private sector initiative will be Mission budgets . . .", [17] and 8% of target mission budgets (both ESF and DA) were to be set-aside for private sector activities. As a result, mission directors, unenamored with the Initiative, reportedly would replace one set of "buzzwords" used in project design with another set to accommodate policymakers in Washington—an integrated rural development project, for example, might be retitled "small farmer".

By March 1988, however, an AID internal management study noted that the Initiative, while unevenly applied throughout the Agency, was well established. Many believe that, after eight years, the program goals of the Private Enterprise Initiative have been largely integrated into the entire Agency.

1. The Private Enterprise Bureau

To outsiders, perhaps the most visible aspect of the Initiative has been the Private Enterprise Bureau (PRE). Established in July 1981, six months after the start of the Reagan Administration, the PRE was the first tangible evidence of the new AID program. The Bureau was originally intended to be the leading agent of the Initiative. Setting up a separate bureau, rather than making it an office within an existing bureau, highlighted the importance the Administrator attached to the program. Moreover, as a bureau, its director—an Assistant Administrator—would have direct access to the Administrator.

The PRE's role in promoting the Initiative was to be twofold:

- As experimenter, the Bureau would formulate new methods of assisting development of private enterprise. It would work in areas previously untouched by the Agency and develop models of projects which the missions could replicate.
- As educator, the Bureau would provide technical support to missions in the areas of its expertise. It would disseminate the models and methods it had developed. And it would train

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[17] Foreign Affairs Committee, Subcommittee on International Economic Policy and Trade, *Foreign Assistance Legislation for Fiscal Years 1984-85,* March 9, 1983, p. 123.

Agency staff in how to work with the private sector and identify opportunities for AID involvement.

Despite its prominence as a separate bureau, most believe that the PRE largely failed in its early years to make a significant contribution to the promotion of private enterprise within the Agency; some think that the Initiative's progress may actually have been retarded by the PRE's performance. Internal agency opposition that might be inherent to any new approach was exacerbated in this case by both bureaucratic and funding issues. Due, in part, to the necessity to avoid bureaucratic turf battles with other parts of the Agency having their own private enterprise-related responsibilities, the PRE was not able to achieve any focus in its first years. Establishment as a separate Bureau had the effect of isolating it and its activities from the rest of the Agency. Moveover, in carrying out of its duties, the Bureau gained a reputation for insensitivity to the other bureaus and the missions. Part of the problem, according to AID staffers, seems to have been a tendency to conduct project-related activity without sufficient communication with the local missions. When it did communicate, Bureau staff tended to tell mission personnel what to do, rather than work cooperatively with them.

Another problem confronting the Bureau concerned funding—although AID's budget was steadily rising between 1981 and 1985, funding for the Bureau was perceived to be at the expense of other functions. In fiscal year 1982, $36 million was re-programmed for the Bureau.[18] In addition, target missions were required to "set-aside" a certain amount of funds for private enterprise projects to be mutually agreed on with the PRE. Roughly $120 million were designated for this purpose in fiscal year 1982. Reportedly, a number of missions resisted this program and, although some activities were initiated under this funding system (only three projects were approved in FY 1982 totalling $25 million), it was formally discontinued in 1985.

Concern regarding the budget drain threatened by the PRE's activities may have been quelled somewhat by establishment in 1983 of the Private Sector Revolving Fund. The Fund, which provides credit assistance to developing country entrepreneurs, was expected to require no new appropriations after it had reached $60 million.[19] The budget of the PRE itself rose to a high of $38 million in FY 1985 and has since declined to an estimated $19.8 million in FY 1989.[20]

Some observers mark the year 1985 as the point at which the PRE found its present niche within the Agency. AID, itself, in its FY 1986 Congressional Presentation drew a distinction between a "start-up strategy" period and what it called a "transition" strategy, running from 1985 to 1987, in which the Bureau would move

[18] Testimony of Elise Du Pont, Assistant Administrator, PRE. September 15, 1982. House Foreign Operations Subcommittee, Committee on Appropriations. *Foreign Assistance and Related Programs Appropriations for 1983 (Part 7).*

[19] In the end, however, it has absorbed between $8 and $16 million annually. Although it was expected that the ability to recycle loan repayments would eventually free the Fund of the need for new appropriations, due to long loan maturities of its initial loans, the Fund has required more appropriations than originally estimated.

[20] Figures, provided by the PRE, exclude housing office activities.

into a well-defined course (in this, it appears to confirm the lack of such a course previously). In 1985, there was a transformation in the leadership and staff of the Bureau. An effort was made to focus its program and, like the other technical bureau—Science and Technology—to be more responsive to mission needs and requests.

Since then, the Bureau appears to have become more diplomatic, seeking a lead role only where leadership has not been taken by other parts of the Agency and contributing to the Initiative largely through the management of the revolving fund and through technical assistance consultant inputs to the missions. Beginning in 1985, the PRE placed three long-term contracts with consulting firms to furnish expertise when needed in privatization, financial market development, and private enterprise development. Such contracts either allow missions "free" technical services or the ability to "buy-in" to the contract, sometimes for more extended services. In short, they encourage missions to get involved in private enterprise projects.

The Private Enterprise Development Support (PEDS) contract provided technical assistance in a wide variety of subjects—from policy reform to export promotion. Although the first PEDS contract was for $1.2 million over two years (1985-87), PEDS II is a five year, $20 million contract. To date there have been 60 assignments in 40 countries. The more narrow Financial Markets contract funded studies in more than 20 countries on the development of financial institutions, highlighting constraints to the mobilization of domestic capital. The Privatization contract, widely viewed as the most singular success of the PRE, led to the establishment of the Center for Privatization. To date $8.5 million in PRE funds, matched by $7.4 million of mission funds, have been spent assisting LDC governments to study and carry-out privatization activities.

In addition to the provision of technical assistance, the PRE was responsible for managing the Private Sector Revolving Fund established by Congress to seek innovative ways to provide credit to small business.[21] Although financially the largest and legislatively the most prominent of PRE activities, the Private Sector Revolving Fund has, in the view of some observers, not had a significant impact on Agency private enterprise operations. Although active in 20 countries since 1984, more than a third of funding has gone to just three countries—Indonesia, Thailand and the Philippines. In addition, there was often little communication between the Fund and missions. According to a 1988 GAO report, loan projects in the Philippines and Indonesia were inadequately coordinated with the missions, which had only limited knowledge of Fund activities.[22] The PRE appears to have recognized the validity of this criticism. According to its Fiscal Year 1988 annual report, the Fund sought in 1988 to improve coordination. Every project obligated was co-designed with the relevant mission, and five of the seven projects were co-financed with missions.

Some observers, both within and outside the Agency, conclude that funds might be better utilized if channeled to missions direct-

[21] Fund operations are discussed in greater detail on page 33.

[22] Government Accounting Office, *Issues Concerning AID's Private Sector Revolving Fund*, July 1988.

ly, noting that missions are generally more innovative than headquarters and that they have developed a variety of loan and guarantee mechanisms on their own. Nevertheless, Fund officials contend that they have developed new financing techniques and initiated work in a number of new areas, including trade financing, venture capital, and technology transfer. Furthermore, a Fund report claims there have been cases, specifically in Thailand and Jordan, where missions have gone on to implement loan projects based on the model established in those countries by the revolving fund.

Although the role of the PRE as "educator" is evident in the framework of the specific technical support services it provides to missions, an effort has been made to train AID staff in methods and approaches which they might employ to increase private sector involvement in development activities generally. Early on in the implementation of the Initiative, it was recognized that AID personnel had had little experience with private enterprise—that many were skeptical regarding the contribution business could make to AID goals and, therefore, might not be able to respond well to the policies being initiated from AID headquarters. In 1984 a training course on "The Role of the Private Sector in Development" was produced by the PRE to "sensitize" AID professionals to the private sector. To date, approximately 150 AID staff have participated in this two-week course which has a positive reputation in the Agency for its effectiveness and utility.

Despite its varied project activities, the Bureau's modest budget, staff size, operation outside the bureaucratic mainstream, and the private sector activities developed by missions and other bureaus, have restricted the reach of the PRE. According to one analyst, by mid-1986 the PRE accounted for less than one percent of total private sector programming of AID.[23] In 1987, AID reported that regional bureaus invested roughly five times more Development Assistance funds alone in private enterprise-related projects than did the PRE.

2. Other Bureaus and the AID Missions

Although the PRE is the most visible symbol of the Private Enterprise Initiative, the AID policy paper on private enterprise development stresses that it is an "agency-wide" initiative. As the figures on private sector funding quoted above would indicate, other bureaus and the missions have taken lead roles in promoting various aspects of the Initiative.

The Bureau for Program and Policy Coordination (PPC). Responsible for overall agency policy coordination, PPC has been the chief formulator of the Initiative. It was involved in the various task forces which have contributed to development of the policy. PPC assumed the leadership role in policy reform, developed the privatization policy and, according to one official, convinced the Administrator to support it. As a reviewer of mission activities, PPC has promoted the Initiative to the missions.

[23] Testimony of Jennifer Bremer to House Foreign Affairs, International Economic Policy Subcomm. *Oversight of Private Sector Activities*, Sept. 10, 1986. p. 114.

The Science and Technology Bureau (S&T). Through its Office of Rural and Institutional Development, S&T has taken the lead role in microenterprise development. In addition, the Bureau is a significant contributor of technical assistance and policy guidance in small and medium business. The Bureau's functional directorates, in human resources, health, energy, agriculture, and population, have each developed private enterprise programs in their own discrete sectors.

The Bureau for Food for Peace and Voluntary Assistance. The Food for Peace Bureau manages those food aid programs noted earlier that assist private enterprise and promote policy reform.

The Regional Bureaus. It is the missions in the field, however, that design and implement the vast majority of AID projects. The extent of support given the Initiative by the Regional Bureaus reflects to some extent the progress made toward integrating the policy into mission programs.

The Bureau for Latin America and the Caribbean (LAC) has always been the leader in private enterprise both in terms of initiatives and size of program. As early as 1982, it had a specialized private enterprise division to review and promote private enterprise activities in the missions. In order to give its function within the Bureau more prominence, the post was upgraded in 1986 to a full Private Enterprise Office, reporting directly to the LAC Assistant Administrator. Missions were required to submit strategy statements specifically aimed at developing private sector activities. A number of missions, in Honduras and Costa Rica for example, established their own private enterprise offices and others designated a specific private enterprise officer to develop and carry out the new programs.

The LAC Bureau's and Latin America region's active role in private enterprise particularly benefitted from the funds appropriated in response to the political situation in Central America. The large sums of ESF money provided to the Bureau allowed it to develop policy reform and private enterprise projects that would not conflict with funding requirements of the more traditional social sectors. By one assessment, half of the total Latin America aid budget is used for private sector-related activities. Between 1982 and 1987, AID has spent over $2.6 billion on private enterprise programs in the region. At present, there are more than 100 active private enterprise projects.

The degree of private enterprise activity undertaken by AID missions in Africa is thought by most observers to be much less than in Latin America.[24] The level of economic development, including that of private business, is much lower; and basic food, health and other needs make greater demands on funding resources. Nevertheless, since 1983, the Africa Bureau has taken measures to promote private enterprise activity. It established a private enterprise office at the Bureau and placed private enterprise officers at key missions. In early 1987, the Bureau also adopted its own private sector policy and strategy. Among other things, it directed missions in

[24] AID data provided to the House Foreign Affairs Committee in 1986, however, stated that $218 million, or 51.7% of total Africa DA and ESF funding, assisted the for-profit private sector in FY 1985.

certain categories of development—20 as of early 1988—to prepare private sector strategy statements as part of the overall AID mission strategy process.

Significant steps to deal with policy reform, identified by many as a key constraint to private enterprise development in Africa, were taken by the Bureau through the establishment of an Africa Economic Reform Program. The program, designed to encourage adoption of policy reforms (discussed in more detail below), compensated somewhat for the lack of designated ESF funding to most countries in Africa.

To give the Private Enterprise Office clout with the missions, it was provided in 1985 with responsibility for a four-year $6 million Africa Private Enterprise Fund (later increased to $27.5 million and extended to 1990) with which to support an array of technical assistance activities. As of January 1988, assistance had been provided to 24 countries. A variety of studies have been funded, including a series of investment climate surveys whose aim is to map a country's private sector and assess needs for its strengthening. The Fund has also supported feasibility and technical studies seeking to identify investment opportunities.

In spite of these efforts, there appear to have been few concrete results, according to a 1988 evaluation of the Fund.[25] Investment climate assessments intended to help the missions engage in policy dialogue had not, in the view of evaluators, led to specific policy reforms. Other studies intended to identify opportunities for private enterprise development had not been translated into projects. A review of Africa programs conducted by the evaluators found an increase in private sector activity in only ten countries.

According to the evaluation, it is the view of mission personnel that the lack of follow-up to Fund assistance was chiefly due to the absence of available funding for private sector programs. There is reason, however, to believe that private enterprise initiatives in Africa began to receive greater emphasis and funding during 1988. The Private Enterprise Office has initiated a new set of programs, and since fiscal year 1988 there has been a considerable boost in obligations under Fund programs. At the close of 1988, the Private Enterprise Office launched an exercise, entitled Manual for Action in the Private Sector (MAPS), which seeks to affect a mission's entire country strategy in a way that will result in the adoption by the mission of a variety of private enterprise projects. Furthermore, the Development Fund for Africa, initiated in 1987, features funding flexibility at mission level which might allow AID staff to bring to bear formerly functional account restricted resources on cross-sectoral private enterprise-related issues. The Congressional Presentation on the FY 1990 Africa budget stresses funneling increased aid in support of both economic growth and private sector development, and the request indicates that more than 25% of the Fund would be used specifically for economic policy reform, financial market and enterprise development activities.

The Asia/Near East Bureau (ANE) formally established its own Private Enterprise Office much later than the other bureaus. Al-

[25] Robert Pratt and Ludwig Rudel, AID/AFR/PRE, *Review and Evaluation of the Africa Private Enterprise Fund,* January 1988.

though the Asia and Near East Bureaus were merged in 1985, it was not until January 1988 that the latter's Private Enterprise Development Fund was extended to Asia. Even so, the Fund, much smaller than its Africa counterpart, was expected to expend only $265,000 in fiscal year 1989. According to one Bureau official, this apparent neglect of the private enterprise policy is deceiving. The Bureau, it is said, has greater decentralization of authority than the other regional bureaus. Application of Private Enterprise Initiative principles are determined by the level of development and the different missions decide the emphasis for their country programs.

A number of Asia/Near East missions have strong private sector programs, particularly in countries considered candidates as "advanced developing countries", i.e. Jordan, Tunisia, and Thailand. Because these and other governments, such as Indonesia and Pakistan, are considered more receptive to private enterprise development, the PRE Bureau has always been more active in Asia than in other regions. In 1988, the Assistant Administrator for the ANE determined that trade and investment would be major emphases of its future Asia programs.

AID Missions. In the end, AID missions worldwide have responded to the policy guidance, reporting requirements, and technical assistance and other programs promulgated from headquarters, by integrating private enterprise projects into their own programs to a greater degree than has been the case previously. According to one AID private enterprise officer, a livestock marketing program which might have been carried out by the public sector prior to 1981, would now be implemented by the private sector. Drawing the distinction between then and now still further, he pointed out that projects about rangeland management and well-digging are more likely to be about livestock marketing now.

In many missions there is a designated officer responsible for private enterprise activities. The officer may take the lead in establishing contacts with the developing country private sector and in reviewing project proposals initiated by other offices in the missions to insure that private enterprise options are fully taken into consideration during the project design process. In Honduras, for example, when a rural road was to be built as part of an AID project, the input of the private enterprise officer helped insure that it led to export market producers.

Levels of mission support for private enterprise activities may vary considerably by country. Country conditions and funding availabilities also place constraints on private sector activities. Fully half of the Costa Rican mission project budget is channeled through the private enterprise office (considerably more, if local currency projects are taken into account). In Ecuador, due to the level of development, lack of unearmarked funds, the status of the private sector office, and a variety of other factors, the proportion is less. Nevertheless, in Ecuador many projects not specifically aimed at private enterprise do have a private enterprise element to them. A portion of the family planning program, for instance, will include a contraceptive social marketing component.

Mission officers in all sectors have become attuned to the possibility of integrating private enterprise into their programs. The extent of this awareness and level of commitment to this approach, however, are not clear. Based on a variety of reports and interviews, it would appear that, for a growing number of AID staff, dealing with private enterprise is becoming standard behavior, especially in the course of designing and implementing activities such as those discussed in the section that follows.

III. PRIVATE ENTERPRISE ACTIVITIES OF AID

To understand the Initiative and to form a basis for examining its implications for the U.S. foreign economic assistance program and developing countries, one must look beyond policy directives and bureaucratic processes and scrutinize the projects and programs undertaken on behalf of private enterprise development. The following section of this report reviews a number of the private enterprise activities which have been conducted by AID during the past eight years. They can be grouped in several categories:

- those that sought to change government policies which bear on private enterprise;
- those that sought to assist private enterprises directly, through credit schemes, training and technical assistance; and
- those that sought to utilize private enterprise to carry out AID's traditional social service activities.

Within these three broad categories of private enterprise activity, there are numerous permutations reflecting the particular economic and social conditions found in the more than 80 countries in which AID currently works. Inasmuch as AID is funding over 2,000 projects at any one time throughout the world, the discussion below does not cover every type of private enterprise project conducted by the Agency. It attempts to focus on both the most common activities as well as those portrayed by the Reagan Administration as most representative of the Initiative.

The information in this section leads to the discussion of issues raised by the Private Enterprise Initiative in chapter IV. It also provides information for judging the extent to which AID is carrying out the goals set by Congress and the Administration and the kinds of concerns which must be taken into account to determine how best to promote private enterprise development.

Quantifying assistance to the private sector. How much aid is targeted on private enterprise? Statistics issued by AID prior to 1986 must be approached with caution.[26] AID has claimed that total ESF and DA for private enterprise amounted to $171 million in FY 1982 and an estimated $270 million for FY 1983. These figures respectively represented 4% and 6% of total ESF and DA appropriations for those years.[27] On the other hand, one FY 1985 figure

[26] It is not possible to say with absolute certainty how many private enterprise activities AID undertakes in a given year. Creating statistical breakdowns of AID activities has always been a problem, but more so with private enterprise because these projects cut across sectoral lines. AID officials admit that until 1986 their figures had been rough at best and not useful for comparative purposes. A new system is to be introduced in 1989 to provide more accurate project data.

[27] Testimony of Peter McPherson. House Foreign Affairs Committee, February 24, 1982, *Role of the Private Sector in Development Abroad*, p. 43. His definition of private enterprise activities included those that contribute to indigenous private enterprise development, including small in-

Continued

cited by AID officials showed project and program assistance "benefiting the private sector" was 48.6% of AID funds.[28]

AID asserts that its most recent figures (see Table A) are more accurate, representing a more consistent analysis and improved data. According to these, in FY 1988, AID obligated $630 million of DA and ESF in support of the Private Enterprise Initiative. It anticipated obligations of $619 million in FY 1989 and, if Agency requests and mission projections are met, as much as $776 million in FY 1990.[29] These figures represent approximately 13% of total DA and ESF appropriations in FY 1988.

TABLE A.—PRIVATE ENTERPRISEDA/ESF FUNDING [1]

(In thousands of dollars, as of July 1988)

	FY 1985 (actual)	FY 1986 (actual)	FY 1987 (actual)	FY 1988 (proposed)	FY 1989 (proposed)
DA	142,172	182,120	179,370	183,984	211,460
ESF	NA	479,849	528,980	446,485	407,845
Total	NA	661,969	708,350	630,469	619,305

[1] Figures provided by AID/PPC.

Missing from these AID estimates of private enterprise activities are ESF local currency counterpart sums. ESF local currency is officially owned by the host country and is generated by transfers of ESF dollars. Nevertheless, an accurate sense of the scope and number of AID private enterprise project activity might include an account of these figures, because a very large proportion of private enterprise project activity appears to be funded from ESF local currency where such is available.[30] For example, at the same time the AID/Honduras mission's Office of Private Sector Programs was responsible for implementing some $72.5 million in private enterprise-related projects, it was also utilizing $160.7 million lempiras in ESF local currency ($80.3 million at the official rate).[31]

Growth of individual project types is even more difficult to characterize, due to lack of worldwide data. The diversity of projects in private enterprise development, if not quantifiable, give the appearance of considerable ferment and growth. According to the Assistant Administrator of the Private Enterprise Bureau there is extensive activity in "policy reform, credit to small borrowers, agribusiness development, health care, investment and export promo-

dustry development, creation of credit institutions, studies of management, marketing and production problems, rural enterprise projects, development of business schools, use of PVOs in private enterprise training, support to local businessmen and chambers of commerce, and technical assistance to governments to develop strategies to reactivate capital markets.

[28] Testimony of Peter McPherson, Senate Committee on Finance, May 20, 1987, *Nomination of M. Peter McPherson*, p. 56.

[29] These figures seek to include all private enterprise DA and ESF projects and those ESF policy reform conditioned programs which are specifically targeted at private enterprise (balance of payments cash transfers, for instance, are excluded). Among other things, these include trade and investment, financial markets, management training, privatization, business development, regulatory reform, policy dialogue, and off-farm agriculture production activities. Totals reportedly do not reflect all PVO activities benefiting private enterprise due to data collection difficulties.

[30] Local currency is often generated from ESF balance of payments cash transfers which are not counted in the AID private enterprise statistics.

[31] September 1988 figures provided by AID/Honduras.

tion and technology transfer."[32] The discussion that follows would support this view.

A. Promoting A Private Enterprise Environment Through Policy Reform

Many believe that critical to the development of the private sector is the economic policy environment in which it functions. In response to various political and economic constituencies, governments, wittingly or unwittingly, have imposed constraints on private enterprise. To foster the development of private enterprise, AID policy is to seek the elimination of these constraints and promulgation of policies which stimulate the growth of private enterprise. Although the foreign assistance program may have encouraged specific LDC economic policy actions in the 1970s—some supportive of private sector growth—an AID policy paper notes that these were far less explicit than during the present period.[33] They were far less numerous as well.

AID has conveyed its suggestions regarding the economic policies of aid recipients through the mechanism of policy dialogue. Policy dialogue is, in fact, one of the "four pillars" of the aid program under the Reagan Administration. Characterizing this dialogue process are several steps:

- an ongoing, often highly personal interaction with recipient governments,
- analysis of the economic situation usually through an AID-commissioned series of studies, and
- agreements, both implicit and explicit, to alter policies.

Policies may be adopted by a country either entirely voluntarily, with no direct incentive provided, other than AID's drawing attention to a problem and its possible solution, or they may be the result of what are called "conditions precedent or conditions convenant" to the provision of U.S. economic aid where aid is provided following fulfillment of certain conditions.

Although policy reform is associated with all types of economic assistance, development assistance funds and PL480 have been used to encourage changes in specific sectors of national life. Because, as AID asserts, the economic policy environment in which individual aid projects are implemented can be a significant factor in project success, agreement to implement a project will often be conditioned on fulfillment of certain policies designed to make that project more effective. The use of ESF, on the other hand, is commonly associated with broader, more macroeconomic policy changes, largely because it is not restricted to a specific project sector and the size of the ESF allocation and its general cash transfer nature provide more leverage.[34]

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[32] Testimony of Assistant AID Administrator Neal Peden to Senate Foreign Operations Subcomm., Committee on Appropriations, May 12, 1988, p. 263.

[33] AID Policy Paper, *Approaches to the Policy Dialogue*, December 1982.

[34] Roughly a quarter of ESF program assistance (excluding Israel) during the past few years has been delivered under Commodity Import Programs (CIPs) which tie ESF foreign exchange to the purchase of U.S. goods. CIPs are also designed to support policy reform, although one study of four 1984 CIPs found the linkage to be weak (possibly because of the relatively small size of these programs). In addition to reform, CIPs often support the private sector by requiring a percentage of foreign exchange to be made available to private enterprise to fill their import needs. AID/CDIE, *Recent Evaluations of AID Commodity Import Programs*, March 1985.

Both stabilization and structural adjustment reforms have had a vital impact on the private sector. The key targets of stabilization programs, monetary and fiscal policies, include measures to establish a realistic exchange rate, promote savings and investment, reduce deficits and inflation, and reduce public sector demands on savings. All such activities assist the rational allocation of resources to private industry. In the view of one study, "successful stabilization measures promoted by ESF cash transfers are likely to be the single most significant set of actions promoting increased private sector manufactures and exports over the long term."[35]

Structural adjustment programs are intended to reinforce stability and, more importantly, stimulate economic growth by controlling inflation and encouraging investment. Many of the structural adjustment programs of the mid-1980s to the present are aimed directly at fostering private sector development. For example:

- To encourage new investment in Jamaica, AID promoted tax reform, including lowering of the corporate tax and streamlining of investment procedures.
- In Somalia, reforms promoting private enterprise have included the rationalization of parastatal enterprise and the liberalization of import and export licensing.
- In Mali an $18 million reform program (September 1985) designed to create an environment conducive to private sector development and to reduce the burden of the public sector on the national economy included rate reductions for business payroll taxes and taxes on business profits; price decontrol of some consumer items; and initiation of a plan to privatize state enterprises.
- In the Dominican Republic ESF policy reforms have promoted the diversification and privatization of sugar lands, including government leasing of 20,000 hectares of sugar lands to private investors; and the liberalization of controls and restrictions on exports.
- To promote private investment in Honduras, the 1986 ESF program required the introduction of legislation for the institution of investment tax credits and tax-loss carryovers (but not enacted by the Honduran Congress), the promotion of foreign tourism investment through a proposal to allow foreign ownership of coastal land (proposal was not presented to the Congress), and the enhancement of private sector export marketing of lumber (two lumber yards were privatized).

The Africa examples in the above list are among projects implemented under a special Africa Economic Policy Reform Program introduced in FY 1985. Funded since FY 1988 at roughly $50 million each year from the Development Fund for Africa, the Program represents 10% of all Development Fund resources. The Reform Program has a very strong private sector emphasis. According to Roy Stacy, then Deputy Assistant Secretary of State for Africa, all its programs were targeted at either reducing government activity in the productive sectors of the economy, reducing or reforming government controls on the private sector or both. In the Africa

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[35] AID/CDIE/Robert Nathan, *Evaluation of Cash Transfers for Policy Reform in the Dominican Republic*, March 1988, p. 46.

program, grants are tied to a series of reforms and delivered in tranches upon fulfillment of conditions. The program also provides funds for technical assistance, commodities, and program coordination to facilitate project success. The Development Fund for Africa as a whole is to become increasingly oriented toward encouragement of policy reform. According to then-AID Administrator Alan Woods, Fund resources will be used to reward those countries which "are most committed to creating an [policy] environment in which growth and development can take place." [36]

Since the 1970s, most AID sectoral reform has been directly related to projects funded out of development assistance functional accounts.[37] The bulk of AID sectoral reform, occurring in the agriculture and financial sectors, has been characterized by efforts to liberalize markets and stimulate development of private business. It generally seeks to assist the objectives of specific AID projects (many of the projects described in later sections have a policy reform element). Where missions attempt to establish new sources of credit, for example, they use program or project aid to encourage governments to permit the growth of private banks (Costa Rica, for example). AID projects assisting small-scale enterprise development might be complemented by efforts to end excessive government regulations and difficult licensing procedures. The design of the project itself often influences policy. Honduras's Small Farmer Livestock project, for instance, requires the government to establish a private sector livestock fund to support private livestock producers.

Although ESF funds continue to be used for macroeconomic stabilization and structural adjustment reform, as these reform programs are put into place or as the IMF and World Bank take over this role, AID gradually is beginning to use ESF to promote sectoral reform, especially in Latin America. In addition to ESF and DA fund support for sectoral reform, the Food for Progress Act, whose first program was inaugurated only in fiscal year 1986, is designed to support market-oriented reforms in agriculture.

Because agriculture dominates many economies in Africa, a number of Africa Economic Reform Program agreements focus on stimulation of agricultural-related business. The programs for Zambia, Mali and Malawi sought to increase the role of the private sector in agricultural marketing. Although focusing on financial policy, AID's Gambia program promoted an end to administrative practices in credit allocation and marketing which discriminate against the private agricultural sector. Its Tanzania program supported major transportation policy reforms, such as construction of rural roads by private contractors, in order to increase agricultural production and marketing.

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[36] Testimony to House Foreign Operations Subcommittee, Committee on Appropriations, March 17, 1988, p. 379.

[37] To draw a clear line between macroeconomic and sectoral reform with regard to private enterprise is difficult, because it cuts across both. Macroeconomic budget and tax policies have a very strong impact on private sector decision-making. Privatization may serve macroeconomic purposes by attacking government deficits, but it also directly expands the size of the private sector. Sectoral reform, however, responds directly to the specific needs of that sector. For example, while policies affecting all prices are macroeconomic, policies to control seed prices are sectoral.

Project and program funds were used to encourage a variety of reforms aimed at developing the financial and industrial side of the private sector. AID persuaded Bangladesh, for example, to deposit its PL480 local currency in private, rather than government-owned, banks, and to allow the private marketing and distribution of fertilizer.

Privatization. At the heart of the philosophy driving the Private Enterprise Initiative is the belief that government should play a more limited role in the economy. Accordingly, one of AID's more common policy reform objective has been the privatization of government-owned enterprises and of government services.[38] Then-AID Administrator Peter McPherson called it "a significant component" of the Initiative and "a major element of our policy dialogue". One sign of the priority put on privatization by the Agency were statements made by AID officials indicating that U.S. assistance would depend on the commitment of developing countries to privatization efforts. Said one official, for example, "If a country is moving in that direction, it would affect their funding levels. Conversely, if a country is moving away from that direction, it also would affect their funding levels." [39] Another demonstration of the policy's importance was the announcement in early 1986 that 36 missions would be required to be involved in an average two "privatization activities" by the end of FY 1987 and two more such actions every year thereafter.[40]

While there has been widespread discussion in recent years on the subject of privatization and several industrial nations have vigorously adopted it for their own economies, developing country governments have actually carried out relatively few privatizations to date. According to the World Bank, nearly 400 developing country parastatals had been privatized during the 1980s.[41] Relative to the more than 3,000 parastatals in Africa, 1,155 in Mexico and over 700 in Brazil in the early 1980s, this figure represents only a small proportion of total parastatals.[42]

One reason more privatizations have not occurred is the complexity and length of the process. For example, privatization discussions initiated by AID in mid-1983 concerning one group of 42

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[38] AID defines privatization as the transfer of a function, activity, or organization from the public to the private sector. While complete divestiture is the privatization approach preferred by AID, privatization may also include simple reduction of the government role in an enterprise and contracting-out of service delivery. The latter is discussed more fully on page 37.

[39] AID Assistant Administrator/Africa Bureau, Mark Edelman, quoted in *Washington Post,* "U.S. Links Some Foreign Aid to Privatization", February 20, 1986, p. A13.

[40] The guidelines define it as completed privatization, however, in conversation some AID officials believed the definition of "activities" to include most any action *in support* of privatization, whether completed or not. Although not everyone of the designated missions met their goal, more than 140 privatization activities were reported in the first year. It is not certain how many of these have led to completed privatizations. Missions continue to report regularly to headquarters on their efforts.

"Implementing A.I.D. Privatization Objectives" AID Policy Determination PD-14. June 16, 1986. See also M. Peter McPherson, "The Promise of Privatization" pp. 17-20 in *Privatization and Development* edited by Steve Hanke, International Center for Economic Growth, 1987.

[41] Defined broadly as increased private sector participation in management and ownership of government activities and assets, leases, management contracts and divestiture being the principal modes. The figure excludes the divestiture of government stockholdings in nationalized enterprises that were once in private hands. *World Development Report 1988,* World Bank, p. 178.

[42] The Mexican government announced in 1987 that it intended to reduce its parastatals to roughly 500 by the end of 1988. At present it has approximately 700. Not all of the others were actually liquidated or privatized; many were sold or transferred to state and local governments. Peter Accolla, *Privatization in Latin America,* 1988-1989, U.S. Dept. of Labor.

Costa Rican government companies did not lead to a first divestiture until April 1987. In many cases, governments are not even fully aware of their holdings. Parastatals, therefore, must be identified, their commercial status evaluated, and an appropriate procedure for privatization established. The entire process must take into account a wide range of potential objections which, at any stage, can present serious obstacles.[43] The process requires expertise in legal barriers and regulations, public relations, capital markets, and management skills that might not be readily available to most developing country governments.

It is generally thought that AID has taken the lead role among foreign assistance donors in promoting privatization. In addition to sponsoring several international conferences on the subject, the Private Enterprise Bureau funded in 1985 the establishment of the Center for Privatization in order to develop a pool of consultant expertise on the process and techniques of privatization. AID has sent over 100 consultants from the Center to 46 missions to advise governments on various aspects of the privatization process. Further, resident teams have been provided in Honduras and Tunisia to formulate a full-scale privatization strategy and oversee its implementation. According to AID, by the end of FY 1989, more than $22 million will have been spent on Center activities. As of April 1988, the Center had been involved in 10 privatizations, with 75 more in the pipeline.[44] Through its consultative work it had a role in numerous other privatizations. Some missions have assisted governments without using the Center; many governments have developed their privatizations entirely on their own, but the general consensus in AID is that the Center has helped make it a major player in this area.

While it is not possible to say how many privatizations have occurred as a direct result of AID assistance, one can relate examples of activities undertaken to encourage privatization. As noted above, one instrument of assistance is technical advice. AID has funded numerous studies for government policy-makers which promoted liquidations or divestitures eventually carried out. In Jamaica, for instance, the liquidation of grain boards and the use of the stock exchange for divestment followed AID studies on the subject. In Bangladesh, AID feasibility studies of private fertilizer distribution assisted privatization of government activity in this area. AID's recent program to establish financial markets, such as stock exchanges, in order to stimulate investment, has also served to provide a method for selling government companies which facilitates broad-based ownership and popular support for the privatization process.

A major tool of AID privatization is the conditionality embodied in ESF cash transfer agreements. In Jamaica, privatization of public enterprises was one of the main structural adjustment

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[43] The more common objections to privatization are that many parastatals were created to fulfill specific social and economic purposes—development of depressed regions, provision of necessities to rural areas, etc.—that the private sector will not replace. Some fear that privatization means handing the national patrimony over to foreigners, political cronies, or wealthy, minority ethnic groups. Labor unions fear loss of jobs. Proponents of privatization point out that parastatals are both economically inefficient and a substantial drain on national budgets.

[44] AID. *Management Assessment: Bureau for Private Enterprise*, April 1988, p. 38.

policy reform objectives. AID used conditionality in its 1982 cash transfer agreement to require the government to study the need to divest publicly owned enterprises. Other agreements required Jamaica to prepare financial audits, determine fair market value of firms, and establish the timing and form of privatization. After laying this groundwork, in its 1984 and 1985 agreements AID specified 30—later increased to 44—parastatals to be privatized (of roughly 200 under the government). The government was required to generate net financial inflows from privatization equivalent to the amount of the cash grant. By December 1987, 19 firms had been sold or leased to the private sector and 8 more were in stages leading to it. These included the sale of a cement company and two bus companies, and the lease of sugar estates, agricultural markets and contracting out of hospital services such as housekeeping and sanitation.[45]

While AID analytical assistance coupled with policy reform is the mainstay of its privatization assistance, the divestiture of Costa Rica's CODESA, another umbrella development investment corporation, depended heavily on the use of ESF local currency funds. In order to facilitate the divestiture procedure, AID funded the establishment of FINTRA, a private sector trust, which would purchase CODESA's assets, put them on a financially sound basis, and sell them. To avoid the inflationary effects of using too much of its ESF local currency for project purposes, AID employed, with Costa Rican support, roughly $140 million of these funds in a bookkeeping transaction to "purchase" several of CODESA's assets and transfer them to FINTRA.[46]

AID has learned valuable lessons from its privatization experience. Political opposition, common in most cases, has taught AID to proceed cautiously. For example, in Honduras the pilot target for privatization has been CONADI, a holding company with approximately 65 firms. CONADI was chosen explicitly because the extreme inefficiency and indebtedness of its companies promised the least opposition to its elimination. Nevertheless, it was felt that opposition could be further deterred by following highly transparent, legal procedures. The AID-funded technical working group drew up legislation that would provide such a process, and ESF conditionality was employed to "encourage" passage of the legislation in the Honduran congress. A Privatization Commission was established with representatives from government, labor, and the private sector to oversee the AID working group which examines the CONADI holdings and develops a strategy for privatizing each one. To date, five complete divestitures have been achieved and project staff are optimistic that the initial phase goal of 12 will be reached by September 1989. The cost of the project has been estimated at $17 million ($13 million of which is ESF local currency).

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[45] AID/CDIE/Robert Nathan Associates, *Jamaica Cash Transfer Evaluation*, December 1987, p.44.

[46] *Evaluation of the Divestiture Program of CODESA*. Center for Privatization. Prepared for PRE/AID. May 1988. For political reasons, CODESA companies were overvalued by the Costa Rican Comptroller General, creating the appearance that AID was using its funds to "buy high and sell low". This practice was questioned by AID/Washington.

B. Assisting Private Enterprise

AID has been providing assistance to the broad range of micro, small, medium and large private enterprises for over twenty years.[47] There is probably no developing country receiving AID assistance that has not had one or more projects which seek to strengthen the capacity of its private enterprises.[48]

Private enterprises in the developing countries face severe constraints in lack of trained personnel at all skill levels, lack of available capital for start-up, operation and expansion, lack of technology and infrastructure, and a plethora of restrictive government policies. AID seeks to address these needs, but its "direct" assistance to private enterprise is not an end in itself. In the view of AID, "private enterprises that respond to profitable opportunities in a free market produce jobs, managerial skills and economic growth. They contribute wealth to society and improve the quality of life." [49] Therefore, in the course of AID's varied efforts to assist a community, improve tax receipts, increase employment, provide satisfaction of basic human needs, obtain foreign exchange to support balance-of-payments, or increase income distribution, the agency may provide assistance to private enterprise.

1. Types of Assistance to Business

Most commonly AID projects meet business needs in the areas of credit, training, and technical assistance.

a. Credit

Access to working or investment capital is the most often cited need of business in the developing world. As a result, most projects focus on provision of credit. One study reports that almost 90 percent of small enterprise projects have a credit component; another states that 80 percent of active microenterprise projects have a credit component. Much of the assistance to medium and large business is provided as credit to exporters.[50] AID funds are gener-

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[47] The definition of micro, small, medium and large enterprise is an important policy issue, serving to target AID assistance on a particular group of people. However, there is no definition which is not in some way arbitrary, given diverse country conditions. One estimate puts the number of definitions of small business in use at over fifty. The distinctions are based on such measurements as number of employees and total fixed assets.

As a result of discussions leading to the FY 1988 and 1989 microenterprise legislation, AID has adopted a "working definition" of microenterprise as an enterprise of approximately 10 or fewer employees. Although small business is frequently defined as 11-50 employees, "locally appropriate" definitions of business size are usually tailored for each project. For comparative purposes, the Honduran Small Business II project definition is:

micro—up to 10 employees and fixed assets of less than $10,000
small—from 11 to 25 employees and fixed assets of less than $50,000
medium—from 26-99 employees and fixed assets of less than $250,000.

On the other hand, the Thailand Rural Industries and Employment Project appears to define small-scale enterprise as 11-50 and under $200,000 in assets. Exchange rate differentials, the character of industry in each country, and the relative level of wealth targeted for assistance may explain the differences between Thai and Honduran definitions.

[48] The majority of such projects have focused on small-scale enterprise. According to one report, between 1952 and 1980 over 775 small scale enterprise projects, principally in Latin America and Asia, were funded by AID. The report further notes that of 240 small-scale enterprise projects in Asia, 95% were initiated before the 1973 New Directions legislation. Of 230 projects in Latin America, 75% were initiated before 1973. Although no post-1980 figures are available, it seems likely that there has been an upsurge in small-scale project start-ups since 1980. Deborah Orsini, *AID Private Sector Initiatives: Past, Present and Lessons Learned,* November 1983, p. 27.

[49] A.I.D. Policy Paper. *Private Enterprise Development,* March 1985, p.1.

[50] For more on export development, see page 34.

ally provided in the form of a grant or loan to an Intermediate Financial Institution (IFI)—usually a PVO or commercial bank—which then on-lends the funds to individual entrepreneurs.

What differentiates smaller-scale enterprise credit from that at the larger end is the reluctance of commercial banks to get involved in what they perceive as the high risk of these small businesses and high transaction costs associated with providing numerous relatively small loans. Many enterprises do not possess sufficient collateral by commercial standards nor are they able to demonstrate anticipated profitability from the investment. At the small and micro end of private enterprise, most credit is reportedly put toward short-term working capital (labor and raw materials) rather than for plant or equipment. Banking institutions maintain application processes too elaborate and intimidating for the more inexperienced entrepreneurs.

While AID projects often bypass this obstacle by providing credit assistance through PVOs, AID has attempted, particularly in the Latin American region, to encourage private for-profit commercial banks and development finance companies to enter the smaller range credit market. It has generally done this by providing loans to the banks on terms profitable to them (in the past with softer than market rates—a practice no longer followed by AID) and, in return, establishing criteria which target the use of loan funds to the smaller end of the business community. It is thought that once exposed to the profitability of the small-end market, the banks will maintain their loan practices to this market even after the AID loan is exhausted. Some argue, however, that, in the majority of cases, the administrative costs of small loans and relatively higher risk involved in making loans to this market will prevent banks from continuing these practices once the AID incentive is removed. Commercial banks, they say, will take the business of the best of the smaller enterprises and leave the rest to PVOs. To date, there exists insufficient evidence to corroborate these views.

In addition to its on-lending activities, AID has experimented with establishing guarantee funds which lessen bank exposure to risk by making a proportion of each loan subject to an AID guarantee. A successful guarantee fund project for small and medium business in Panama is presently being replicated in Honduras. This Fund will leverage its reserves on a 1:10 basis—with $1 million the Fund can guarantee up to $10 million in loans. In the 1988 trade bill, the Private Sector Revolving Fund was granted the authority to leverage a pool of its funds on a 1:4 basis.

b. Training

Entrepreneurs are often lacking skills in management, accounting, and administration without which their businesses are inefficient and poorly run. In the broadest sense, most AID-funded education programs benefit the private sector by providing skills and knowledge to the pool of future employers and employees. Vocational education and technical training programs, however, are geared specifically toward fulfilling the requirements of employers. Although AID has been providing such training for decades, descriptive statistics indicating trends are not available. Nevertheless, there is some evidence that, as a result of the Private Enterprise Initiative, increasing amounts of training have been targeted toward fulfilling private enterprise human resource needs rather than those of government.

In-country training projects designed expressly to assist business occur in virtually every AID mission and take a variety of forms. They may target their assistance to a particular sector of the business community where there is an identifiable need. In Ecuador, for instance, AID has since 1984 supported a training program ($0.5 million), established under the auspices of the Association of Private Banks, to train personnel in the banking, finance and insurance industries. It provides practical instruction to all levels of workers—from management to security guards. AID's involvement includes procurement of equipment, such as computers and learning aids; training of local instructors; and provision of instructors from the United States. In Costa Rica, the Training for Private Sector Development Project ($5 million) carrries out extensive training in the broad range of industries related to export expansion and earning foreign exchange. In its first year, 1984-1985, it had served almost 1,000 trainees and 190 companies by providing more than 24 different courses.

On a worldwide basis, the Private Enterprise Bureau has initiated a $650,000 pilot program to provide short one-week courses for private and public sector decision makers on subjects tailored to the needs of a particular country. The first course, held in Jordan in May 1989, covered the development of an export economy. Future courses will be held in Kenya on free trade zones, Algeria on the private sector in agriculture, and Thailand on how to attract foreign investment.

Some programs provide training to a specific level of business which may share common problems, such as those faced by existing and new small entrepreneurs. The Lesotho Entrepreneurship Training Program, begun in 1978, provides training in the basic business skills suited for this group. Traders and small manufacturers receive instruction in such subjects as marketing, financial management, inventory control, and labor relations. These activities are frequently advanced in coordination with credit projects. One of these, the Colombian Carvajal Foundation model used in one AID project in Ecuador, has found that, in many cases, training obviates the need for credit by demonstrating to the entrepreneur cost-saving techniques of which he had been unaware.

Some projects not only provide a particular set of skills useful to a wide variety of businesses, but seek to meet needs of a particular location. In Guayaquil, Ecuador, one project targets the skills required by receptionists, secretaries, and accountants, because there is a large demand for such people in that rapidly growing city which is not being adequately met by existing technical institutes.

In addition to in-country instruction, AID, for many years, has brought people to the United States for various forms of "participant training", roughly half for academic degree study.[51] To meet the needs of private business, however, AID has had to design shorter span participant training programs and has established in-

[51] The participant training program is a rapidly growing program. In fiscal year 1987 there were 17,685 participants, up from 9,012 four years earlier.

novative linkages with American business. An Indonesia project brings businessmen to the United States for short-term training. The Entrepreneurs International Program, cited by AID as a major worldwide training initiative, offers short-term on-the-job training opportunities with American firms to developing country entrepreneurs.

Although there are no worldwide figures to indicate what proportion of total trainees come from the private or public sectors, the new participant training programs, such as Entrepreneurs International, do suggest the impact of AID's private enterprise emphasis in recent years at all levels of the AID bureaucracy. At the mission level, for instance, the Botswana Work and Skills Training II project, which provides both participant and in-country training, specifies that 45% of long-term trainees (most to be educated in the U.S.) and 38% of short-term trainees come from the private sector. Its predecessor project had provided training to only a few private sector individuals.

The Human Resources Development Assistance project, conducted by the Africa Bureau, is a $65 million effort to provide in-country and participant training to 32 African countries. Half of these resources are targeted to the private sector. In addition to training-dedicated projects, there is almost always a training component in other development projects. Therefore, it is likely that the increase in private enterprise-related projects has meant a significant increase in project-related training for private enterprise personnel.

c. *Technical Assistance*

Sometimes technical experts are provided to IFIs and to individual entrepreneurs in order to introduce new methods and enhance their performance. Microenterprise specialists from American PVOs such as Accion/Aitec are stationed at a local developing country PVO for periods ranging from one month to several years in order to establish a credit program capability within the organization. Since 1972 the Institute for International Development, Inc., with $4.5 million of AID support, has set up from scratch indigenous PVOs to assist small and micro business. In the last seven years alone they have established eight such organizations and have 12 others in development.

The International Executive Service Corps, supported by a contract with the Private Enterprise Bureau (between $5 and $6 million in each of fiscal years 1982–1988), annually provides the specialized advice of nearly 700 retired American businessmen to individual local small and medium businesses. In Ecuador, for example, an IESC-furnished mushroom expert helped a company double its production within two months.

2. Business Assistance Programs

Four AID activities to assist private enterprise emphasized during the 1980s are most noteworthy: development of business associations; microenterprise assistance; the private sector revolving fund; and export development/investment promotion.

a. Development of Business Associations

AID has helped to establish and promote institutional development of business and trade associations which, as in developed countries, may provide leadership in advocating policy reforms on behalf of its business membership. In the Latin America region, through seed funds, it has fostered establishment of thirteen private sector organizations. For these as well as for existing organizations, it often furnishes technical assistance to help manage the organization and provides funds to conduct studies of the policy regime and make recommendations for change.

In addition to strengthening these business institutions, AID has attempted to encourage establishment of channels of communication between business and the government. In Ecuador's the Dialogue Program, for example, a U.S. technical assistant working through INCAE, a Costa Rica-based management institution, is attempting to bring together all chamber of commerce leaders to forge a consensus on appropriate policies. These will then meet with government and labor groups to formulate recommendations that might be successfully integrated into the government program.

Business associations are additionally used to a large extent as implementors of AID credit, training and business information service programs aimed at the particular membership they represent. For example, in Ecuador, AID supports information/workshop programs conducted by The Federation of Ecuadorian Exporters and the Ecuador National Association of Businessmen; and training programs conducted by the Chamber of Commerce of Guayaquil, the Private Banks Association, and the Chamber of Small Industries of Guayaquil.

b. Microenterprise [52]

Although many suggest that businesses are best understood as existing on a continuum of size and level of sophistication, microenterprises are increasingly being singled out and treated differently by development specialists. There have been AID-funded microenterprise projects since the early 1960s, but the recent dramatic surge in attention to this particular segment of the business spectrum is widely viewed as the result of congressional hearings and proposals by religious and humanitarian PVOs.[53] As a result of this interest, beginning with the fiscal year 1988 budget, Congress earmarked funds specifically for microenterprise activities—$50 million in FY 1988 and $75 million in FY 1989.

The proprietors of microenterprises are the poorest of self-employed entrepreneurs. They generally exist in what has been called the informal sector of the economy, unregistered with the government, unrecognized by formal financial institutions and operating

[52] AID's Bureau of Science and Technology has run a continuing series of microenterprise research projects since the mid-1970's. In 1988, AID's Center for Development Information and Evaluation (CDIE) pursued a stock-taking of AID's active microenterprise projects. However, many features of the broad range of microenterprises—how they are formed, who establishes them, rates of failure—remain unknown. Cited statistics must be treated with caution.

[53] For example, see *Micro-enterprise Development Legislation*, House Committee on Foreign Affairs, March 3, 1987; *Microenterprise Credit*, House Committee on Banking, February 25, 1986; and *Banking on the Poor*, Select Committee on Hunger, March 12, 1987.

at the edge of profitability. They are unskilled street and market vendors, and semi-skilled, often household-based craftsmen, bakers, and shoemakers. One organization which specializes in assisting microenterprises estimates they comprise between 30% and 70% of the labor force in developing countries. They estimate that in Lima, Peru alone there are 300,000–500,000 microenterprises.

Efforts to assist microenterprises face even more serious obstacles than do those for small-scale enterprise. Access to credit of microenterprise proprietors is more restricted given their greater lack of collateral and the higher risk they appear to represent. Many are mobile, are in vending rather than productive activities, are poorly educated, and have minimal training in business. They are locked out of the formal sector by intimidating paperwork, government regulations, the threat of taxation, banking practices, and liquidity shortages. Benefits accruing to the formal sector—access to credit through financial institutions, visibility in the market, and legality—are denied them. Finally, it is important to note that there are many more micro businesses than other types of enterprise and that the size of loan they require is considerably smaller than other, more established, business.[54]

One recent study, based on experiences in 32 projects, suggests that AID's microenterprise projects have tended to adopt one of three approaches, differing by targeted population, types of services, and institutional structure of program: (1) projects seeking to help highly disadvantaged groups become microentrepreneurs, (2) those assisting already existing enterprises to expand sales and income, and (3) those focusing on assisting the more productive, better managed enterprises to graduate from the microenterprise sector.[55] In practice, however, projects do not fit so neatly into these categories. According to many observers, projects assist an array of microenterprises in various stages of development and various sub-sectors of the economy.

At present AID is conducting roughly 87 microenterprise projects funded at $290 million over their project-life.[56] Only ten, however, representing more than a third of funding, focus exclusively on directly providing services to microenterprise. These tend to be projects initiated more recently than the others. The rest assist mi-

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[54] Perhaps the most well-known of microenterprise programs is the Grameen Bank in Bangladesh. As of February 1986 it had provided over $30 million in loans. The average size of its loans is $60 and the largest loan amount is $200.

It is risky to generalize about microenterprise credit projects. While many of the features of the Grameen Bank, established in the late 1970s, are imitated in other countries, there are innumerable variations. To make up for the lack of collateral, Grameen borrowers are often required to form themselves into groups (in Latin American versions these are called "solidarity groups") which take responsibility for repayment of loans made to each member. But there are many programs which loan to individuals and these may require that the borrower find someone to vouch for them or that the borrower complete a training course to become eligible for a loan.

Some common features: Loan repayment rates can be impressive, many programs having rates of more than 90 percent (in some cases this might be because loans are "rolled over" so that, instead of default, clients "repay" using another loan). Many programs require that borrowers establish savings accounts which are included in the repayment fee. Many also have an escalating-scale of loan eligibility. For example, a borrower's first loan may be $50, on repayment his second loan is $100, and so forth. Short-term loans are very common and projects are characterized by many repeat borrowers.

[55] James J. Boomgard, *A.I.D. Microenterprise Stock-taking: Synthesis Report*, March 1989, Draft.

[56] Joseph M. Lieberman and William Doyle. *A Statistical Look at AID's Microenterprise Portfolio*. Draft, February 1989. p. 1.

croenterprises as incidental to a broader effort, either to assist a range of business types or to develop the private sector in general, or upgrade institutional development of PVOs and financial institutions which assist business.

Most projects—55 of the 87—provide the full array of credit, training and technical assistance services. Sixty-seven (representing 63% of total funding) contain training and/or technical assistance components, sometimes alone, but more often in conjunction with credit programs. PVOs implement two thirds of the projects, representing 52% of funding and financial institutions, such as banks and credit unions, implement fourteen (37% of funding).

Project characteristics vary considerably.[57] In Guatemala, AID support for FDM, a local PVO dispensing small business loans to new and existing enterprises owned by groups of women, consisted of start-up operating expenses, equipment and staff salaries, as well as help in establishing a credit fund. There were 33 fund beneficiaries during the three year project, receiving loans averaging $5,470 each. The target group were women of working or lower-middle class families who already have a skill such as sewing or hair dressing. Since the completion of the AID project, FDM has continued to provide loans and technical assistance to women clients utilizing subsidized loans from the Inter-American Development Bank and the World Bank. It now has an active portfolio of 140 loans and dispenses an average of eight new loans a month.

An Indonesian village credit organization, KUPEDES, by contrast, serves a much larger client population, consisting of individual rural traders and farmers, mostly in need of working capital for family enterprises. In this case, however, loan size is much smaller than in Guatemala, averaging $326 in 1988. Loan funds for the KUPEDES credit program come from Indonesian government and bank sources. Beginning in 1984, AID assisted the institution with advisors and equipment to upgrade financial services, accounting systems, and training practices. Subsequently, the number of loans provided to borrowers grew from 640,000 in the first year of AID assistance to 1.3 million in 1988.

c. The Private Sector Revolving Fund

The Private Sector Revolving Fund, like microenterprise, is, by virtue of the congressional role in its establishment, AID's most prominent program of credit assistance to business. Although modest relative to AID's worldwide credit activities, it is the largest program managed by the Bureau for Private Enterprise. Its legislative mandate requires that Fund assistance be made primarily to small businesses and cooperatives to which credit is not generally available. Projects financed must have a demonstration effect, be innovative and financially viable.

To facilitate this role the Fund was provided with features unique in the Agency, but believed to be useful for dealing with the private sector. Its assets were not required to be obligated during any particular fiscal year so that the Fund's managers could operate with maximum flexibility. The ability to re-use repayments was

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[57] See individual field studies conducted by AID as part of its microenterprise stock-taking in Guatemala, Senegal, Indonesia, Egypt, Ecuador, Cameroon, Paraguay, Malawi. March 1989.

expected to encourage managers to negotiate terms most favorable to AID, and to terminate loans not being utilized efficiently and utilize them for other projects. Furthermore, Fund project managers were all recruited from private sector banks.

The Fund has experimented with several kinds of loans during its six year existence, but the great majority are now in the form of guarantees to Intermediary Financial Institutions (IFIs). As opposed to direct loans, guarantees reduce the foreign exchange risk that would be incurred by the financial institution in borrowin dollars. Local bank funds, partially guaranteed by AID, are lent at market rates to borrowers who are defined by agreement between the IFI and the PRE. A main objective of the Fund is to induce banks to move into new markets that otherwise would not receive financing, particularly small businesses in rural areas.

In September 1988, Congress granted the Fund specific authority to issue guarantees against losses on loans made by financial institutions. These guarantees cannot exceed fifty percent of the cost of the activity financed and the reserve backing the guarantees must be at least 25 percent of the contingent liability. In other words, with only one million dollars in the reserve, AID can guarantee $4 million of a bank's $8 million in loans.

During its history, the Fund has engaged in a variety of financial transactions: providing credit to businesses in the export sector, to agribusiness (roughly half of its loans), to a major microenterprise PVO with local affiliates throughout Latin America (its only microenterprise assistance project), and, through direct loans, establishing venture capital companies in Thailand and the Caribbean Basin. Up to the end of 1988, the Fund's portfolio consisted of $67 million in projects (representing obligations of roughly $12 to $16 million per year), but the new guarantee authority may significantly raise this total in coming years. In its first year of operation it could generate as much as $50 million in loans to small and medium business.

d. Export Development/Investment Promotion

The Agency for International Development has undertaken a number of projects which seek to stimulate a country's capacity to export products abroad. Such practices are in line with AID's private enterprise development strategy which encourages "a shift from policies which promote general import substitution to policies which open an economy to international trade." [58] Furthermore, a

[58] AID Policy Paper. *Private Enterprise Development,* March 1985. p. 3.

It is the common wisdom of developed countries and the World Bank that import substitution practices distort market mechanisms through overvalued exchange rates, import restrictions and tariffs that make it difficult for developing country economies to compete and grow.

There are some, however, who criticize the philosophy of "export-led" growth which propels AID policy and practice in this area. One criticism is that it tends to force developing countries to specialize their economies, thereby making them more dependent on international prices. An export economy is victim to world business cycles fluctuations. Moreover, infant industries, which might be able to compete given time to mature, may fail under a completely open economy.

While the debate may be presented in stark extremes, in actual practice, the issue concerns where along the scale between the two extremes a government's policies will fall.

The debate has been given new prominence in recent years, because export-led growth is seen as a solution to developing country debt. In order to pay for both the debt as well as the imports with which to generate more production, it is argued that developing countries require foreign exchange; and to get this foreign exchange, they must export.

shift in its agriculture policy objectives from an emphasis on increased food production to that of increased rural income has largely manifested itself, according to several AID officials, in a growing number of projects promoting production for foreign exchange, i.e. for export.

Export projects tend to focus on nontraditional industrial and agricultural exports, because traditional products have generally found their market already and less traditional areas have the potential to make the greatest contribution to new growth. Export projects fall into two categories: those which directly assist the indigenous private sector to export and those which attract foreign investment in export schemes.[59]

Partly because of the enormity of its debt, the high level of development, the advantages provided by the Caribbean Basin Initiative, and its proximity to the United States, Latin America is the site of a large number of AID export/investment promotion projects. Twenty-eight of 105 active AID-funded projects in the Latin American private sector as of June 1988 had an export-related component. This section is largely based on a review of activities undertaken in Costa Rica which are highly representative of similar activities elsewhere in the region.

(1) Indigenous export. There are a number of obstacles commonly faced by potential indigenous exporters: lack of infrastructure, an unfavorable policy environment, lack of quality control and an inability to identify markets abroad. AID assistance to overcome these obstacles may include funding studies to identify potential products for export and government policies hindering it, providing technical experts to advise and train producers on specific product styles and procedures of dealing in the international market, funding sources of credit for exporters, and establishing offices abroad to promote a developing country's products. Infrastructure assistance, provided mostly in transportation, is rarely undertaken now by AID.

AID considers a favorable policy environment to be critical to export growth. In Costa Rica where export development is a primary focus of its program, AID has used its policy dialogue with the government to encourage the adoption of export incentives, facilitate access to foreign exchange, and eliminate taxes on export products. So that agricultural export produce will not rot in containers awaiting shipment abroad, AID-sponsored experts have persuaded Costa Rican customs to introduce more efficient service at airports. In Honduras, AID is organizing a major department in the Ministry of Economy in order to get the government to focus on export promotion.

Many credit programs supported by AID are designed specifically to assist exporters, usually exporters of non-traditional products. In Costa Rica, for example, AID provided a $10 million loan in 1981 to a private export bank (BANEX) which allowed it to provide export-oriented banking services, make credit available to export producers and create a trading company to assist exporters. During the past few years, the AID mission has also provided a $10 million

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[59] Not all investment promotion projects are export-related, but it is likely that the vast majority are.

loan to the Corporacion Costarricense de Financiamiento Industrial Internacional (COFISA) which gives credit preference to exporters and a $20 million loan to the Private Investment Corporation which provides investment packaging services for exporters.

With regard to direct assistance to exporters, it has, in some cases, been enough to help developing country entrepreneurs, unfamiliar with the needs of the international market or even how to enter it, make contact with the U.S. market. In Ecuador, for example, contacts made through AID assistance between the wood industries association and North Carolina furniture manufacturers have facilitated a doubling of lumber exports in two years. But such cases are reportedly not the norm. In Costa Rica, the AID mission came to the conclusion that improving marketing capacities is not sufficient to improve the ability of local entrepreneurs to export. What is needed is an improvement in productivity to help producers meet the quality, quantity, and delivery requirements of the world market. This, however, requires a comprehensive and complex response which, in the case of Costa Rica, encouraged AID to emphasize investment promotion in its export activities.

Despite these difficulties, AID/Costa Rica is continuing to assist local producers, in part due to political pressures and the desire not to be perceived as being against local business. As of mid-1987, almost half of AID credit project support to exporters had gone to locally owned business. AID has employed a private, for-profit broker to promote Costa Rican exports to the United States. Efforts are being made to encourage foreign investors to utilize local producer components in their products. And AID is setting up a pilot program to provide technical and marketing assistance to selected companies within selected sectors to subcontract for foreign companies.

(2) Foreign Investment Promotion. In addition to encouraging the adoption of policies conducive to an investment climate attractive to foreign investors, AID has sought to stimulate foreign investment through a number of project activities. An AID-funded Program for Investment and Export under an AID-established private institution—the Coalition for Development Initiatives (CINDE)—set up offices in Europe, the United States, and Asia to promote Costa Rica as a place for foreign investment in export-related industry and agriculture. Policy dialogue moved the Costa Rican government to establish export processing zones from which foreign investors could operate, and AID credit lines have helped fund zone construction.

In its first two years of operation the CINDE program brought in over $50 million in foreign investment and created roughly 8,000 jobs at a cost per job far below that of many other employment generating projects. Although the results of the Costa Rican export promotion project may not be replicable in countries where political instability does not appeal to foreign investors, other AID missions, including Honduras, are looking to the CINDE project as a potential model for export promotion.

C. Using Private Enterprise To Implement AID Objectives

The majority of AID projects have been implemented through governments, because many of the education, health, agriculture, transportation and other services which AID projects sought to improve are considered to be the responsibility of government in most developing countries. In its effort to encourage expansion of the private sector, AID has utilized the private sector as much as possible to implement development activities and convince governments to act similarly.[60] To stimulate AID activities further in this regard, the fiscal year 1990 budget request contains provision for a $20 million development assistance account reserve from which missions and regional bureaus can draw to initiate new projects promoting the provision of services by the private sector

To date, AID has undertaken a variety of efforts promoting the use of private enterprise in its own projects and to provide developing country government services. In the field of basic education, its work has been aimed at decentralization—lessening the government role—rather than any strong promotion of for-profit private enterprise. In Jamaica, however, it has underwritten the private production of textbooks, and in some countries, such as Haiti, it has attempted to work with private schools. In others, AID has funded studies to examine the feasibility of charging public school fees. In agriculture, AID has advocated the use of private enterprise to produce and distribute agricultural inputs such as seeds and fertilizer. AID has also used leverage derived from ESF-funded policy dialogue programs to acquaint governments with the concept of contracting-out. One agreement in fiscal year 1984 required that the Costa Rican Ministry of Public Works and Transport initiate a demonstration program on the use of private contractors for road maintenance.

Although constituting roughly a quarter of the development assistance budget, AID health and population programs are generally not implemented through the indigenous for-profit private sector (according to one source, only four percent of funds). These projects are implemented on behalf of developing country governments by both American and indigenous PVOs. AID's health and population programs tend to have specific goals related to such quantifiable indicators of success or failure as the proportion of population covered by immunization or having access to family planning services and rates of child survival. What role local private enterprise and market mechanisms can play in meeting these goals has become the subject of much AID-funded research in recent years.

AID perceives several potential advantages in utilizing private enterprise to deliver health and family planning services. Foremost among these are the expected greater cost-efficiency of private enterprise and the potential ability of such enterprises to attain financial sustainability. They may also reach the target audience more effectively. Private enterprises have established their own

[60] Although AID has been using the vehicle of indigenous non-profit non-governmental organizations (NGOs) and private and voluntary organizations (PVOs) in project implementation with increasing frequency since the mid-1970s, these organizations do not function under market principles. Therefore, NGOs serve Private Enterprise Initiative objectives in only one, limited respect: as an alternative to government performance of the same function.

marketing and transportation networks. Contraceptives could be distributed, for instance, using the existing private chain of truckers and retail shops. In the health and population sector, use of the private sector for service delivery might be expanded to encourage development of commercial and manufacturing activities. Health products, such as vaccinations and contraceptives, could be manufactured in more developing countries, and private clinics and health care practitioners established.

Programs that would take advantage of some or all of these benefits are, for the most part, still in the research or pilot stage. Some have progressed to project stage. In Kenya, for example, AID is helping the government to contract-out the management of its public hospitals. AID is assisting private companies in Ghana, Guatemala, Paraguay and elsewhere with start-up loans and technical advice to manufacture and sell the solution used in oral rehydration therapy (ORT). Hoping to reach more people and supplement existing public services, AID is helping employers in developing countries to initiate family planning services within the context of their existing employee-based health programs. Roughly 60 percent of the $28 million Enterprise Program, begun in 1986, has been dedicated to assist businesses in this regard.

While these programs are only just being introduced in some parts of the world, AID has been involved in contraceptive social marketing (CSM) since 1972 and has funded perhaps as many as two dozen such projects. CSM generally involves the use of market techniques, such as advertising campaigns, market research, and retail distribution and sales, to achieve the objective of greater contraceptive use at low program cost. Most CSM projects are conducted by organizations with a commercial orientation, but, despite charging customers for their product, these have not usually been strictly profit-making free market enterprises. The contraceptives themselves are subsidized by AID, allowing the implementing company to set lower prices in order to provide greater access to lower income groups.

The Housing Guaranty Program is AID's principal channel for responding to developing country needs in the areas of shelter and urban development. It is often cited as the Agency's oldest private sector activity, chiefly because the program underwrites U.S. private sector financing of loans to developing country housing institutions through a full faith and credit U.S. Government guarantee.[61] Furthermore, early in its history, the program helped establish many developing country private saving and loan institutions as part of its original mandate to stimulate local credit institutions which might insure that housing finance could be provided on a continuing basis after AID programs ended.

In the mid-1970s, however, as a result of the New Directions legislation, AID shifted its focus to changing LDC government policies in order to encourage greater assistance to low income groups. It also began to require that the government of the borrowing country itself sign a full faith and credit guaranty of repayment of the

[61] Also, U.S. construction firms were used initially to build demonstration housing projects.

loan. Since then, most loans have been made to housing institutions in the public sector.

In recent years, under the auspices of the Private Enterprise Bureau, housing program officers have intensified efforts to encourage developing country private enterprise to take a greater role in the development, financing and building of housing projects. In Botswana and Kenya, for example, low-cost shelter projects are being financed through private building societies. In Jordan, according to AID, half of the housing programs funds, although channeled though the government housing bank, are directed at private developers and aimed at encouraging them to enter lower income markets. AID has provided technical advice to support the creation of private housing banks in Haiti and India. AID also has encouraged governments, such as Panama, to bid out to the private sector more construction work.

Because governments are not likely to sign guarantees on behalf of private sector entities, AID initiated a $29.9 million Worldwide Private Sector Housing Guaranty program in 1986 in which direct lending to private sector developers would be permitted without the necessity of a host country guarantee.

IV. ISSUES RAISED BY THE PRIVATE ENTERPRISE INITIATIVE

No program or policy approach to foreign assistance has ever been totally free of critical examination. Given the enormity of the needs of developing countries, the challenge to find workable solutions, and the limits to U.S. economic assistance resources, all policies and programs contend for attention and funding. The Private Enterprise Initiative is no exception.

The Initiative offered a new approach and a new set of programs to the foreign assistance agenda. The concept and the projects it has generated have been provocative. Although the idea that private enterprise is an important contributor to national economic growth is common wisdom in the West, the Initiative took this thought a step further, asserting that private enterprise could be the best engine of the kind of development sought by the U.S. aid program. The Agency for International Development was directed to find suitable means to stimulate private enterprise growth. In its challenge to existing policy, its emphasis on the private sector, and concurrent de-emphasis of the public sector, the Initiative has been a departure from the past.

A variety of issues have been raised during the eight year implementation of the Initiative, several of which are discussed in the following pages:

- Does the Initiative run contrary to basic human needs?
- What has the Initiative meant for developing country governments?
- Which private sector should AID assist?
- Is financial sustainability best attained through the private sector?
- What institutional obstacles does Initiative implementation now face?

A. Basic Human Needs and the Private Enterprise Initiative

Since the introduction of the Private Enterprise Initiative in 1981, many observers have wondered whether the new program of support for the private sector was not in some way incompatible with the objectives of the 1973 New Directions legislation which requires the U.S. aid program to support the "poor majority" in developing countries. The program which evolved from this mandate sought to meet the "basic human needs" of these countries' peoples through projects directly assisting the poor in contrast to earlier aid projects which largely stressed provision of infrastructure and the financing of factories in an effort to increase the overall GNP of a country.

In its first years, newspaper and journal articles suggested that the private enterprise policy represented a significant shift from the New Directions approach. Following the Initiative's introduction to the Congress in the fiscal year 1983 Congressional Presentation document, the House Foreign Affairs Committee emphasized that it expected the Initiative's activities to be fully compatible with New Directions and intended to review their implementation accordingly. In the years that have followed, congressional hearings on the foreign assistance program have repeatedly raised the question of compatibility between the Initiative and basic human needs approaches to development.

One reason for this suspicion of incompatibility was the belief that the Initiative might be a return to the pre-New Directions indirect approach to development in which the poor were expected to receive benefits via a "trickle down" process. This view developed, in part, because of the Initiative's association with an administration advocating a similarly characterized economic strategy for the domestic economy.[62] Any recommended shift in emphasis away from the "bottom up" approach, which many believe was mandated by the New Directions legislation of 1973, implicitly suggested a rejection of the basic human needs objectives which the legislation supported. Some presumed that funding of a large number of new private enterprise projects would mean a diversion of resources from activities in population, health, and education, where projects directly targeted the poor. Congress supported the Private Sector Revolving Fund, in part, because it would "shift a significant portion of support for private enterprise activities onto a self-sustaining basis and reduce the extent to which expansion of that development effort requires appropriated funding." [63]

While the Administration admitted that it was re-examining the New Directions approach, officials contended that a revised approach would continue to be consistent with the mandate of assisting the poor majority. Said AID Administrator McPherson, "We're going to address the needs of the poor majority, just do it differently." [64]

From the perspective of 1989, a number of arguments could be raised in support of this view. For one, meeting basic human needs has remained an AID policy objective. In its policy papers, AID has always viewed the Initiative as a component of that policy; it is simply a different means of meeting basic human needs of the poor and, as such, is consistent with standing legislation. Second, the legal authority to promote private enterprise already existed in U.S. legislation in 1981. Legislation added since then, especially that establishing the Private Sector Revolving Fund, has only reinforced existing authority. Third, the "traditional" projects in such sectors as health and education associated with direct targeting of the poor were never abolished. A fourth argument is that the Initiative specifically helps the poor in a number of ways: it emphasizes generating jobs and raising incomes, "independent of government subsidies and overburdened national budgets", allowing for self-sustaining growth which increases the purchasing power of the poor

[62] Christopher Madison. "Exporting Reaganomics—The President Wants to Do Things Differently at AID". *National Journal,* May 29, 1982, pp. 960-964.

[63] Senate Foreign Relations Committee. *Report on S. 1347, International Security and Development Cooperation Act of 1983,* no. 98–146, p. 23.

[64] Quoted in "Exporting Reaganomics", *National Journal,* May 29, 1982, p. 960.

and "enables them to meet basic human needs by their own efforts and choices". Further, it is argued that private sector delivery of services brings health care, training, education and agricultural techniques to the people, including the poor, more efficiently and reliably and often at less cost than public sector vehicles.[65]

Although the alarm that greeted the Initiative in some quarters in its early years may not have been justified, programs instituted during the past eight years have raised questions regarding the utility and effectiveness of the Initiative's particular approach to meeting the needs of the poor majority. Three aspects of the Initiative have been challenged on these grounds: specific private enterprise programs, the use of the private sector as a delivery mechanism, and the emphasis on using AID resources to encourage national economic growth (rather than directly targeted assistance to the poor).

1. Private Enterprise Programs

A number of the private enterprise-related programs conducted by AID have been criticized for having no direct positive impact on the poor. In many cases, however, such programs—assistance to business associations, policy reform assistance, and credit supplied to medium-sized business—have the purpose of strengthening national economic growth in order to create job opportunities and help governments afford sustainable social programs. Questions raised about several of the most prominent private enterprise efforts of the 1980's—policy reform and programs to assist business directly—are discussed in the following pages.

a. Policy Reform

A major component of the Private Enterprise approach has been policy reform. Of those most vocally concerned about basic human needs, some have focused on the negative impact on the poor resulting from macroeconomic policies "imposed" by the IMF and World Bank under stabilization and structural adjustment programs, and have called for "structural adjustment with a human face". Although officially implemented separately from these institutions, U.S. policy reform tends to support or supplement these programs. As the December 1986 riots in Zambia and 1989 riots in Nigeria and Jordan demonstrate, policy reform may adversely affect the poor. According to a 1988 congressional staff study mission to West Africa, "despite rising per capita growth, structural adjustment has produced little enduring poverty alleviation, and certain policies have worked against the poor."[66] In addition to higher food prices, reforms often mean reductions in government expenditures on health and education and in government employment. Opening up domestic markets to foreign competition may drive formerly protected industry and its labor force out of business.

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[65] Testimony of Neal Peden, Assistant Administrator, PRE Bureau, Foreign Operations Subcommittee, Senate Appropriations Comm., *Foreign Assistance and Related Programs Appropriations for FY 1989*, May 12, 1988, p. 259–260.

[66] *Structural Adjustment in Africa: Insights from the Experiences of Ghana and Senegal*, Report of a Staff Study Mission to House Committee on Foreign Affairs, March 1989, p. 2.

Some critics suggest that ESF program funding used for policy reform is a diversion of AID resources from project funding which could be used primarily for the direct provision of assistance to the poor. As a recent Department of Treasury report noted, "economic equity is not an issue easily addressed by adjustment programs." [67] Even many supporters of policy reform believe that AID should incorporate poverty-alleviation measures into IMF, World Bank and its own reform programs. Under the Private Enterprise Initiative, these measures might be policies favoring the small farmer or policies which encourage the growth of small business or microenterprise. AID, however, is only just beginning to move into a systematic study of the informal sector with a view toward influencing the composition of government policies which most directly affect the poorest entrepreneurs.

AID refutes the notion that the consequences of reform for the poor are mostly negative. Policy reform, they contend, whether it be macroeconomic market-oriented structural adjustment reforms or the targeted stimulation of private enterprise through such policies as privatization or encouragement of private agricultural markets, is a necessary condition for successful projects aimed at alleviating poverty. Although most AID-supported policy reforms have been aimed at macroeconomic changes, AID officials make the case that their sectoral reform programs, many in agriculture, are more overtly oriented toward assisting the poor. They refer to Africa economic programs which support decontrol of prices and stimulation of private agriculture markets, arguing that these have benefited small farmers.

AID has taken some steps to insure that the poor are not significantly harmed by policy reforms. AID claims that policy reform projects, such as those developed under the Africa Economic Reform Program, are, in fact, designed "to alleviate the political stress that policy reform brings". Presumably this means that extra funds provided through these programs are used to assist those people negatively affected by the reforms. In some cases, the reforms themselves explicitly seek to help the poor directly. The $80 million FY 1989 ESF agreement with Guatemala required its government to dedicate larger portions of the budget to social spending. In another case, AID helped compensate for the negative impact on the poor caused by the Agency's requirement for the termination of rice subsidies in Jamaica. Anticipating a rise in prices, it assisted in the creation of a food stamp system to insure that the food needs of the poor were met.

Finally, AID officials note that the apparent negative impact of policy reforms must be weighed against the far greater negative impact that would ensue if policies had remained on their original course. One AID study estimated the loss of GNP "due to resource misallocations resulting from misguided policies" at between six and eighteen percent.[68]

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[67] Department of the Treasury, *First Report to Congress Concerning World Bank Strategy and Lending Programs in Debtor Countries,* March 1989, p. 17.

[68] Steve Haggblade, et. al., *The Effect of Policy and Policy Reform on Non-Agriculture Enterprises and Employment in Developing Countries,* AID, 1986.

b. Assistance to Business

Although AID provides assistance to a wide range of businesses, the extent to which the poor have been served directly by these projects has been questioned. To some, there is a clear policy choice to be made between the objectives of poverty alleviation and business development. To others, helping business develop is the best way to alleviate poverty.

A critic of assistance to exporters, for example, asserts that "the benefits [of export-oriented development] stay mainly in the rather elite export-import sectors. . . ." [69] In general, AID projects assisting indigenous exporters and those creating linkages between foreign investment and local component suppliers focus on medium and large-scale business. Micro enterprises and most small operations owned by those in the poor segments of the population are not viewed by AID export specialists as having potential for developing the quality product in quantities necessary to be competitive exporters. In agribusiness, particularly, they do not possess capital to risk in an uncertain world market. However, although the poor are not directly served by export promotion and foreign investment projects, they are immediate beneficiaries of job creation resulting from these projects and would benefit as well from the positive impact of increased foreign exchange availability and national economic growth.

Whether AID business projects directly assist the poor majority to the full extent possible hinges, in part, on the way AID defines targets for its assistance. Business beneficiaries are generally determined on the basis of size defined by number of employees and amount of fixed assets.[70] On a number of occasions, projects which were supposed to assist predominantly small business have, in fact, mostly helped medium business. More important, the choice of definition of business size, in the view of some, has favored the high end of the scale, allowing more assistance to go toward larger businesses.

The Private Sector Revolving Fund, for example, like other AID programs, has much freedom in determining a definition for "small-scale".[71] Some have expressed skepticism as to whether Fund beneficiaries have, in fact, been small-scale, and, presumably, would offer a different definition of small than that used by the Fund. According to a Fund official, small is on average defined as an enterprise with fixed assets under $250,000. Roughly half of Fund beneficiaries fall below this level. The *average* beneficiary of the Far East Bank and Trust Company loan guarantee had $247,000 in fixed assets. The guarantee facility established for the Dominican Republic's Financiera Nacional de Desarollo was targeted at non-traditional export businesses with fixed assets of less than $1 million.

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[69] Stephen Hellinger, Co-Director, Development Group for Alternative Policies, quoted in *National Journal*, April 8, 1989, p. 849.

[70] For a discussion of business size definitions, see footnote 47.

[71] One illustration of the variable nature of these definitions is Thailand where the Private Sector Revolving Fund, in its Thai Danu Bank project, targeted business with fixed assets of less than $400,000. In the same country, the AID mission's own small rural enterprise assistance project put a ceiling of $200,000 in fixed assets on *its* potential beneficiaries.

The debate that occurred in the context of consideration of the microenterprise authorization legislation (H.R. 910 and S. 998) in 1987 also was conducted in large part around definitions of business size. Throughout negotiations on the shape of the legislation, proponents of the legislation, wishing to target assistance to the poorest 20% of the population, sought to limit the size of loans to under $300 ($150 in H.R. 910) and restrict the definition of microenterprise to a maximum of four people.[72] AID, on the other hand, sought to raise the maximum employee ceiling and to allow greater flexibility in loan sizes. Proponents of the legislation argued that the vast majority of microenterprises employ four or fewer people.[73] In their view, AID's assertions that even a limit of ten was restrictive and would force the allocation of loans to less viable businesses suggested that AID would direct available funds to those in the upper edge of the definition and, as much as the legislation would allow, to small-scale, not micro, enterprise.

Although the microenterprise authorization legislation died with the foreign assistance authorization bill to which it was attached, in both FY 1988 and FY 1989 appropriations bills, Congress earmarked funds for microenterprise and made recommendations in report language. AID has taken into account much of this guidance in its implementation of microenterprise programs and views the legislation as maintaining much of the program flexibility it sought. AID policy guidelines for the missions define microenterprises as having no more than "approximately" 10 employees, but, in lieu of this, does allow the use of a "locally appropriate" definition. While the average loan size should not exceed $300, a larger size is permissible in order to achieve the objectives of the program.[74]

Because of Agency efforts to increase the employee number definition of microenterprise and the permissible size of loans, some proponents of the legislation cast AID as the villain opposing assistance to the poor. Some observers suggested that congressional activity was required to make up for footdragging on the part of AID. One group of Representatives accused AID of "ignoring the 'bottom up growth'." [75] However, while many do agree that congressional interest has played a major role in encouraging an increase in microenterprise activity, AID can fairly claim that it had already been actively funding microenterprise projects. When Congress mandated $50 million, AID was preparing to spend $56 million and will spend at least $10 million over the required $75 million in FY 1989. Further, more than 52% of current microenterprise project funding is channeled through PVOs not inclined to ignore the poor.

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[72] Loan size, like employee number, is considered an indication of beneficiary, because smaller businesses require smaller loans.

[73] For example, of enterprises with 50 employees or fewer, those with five or less account for 94% in Jamaica, 96% in Indonesia, and 95% in Sierra Leone. Carl Liedholm in *Private Sector Connection to Development*, Subcommittee on International Development Institutions and Finance, House Committee on Banking, July 16, 1985, p. 93.

[74] AID Policy Determination, PD-17, *Microenterprise Development Program Guidelines*, October 10, 1988.

[75] Congressmen Edward F. Feighan, Benjamin A. Gilman, Lee H. Hamilton in Dear Colleague letter dated February 20, 1987, printed in *Micro-Enterprise Development Legislation*, Subcommittee on International Economic Policy and Trade, House Foreign Affairs Committee, March 3, 1987, p. 15.

Many observers believe that what lies behind the debate on beneficiaries is another continuing debate on whether microenterprise project objectives should be those of "poverty alleviation" or of "business development". Some at AID objected to the proposed microenterprise authorization legislation in part because it legislated a "minimalist" approach to microenterprise in which credit would be the chief form of assistance, and the chief objective would be simply to enable entrepreneurs to expand sales through incremental improvements in performance. This approach would allow little flexibility to help microenterprises expand into the formal sector and to stimulate economic growth.

AID and World Bank studies indicate that the optimum size of business to target for employment or income generation projects is from 10 to 50 employees, in the small and medium-scale, not microenterprise, range. AID officials have argued on a number of occasions that

> . . . directly targeting credit to those at the lower end of the per capita income spectrum may make it more difficult to achieve sustainable results. Businesses with more skills benefit more from credit and technical assistance programs and sustain more new employment opportunities.[76]

Many at AID believe that programs aimed at the most viable entrepreneurs will, in the end, have the broadest impact on the poor.

Advocates of a "poverty alleviation" approach to microenterprise point out that the "business development" emphasis ignores the bulk of microentrepreneurs whose work, from an economic point of view, is redundant and of low value-added. There are, they claim, both economic and social benefits to be had by assisting the poorer elements of the business spectrum. Microenterprise production activities create forward and backward linkages which stimulate the market for locally produced goods and services and unify the economy. Furthermore, PVO officials who implement microenterprise projects claim that these projects help to generate income in a multiplier effect—for every $1 loaned, earnings of $4 to $5 are generated.

Most important and most ignored in the business development argument, say advocates of targeted assistance, are the widespread social benefits of microenterprise assistance. They point to the Grameen Bank in Bangladesh, which produced a 70 percent increase in household income in only two and one half years, which in turn allowed an improved diet, more adequate clothing and housing, and better medicines for poor families. Women, in particular, benefit because they make up a large proportion of actual and potential microentrepreneurs. In Honduras, two thirds of small rural enterprises are run by women. The proportion is 40–50% elsewhere. Making credit available, therefore, provides women with new opportunities. Within two years after the Grameen Bank began to provide loans, the percentage of working women in Bangladesh rose from 5 to 25 percent. It is the direct benefits provided by microenterprise to poor households, the increase in human dignity

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[76] Testimony of Martin Dagata, Deputy Assistant Administrator, PPC/AID, Subcomm. on International Economic Policy and Trade, House Foreign Affairs Committee, *Micro-Enterprise Development Legislation*, March 3, 1987, p. 49.

provided the poor, notably women, that are most often mentioned by advocates of microenterprise as the chief arguments in favor of increased assistance.

2. Use of Private Sector as Delivery Mechanism

An important and unique feature of the Initiative has been the effort to utilize the private for-profit sector and for-profit market mechanisms to provide AID "basic human need" project services formerly delivered by non-profit organizations and government agencies. Part of this effort has also been to get governments to turn over some service functions to the private sector. In addition to encouraging expansion of the private sector, AID believes that these services can be performed by private enterprise much more effectively and inexpensively and are more likely to become self-sustaining. To the extent that such services reach the poor, such moves would be beneficial.

The efficiency associated with many private enterprises may also save budget resources, freeing governments to do other things with their money. Most governments use a significant proportion of their budgets for services in health and education and are still unable to fulfill the demand in these areas. Encouraging the private sector to provide its own health services or vocational training would take a burden off government service systems. Although the private sector may only wish to operate in profitable areas, at least this frees up government funds that could be used in "unprofitable" areas. Partial privatization of government services through contracting-out might save money if the service can be performed more inexpensively by business.

Although the argument can be made that not enough has been done to date to exploit those areas where the private sector can be more helpful to AID objectives, there is reason to believe that the use of private enterprise methods and organizations to serve the poor has distinct limitations. In the area of health and population, for example, some specialists believe that private enterprise projects are unlikely to make significant inroads outside of urban areas. Although AID is trying to reach the rural areas by including private sector midwives and traditional healers in some training programs and, in Ecuador, is subsidizing private rural clinics for those doctors willing to serve such areas, it has been suggested that the profit motive which characterizes private enterprise restricts profitable activity to urban areas where transport and other contraception distribution costs are lower and to those income levels which can afford to pay for medical care or products.

Charging for services, while encouraging their proper use, deters the poor from utilizing available services. In Ghana, for example, where health care fees were initiated in 1985 as a result of structural adjustment reforms, health service utilization has reportedly declined among low income groups.[77] Some AID officers also believe that charging for services has the effect of restricting the type of service provided in a way that conflicts with AID program needs. Whereas AID programs in child survival, nutrition, and other

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[77] *Structural Adjustment in Africa*, Committee on Foreign Affairs, March 1989.

health areas are aimed at prevention of disease and illness, most private health services are oriented toward curative care, largely because people are inclined only to pay for care that resolves a visible problem. Therefore, unless developing country private enterprise delivery solutions can be moved away from an emphasis on curative care, orientation toward serving affluent patients and concentration on urban areas, opportunities to serve AID health and population goals are likely to remain limited.

In the housing sector, as well, it has been difficult to get the private sector to provide housing services benefitting the population required by its New Directions legislative mandate: those below a country's median income level. Many believe that the private sector is not likely to accept the risks of lending to lower income groups. As evidence they note that even governments have often been resistant to low-income housing programs, favoring instead middle and upper-income housing located in major cities. Most beneficiaries of the housing program fall in the 35th to 50th percentile of wealth.

There exists, therefore, a belief that private enterprise implementors will be unlikely to continue housing programs designed to assist lower income groups after AID projects end, because they are perceived as unprofitable. A United Nations report, cited in a 1984 GAO study of the housing program, indicates a number of obstacles to private sector involvement, including that greater profits can be made from a few large loans rather than many small ones, the assumption that default rates on mortgages are higher for lowincome people, and that low income groups lack sufficient collateral.[78] In the course of its own investigation, the GAO study found that in some countries—Kenya for example—the high cost of land makes only very large developments financially feasible for low-income families. Although it thought that AID would have no trouble gaining "some short-term participation" of the private sector, the GAO report predicted that, due to obstacles like those mentioned above, a long-term, sustained commitment would be difficult.

For those in the lowest income range—below the 35th percentile—slum upgrading and sites and services activities have been promoted by AID since the New Directions legislation as responsibilities of government. While it is thought unlikely that the private sector might become involved here, a few pilot efforts have been made to bring the private sector into this field. In Ecuador, the housing office is trying to get private banks to accept people from the low income informal sector as subjects for housing credit. It is doing this by bringing the banking and informal sector communities together for a dialogue. AID also believes that some government policies such as excessive zoning or building standards make provision of low cost shelter by the private sector difficult, and it is working to alter these policies. One AID official has suggested that perhaps the best way to combine the requirement that the poor be served and the desire to facilitate the private sector is to encourage the private sector to provide housing to the 35th to 50th percentile

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[78] Unspecified U.N. report quoted in Government Accounting Office, *Management of the Housing Guaranty Program,* April 25, 1984, p. 19.

group. This might allow government to devote its attention and resources to even lower percentile groups.

3. National Growth vs. Targeted Growth

One of the chief criticisms of the Private Enterprise Initiative strikes at the premise on which it was established—that basic human needs may be met by stimulating broad-based economic growth rather than emphasizing direct efforts to target the poor.[79] For these critics, the Initiative was a variant of the "trickle-down" approach which characterized U.S. aid policy before the New Directions legislation. They argue that growth can occur with little benefit to the poor and claim that the experience of developing countries has shown that there is a very low correlation between national growth rates per capita and growth in incomes of the poorest 40% of the population. In across-the-board growth, the majority of benefits go to the relatively prosperous. Only targeted economic growth, in this view, would allow the poor to grow by a higher percentage than the rich.[80]

As noted earlier, AID argues that the poor have benefited in those countries which have experienced relatively rapid rates of growth. In the so-called "Asian Tigers", real wages are five to ten times what they were thirty years ago. In middle income countries the number of absolute poor and levels of poverty are significantly lower than in slow-developing countries.[81] Furthermore, growth stimulates productive employment which must relieve poverty. AID has also made the point that any growth, but particularly that which emphasizes foreign exchange earning exports, is important at this stage, because, until the debt situation is under control, developing country budgets will have difficulty maintaining the social programs which play a role in the redistribution of wealth and satisfaction of basic human needs.

The degree to which growth eventually helps the poor depends on government policies. The AID mission in Costa Rica makes the case that government social programs (67% of its expenditures) have traditionally enabled the poor to reap a higher share of national income than is the case in most other developing countries. Therefore, there is some assurance that general economic growth in Costa Rica does "trickle-down" to the poor. Using the same logic, however, it is doubtful whether the same could be said for Guatemala or Honduras where government policies and practices do not facilitate the distribution of national income.

Although it is difficult to generalize about all AID mission programs, to some extent, AID tries to help meet unfulfilled social needs. The Honduras program maintains a much larger "basic

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[79] AID often prefaces the phrase economic growth with the term "broad-based". Broad-based economic growth, however, appears to mean different things to different people. Critics seem to believe that its use by AID indicates support for an aid program directed, not at the poor, but at the economy as a whole. AID uses it to indicate growth benefiting everyone, including the poor, and not just the wealthy.

[80] Testimony of Richard Newfarmer, Subcommittee on International Economic Policy and Trade, House Foreign Affairs Committee, March 9, 1983, pp. 58, 68–69. 72–74; testimony of Dr. Ernest Loevinsohn, House Foreign Affairs Committee, *Objectives of U.S. Foreign Assistance: Does Development Assistance Benefit the Poor?*, August 17, 1982, pp. 53–67.

[81] See Raymond F. Mikesell, *The Economics of Foreign Aid and Self-Sustaining Development*, prepared for the Depts. of Treasury, State and AID, February 1982, pp. 33–46 for a good exposition of this argument and its converse.

human needs" portfolio than does the Costa Rica mission. Worldwide, AID has not given up on direct interventions in basic human needs. According to then-AID Administrator Woods, from FY 1987 to FY 1989,

> combined funding for health, child survival, education, nutrition, family planning and AIDS accounts for over 40 percent of total development assistance funding [agriculture which helps both growth and basic human needs would add more to this figure]. However, while improvements in certain basic human needs can be initiated by foreign assistance programs, they can only be sustained when the countries grow economically.[82]

For some, the "trickle-down" argument boils down to a question of efficiency. Critics say that direct targeting of assistance is a more efficient means of achieving the satisfaction of basic human needs. Proponents of the private enterprise approach argue that it may only indirectly benefit the poor, but its ultimate impact would affect a wider number of people in a more lasting, sustainable way through increased levels of employment. "It is difficult to say, at this early stage," noted one AID official in 1982, "how long the lead time will be for directly benefitting the poor." [83] There is little evidence yet available to throw light on the trickle-down effect.

B. AID and the LDC Government Role in the Private Sector

Implicit in the Private Enterprise Initiative is the idea that the role of governments in developing country economies has been of special importance in determining the outcome of economic growth. To date, in the view of Initiative proponents, that role has been largely a negative one. Developing country governments have, with the possible exception of newly industrializing countries (NICS) such as Taiwan and Singapore, promulgated policies and regulations restricting development and growth of the private sector.[84] Governments have undertaken functions which the private sector might well assume more efficiently and cost-effectively. And government ownership of parastatal enterprises has discouraged the growth of private enterprise.

For many, economic growth is not a question of how big government's role is in the economy, but rather the kind of economic strategies it is promoting.[85] One study of 17 developing countries suggests that those encouraging private savings and channeling credit to the private sector enjoyed higher rates of growth than those where state-owned monopolies and excessive state spending

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[82] Senate Committee on Appropriations. *Foreign Assistance and Related Programs Appropriations, FY 1989 (Part 2).* April 26, 1988. p. 97.

[83] Testimony of Frederick Schieck, Deputy Assistant Administrator, PPC/AID, to House Foreign Affairs Committee, *Does Development Assistance Benefit the Poor?*, August 17, 1982, p. 84.

[84] Some argue that NIC governments, too, have been highly interventionist. See Michelle Gitelman, "The South Korean Export Miracle: Comparative Advantage or Government Creation? Lessons for Latin America", *Journal of International Affairs,* fall 1988, v.42., pp. 187–198.

[85] For a lucid discussion, see John D. Macomber, "East Asia's Lessons for Latin American Resurgence" pp. 469–482 in *World Economy,* vol. 10, December 1987. The implication that big government per se is the problem has been questioned by analysts. In one study of the behavior of 85 countries from 1970 to 1980, the size of government was not found to be a significant factor in growth performance. Richard Newfarmer, "The Private Sector and Development" in Overseas Development Council, *Agenda 1983,* pp. 117–138.

had crowded out the private sector.[86] Based on the experience of the NICs, many also believe that governments pursuing export-led, rather than import-substitution, policies are likely to achieve higher growth rates.

AID has promoted a set of economic policies in its policy dialogue with developing countries that stresses private enterprise development. Although foreign assistance has generally reflected a prescription of what the U.S. believes a developing country should be doing, the level of specificity in economic policy recommendations is significantly greater in the 1980s than in the past. Through its emphasis on divestiture of government enterprise, privatization of government services, and the transfer of project funding from government to the private sector, AID appears to support an LDC government role substantially different from what it had been previously.

This approach might have significant ramifications. For example, it could create friction with governments sensitive to interference in their domestic affairs. The role of government vis-a-vis the private sector is a particularly delicate topic for developing countries. Actions common to the history of many developing countries—such as the nationalization of private, especially foreign, companies; adoption of import substitution strategies; and government embrace of a central role in the economy—have represented an assertion of economic independence from the industrial countries. While many governments are now beginning to redefine their role by initiating privatization programs, in no case is an LDC government preparing to turn over all its parastatals to the private sector.

Regardless of the merits of a given policy, by funding advisory services to identify government constraints on private business, by funding private business associations so they can lobby governments with a private sector point of view, by addressing issues regarding the role of government in the economy, and by assisting privatization, AID may be perceived as meddling in the internal affairs of aid recipients. As a result, AID private enterprise activities have rubbed up against political opposition in a number of developing countries.

In Jamaica, explicit conditions made by AID in 1984 and 1985 listing, among other things, firms to be privatized and instructing the government on how to deregulate commodity markets, led to a deterioration of relations between AID and the Jamaican government. AID's conditions were perceived by Jamaican leaders as "unnecessarily heavy-handed and politically unacceptable." [87] AID pressure on both Mozambique and Kenya in 1985 to privatize their food aid distribution, reportedly, caused much resentment in these governments, particularly because food is regarded as a strategic item by both countries.[88] Some are concerned that such situations will be more common as private enterprise activities receive greater emphasis.

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[86] Study by Keith Marsden cited in Foreign Assistance Committee Hearing, *Oversight of Private Sector Activities*, September 10, 1986, p. 40.

[87] AID/CDIE/Robert Nathan Associates, *Jamaica Cash Transfer Evaluation*, p. 89.

[88] Transcript of "private" hearing held by Senator John Melcher on Farm Export Obstacles, September 5, 1985.

AID recognizes the negative connotations implicit in the conditionality it attaches to its assistance. As an AID policy paper puts the case, ". . . From the U.S. viewpoint it is obviously much better that the IMF or the World Bank bear the onus for insisting on inconvenient or unpopular policy reforms." [89] To date, AID has demonstrated considerable caution in this regard. Because AID officials view privatization as a "high risk" political process, in both Costa Rica and Honduras, AID's support for privatization of parastatals has been characterized by sensitivity to the political atmosphere, and part of its project activities are designed to build public support for privatization. A major obstacle to private provision of services has been government resistance to any infringement on what they consider their traditional roles. AID officials have noted, for example, that, given government sensitivities in the education sector, it would be very difficult to promote any project that might seek to work exclusively in the private sector. Therefore, it has been necessary to suggest adoption of private sector alternatives within the context of those AID projects which work with governments to foster educational reform or the training of educational administrators.

For some, on the other hand, AID is entirely too cautious. Strategic considerations, these critics say, have prevented AID from pursuing a harder line in support of policy reform in both Egypt and Honduras. It is likely that concern for government stability has tempered AID activities elsewhere.

Historically, foreign economic aid has been delivered through the governments of developing countries. Virtually all mission-funded project activities are obligated through the signature of bilateral government-to-government Project Agreements. Assistance provided to private organizations generally has had to be approved by a government. Although there is widespread agreement that actual project implementation is increasingly in the hands of private organizations, both voluntary and for-profit, the record remains mixed. In 1985, AID reported that 75% of its Development Assistance projects in Africa were still directed through governments. Of 183 active DA projects in Asia, 160 were run through the government. On the other hand, of 282 DA projects in Latin America and the Caribbean, almost half were run through non-governmental groups, half of these for-profit organizations.[90] Another sign of the shift away from government was a policy introduced in 1985 requiring that parastatals only be assisted as a step toward their privatization. Previously, AID has used parastatals to implement a range of projects and had assisted them as part of its institution-building process.[91]

There are signs that, should AID's support for a lesser government role and its expanded support for private enterprise be more

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[89] AID Policy Paper, *Approaches to Policy Dialogue*. December 1982, p. 18.

[90] House Foreign Affairs Committee, *Foreign Assistance for FY 1986-87*, March 7, 1985, pp. 537-38.

[91] Some observers have suggested that AID follow the World Bank example and devote greater attention to restructuring existing parastatals in order to make them more efficient, rather than to eliminate them. With respect to proposed and potential economic assistance programs for Eastern Europe, it has been suggested that AID's position on parastatals may hamper its ability to respond to the private sector needs of the socialist economies of Poland and Hungary where government organs play a major role in most aspects of economic life.

greatly reflected in its resource transfers, governments protective of their sovereignty or dependent on aid to fulfill their own development plans may not approve increased U.S. efforts to bypass them. Many in the Costa Rican government and media, for instance, reportedly saw AID funding of the private Coalition for Development Initiatives (CINDE) as a diversion of resources which they thought more properly should go toward assisting the export promotion efforts of its own Ministry of Foreign Trade. In Honduras, the AID mission has negotiated an agreement with the government on the percentage of ESF local currency funds to be allocated to private enterprise related projects. Some are concerned that rules recognizing government ownership of local currency might jeopardize assistance to the private sector because governments are not inclined to be generous toward the private sector with public sector funds (and the private sector may be wary of losing independence if it accepts funds from its own government).

There are other possible disadvantages to a significant movement away from government. U.S. political leverage may be weakened as aid circumvents government. Further, even most proponents of AID's private enterprise emphasis note that governments do have a role to play in promulgating free market economic policies. AID, accordingly, helps governments develop analytical and institutional capabilities for generating their own reform measures. In addition, most observers accept government responsibility for provision of health, education, and other services, and AID continues to assist governments here. There are many as well who view moves to deemphasize the role of government as a threat to its role in insuring equity.

C. Financial Sustainability

One charge leveled at the New Directions approach to development in 1981 was that it failed to produce sustainability. Donor projects had established the basis for government to provide new services—clinics, schools, irrigation systems—without covering the necessary recurrent costs, such as salaries for doctors and teachers and supplies, to keep them going. These costs had been left to governments which were ill-prepared to absorb them. Furthermore, many believed the overall U.S. economic aid program itself was in danger of become financially unsustainable, due to a predicted scarcity of budget funds.

The Private Enterprise Initiative promised to insure greater sustainabilty in two ways. First, by utilizing market forces, projects would become sustainable. Put simply, projects run by the private sector—hospitals run by private managers, roads constructed by private contractors, credit operations run through private banks, etc.—would be more efficient, functioning as they do on the profit motive and responding to market forces to determine resource allocation. They would be more sustainable in the long run, as well, by charging for services.

Secondly, the aid program itself would be more sustainable using private sector methods. In Peter McPherson's view, private enterprise projects were to represent a prototype of an "AID for the future", an AID which would rely increasingly on leveraging relatively small amounts of public sector funds in order to attract greater amounts of private sector resources with which to accomplish its goals.

Although the aid program's need for public sector funds did not substantially alter, a number of steps have been taken during the past eight years to bring private sector funds to bear on development activities. Many of these have been described in preceding pages. The Private Sector Revolving Fund's direct loan and guarantee practices, where loans or guarantees are used to entice greater private sector commitment of financial resources, are an example of this approach. Efforts to encourage private enterprise to offer family planning services within employee health programs is another.

There has been some success as well in fostering greater financial sustainability in AID projects using private sector methods. By charging fees, a number of training programs have become more self-sustaining. For example, the Honduran Association of Managers and Entrepreneurs, a management training institution assisted under an AID project, achieved an 83% self-financing level within two years. Sixty-four percent of in-country training costs in a Costa Rican export industry training project had been contributed by trainees or the companies employing them in the first year of operation.

In the population sector, evidence suggests that Contraceptive Social Marketing is a more cost-effective alternative to traditional clinic or community based family planning distribution approaches. Technical assistance provided by the International Executive Service Corps recoups at least some of its costs by charging fees on a sliding scale based on business size. Only a few credit programs—those conducted by the Private Sector Revolving Fund through commercial banks are one example—currently cover all or nearly all their costs. Due to administrative expenses of providing numerous loans, small and microenterprise programs tend to cover 60–90% of their costs. However, if interest rate charges to entrepreneurs were to rise sufficiently, a self-sustaining credit program serving the small end of the business scale might be possible. AID has made a start in this direction by eliminating subsidized rate charges, requiring that no less than real positive interest rates be charged.[92] Where a rate cap exists in a country, AID policy dialogue has in several cases sought to remove this cap.

In addition to achieving greater sustainability, there are several other benefits to be had by adopting private enterprise practices in project implementation. Charging for services encourages efficient use, insuring services are not wasted and that they go to those who want them. Charging an appropriate interest rate, instead of a subsidized one, encourages business efficiency and better prepares entrepreneurs for market competition.

There are, however, some drawbacks to the achievement of greater sustainability. One study suggests that social objectives are not necessarily compatible with the goals of financial self-sufficiency.

[92] Although this practice may sound inconsiderate of the plight of the poor, alternative sources of credit in the informal sector—loan sharks—might charge a rate 5 to 10 times higher than the real interest rate.

"CSM [Contraceptive Social Marketing] project experience indicates that there appears to be a very real tradeoff between obtaining the social objective of providing widespread accessibility of CSM contraceptive products at prices the poor majorities can afford, and attaining project financial "self-sufficiency"—especially within a relatively short (5–10 year) time frame." [93] As noted earlier, the requirements of profitability do not always benefit the poor in health, education, housing, and other sectors.

Furthermore, there are a number of other project objectives which are not easily attainable on a financially sustainable basis. In the case of training programs, particularly those serving the developing country business community, American up-to-date teaching techniques and state of the art equipment are highly valued resources, providing a stamp of modernity otherwise lacking in alternative programs. However, American instructors and equipment are expensive and programs requiring them may have difficulty achieving sustainability without charging prohibitive fees. Some believe it to be in the U.S. interest to maintain an American connection to such programs for trade and political reasons regardless of the developmental value of assisting their independence.

In the case of microenterprise, an approach considered by many to be the more financially sustainable is less favored by many at AID, because it does not meet certain economic development objectives. The "minimalist" approach, which emphasizes provision of credit alone, without more expensive training and technical assistance components, currently represents 37% of microenterprise project funding. Although some believe that minimalist credit can be provided to a greater number of entrepreneurs and reach the poor more effectively as a result, its detractors say that training to upgrade management and administrative skills, and technical assistance to develop a saleable product or locate markets for their goods is necessary if entrepreneurs are to achieve higher productivity and grow into the formal sector of the economy. Achievement of these long-term objectives would justify a failure to achieve near-term financial sustainability.

D. AID and Private Sector Components

For many, there is no question whether AID should assist the private sector. Rather, at issue is which private sector it should assist. Although the aid program has targeted various types of private enterprise, funds for this effort are limited and decisions must often be made which emphasize one segment of the private sector over another. Each segment has its supporters and detractors.

Those who believe that microentrepreneurs in the "informal" part of the private sector should be the chief beneficiaries of private enterprise assistance tend to contest that portion of aid which assists larger businesses. On the other hand, proponents of aid to small business argue that it generates more employment than other businesses. Medium and large businesses, still others argue,

[93] Annette L. Binnendijk, *AID's Experience with Contraceptive Social Marketing: Synthesis of Project Evaluation Findings*, AID/CDIE, July 1985, p. 23.

are more viable candidates for export activities and linkages to foreign technology and investment.

There are others who single out for criticism export projects—some because they assist mostly larger businesses, many of them agribusinesses, and others because assistance to agriculture exporters damages the ability of countries to feed themselves by giving precedence to export markets over domestic ones. Proponents of export projects, on the other hand, believe that they are the most likely activities to stimulate new growth, will provide much needed foreign exchange, will help eliminate foreign debt, and provide resources for food that may be more cheaply bought than that locally produced.

When first introduced, the Private Enterprise Initiative was accused of being foremost an attempt to assist the U.S. private sector. Although using the U.S. private sector, according to AID, is simply a means to the end of assisting developing countries, in its efforts to promote foreign investment and technology transfer, more opportunities have arisen to link private U.S. commercial business (as opposed to development consulting firms) with developing countries. Roughly one fourth of all Private Sector Revolving Fund projects, for instance, have involved the U.S. private banking sector. Some would question whether some of these activities have as their objective indigenous private enterprise development or expansion of U.S. trade, and whether the prime beneficiary is the developing country or U.S. business. Others, however, would support more, rather than fewer, AID activities to advance the U.S. trade position, saying the partnership between the U.S. and LDC business is key to successful development.

Even within categories of private sector assistance there are disagreements over program emphasis. Some supporters of export projects give priority to activities assisting indigenous exports rather than foreign investment promotion. They contend that local entrepreneurs best learn skills necessary to a successful export economy by doing them themselves and are better able than foreigners to understand the local culture and business environment. Technologies they use are more appropriate to the local economy and, most important, their businesses have greater linkages to the domestic economy and, therefore, a greater overall growth effect. Foreign investment is often in assembly industry which provides employees with few skills and produces comparatively little domestic value-added from which to reap foreign exchange benefits. Many believe that assembly industry will just go away as soon as more cost-efficient locations appear. Tax advantages provided to attract such activities can also hurt the nation's fiscal situation.

Those who support funding of foreign investment projects, citing Taiwan and South Korea, believe that diversification into more complex manufacturing will eventually follow establishment of assembly industry. They point out that foreign industries are more efficient than local ones, bring in new capital, and, with links to international markets, can merchandise products more quickly.

Although the AID program has benefited many kinds of developing country business, within individual countries decisions on business projects may appear to favor one sub-sector of the economy or one business over another. Direct loans have sometimes been made from the Private Sector Revolving Fund to individual businesses. Concerned that this practice may be unfair to competing businesses, some favor loans through intermediaries rather than direct loans to avoid favoring one company over another. In choosing particular sectors for business projects—non-traditional export products versus traditional, coffee vs cattle—AID must contend with the displeasure of those sectors of the business community which were not selected for project funding. AID itself has responded to concerns that its private enterprise programs might assist "cronies" of national rulers, or, through privatization, help create private monopolies in lieu of government ones. Its policy is to avoid either situation.

Many AID missions generate annual private sector strategy statements and have funded studies attempting to "map" the developing country private sector in order to come to terms with the needs of the diverse elements composing the private sector. Nevertheless, given the numerous options and the limited resources with which to address them, efforts to assist the private sector, like those to assist the public sector, are often conducted in a piecemeal fashion. Some believe this could lead to undesired effects. Privatization projects, where private sector management capabilities remain undeveloped and where sources of capital for the purchase of these firms remain in the hands of foreigners or cronies, may not have positive results. Support for a growing private sector without preparing governments to regulate in order to protect consumers or the environment may have unintended consequences.

E. Obstacles To Implementation

During the past eight years, efforts to implement the Private Enterprise Initiative have run into a number of institutional and policy constraints which, many believe, have impeded its progress. While some of these have been removed, others remain and might be addressed in future years.

1. AID Staff

Soon after the Initiative was introduced, observers noted that AID had insufficient numbers of staff qualified to implement it. In order to develop projects assisting the private sector, AID needed people who could understand the business environment. During the past eight years, AID has recruited a number of individuals with business experience for positions as private enterprise officers at field missions. The number of such officers rose from 49 in 1983 to 74 in early 1988. But, reportedly, there remains a shortage of health, population and other technical personnel with the ability to adapt business methods to their sectors. On a more elementary level, roughly 150 AID staffers have taken a two week PRE-formulated training course to introduce them to the distinctive characteristics of private enterprise development. However, some believe not enough upper echelon staff, including mission directors, have taken the course to have made a significant impact on the aid program.

The more specialized needs of the PRE have presented a greater challenge. Several PRE staff members have been brought in from the private sector as temporary, administratively-determined appointments because of the difficulty in attracting qualified people with banking and investment experience into government careers (three more such posts were recently approved).[94] Ironically, in the early years of the Initiative, private sector appointees were reportedly somewhat ineffective due to their inexperience with AID practices.

Many believe that the number of personnel with necessary expertise remains insufficient, particularly so if the Initiative is to expand. A 1988 AID management assessment of the Bureau for Private Enterprise, contending that the public personnel system is inadequate to the special needs of the private enterprise effort, suggested that AID find new ways to reach out into the private sector in order to find appropriate staff. Use of the IESC, the President's Commission on Executive Exchange, and direct requests to the CEOs of corporations were proposed avenues toward solving this problem.

2. Accountability and Oversight Restrictions

Some believe that because AID must be accountable to Congress and the taxpayer, it is too conservative in its dealings with business to assist the "riskier" prospects—new, untried areas of investment and small and micro enterprises. In the case of the Private Sector Revolving Fund, for example, legislative restrictions limiting guarantees to 50 percent of risk of loan default and requiring that the Fund be self-sufficient, have inhibited it from taking risks. Only 16% of its portfolio are for direct loans to individual businesses which are more likely to face default than are guarantees to Intermediate Financial Institutions.

In 1982 congressional hearings, then-Assistant Administrator of the PRE Bureau, Elise DuPont, defending the Bureau against charges that its loans may be abused, noted that the PRE was designed to be in the "business of lending money, under medium-term, fixed-rate conditions. And when you lend money, you do it in a businesslike manner . . . We make judgments, as a businessman would make judgments, on the viability of the enterprise." [95] The problem, say critics, lies in the tendency of government to be a conservative businessman rather than innovative risk-taker. PRE investment loans have lost only two percent from defaults over the past eight years. Although many believe that a low default rate is indicative of a well run public program, in the view of critics, this might also be evidence of its risk-adverse nature. Unless Congress encourages AID to take risks, they say, assistance to private enterprise will be restricted to relatively safe investments and/or those predominantly in the medium to large range of business.

Similarly, some believe that, in order to stimulate business growth, AID should be permitted to make equity investments such as those made by the International Finance Corporation (IFC).

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[94] A similar problem has reportedly been encountered by AID in obtaining the types of skilled consultants it requires for provision of technical services. Private sector consultant fees for banking, investment and industrial specialists are generally significantly higher than AID's procurement regulations allow.

[95] House Foreign Operations Subcommittee, Committee on Appropriations, *Foreign Assistance and Related Programs Appropriations for 1983 (Part 7)*, September 15, 1982, p. 269.

Until 1988, no U.S. Government agency had the authority to take an equity position in a for-profit enterprise abroad. Congress amended the Foreign Assistance Act in 1988 to initiate a program, on a pilot basis, which gives OPIC the authority to make equity investments in U.S. business projects in developing countries under certain conditions. Some argue that the same authority should be granted to AID with regard to indigenous developing country business.

Others, however, believe that the U.S. Government should not be involved in individual business projects, whether through direct loans or equity investment. Some also suggest that AID staff are too overburdened with other work or do not possess the skills necessary for participating in private sector management decisions.

For purposes of accountability, AID is required to maintain an oversight role in project activities. Its oversight procedures are considered by some to make private sector projects especially cumbersome. Observers suggest that the private sector requires a degree of speedy decision-making not the norm for AID. Many private entrepreneurs are thought to be adverse to the detailed financial reporting requirements demanded by AID. As a result, AID private enterprise officers note, opportunities to work with the private sector have sometimes been lost.

Even at the project design stage, differences between standard AID practices and working with the private sector are large. To lessen the element of risk and heighten accountability, projects are designed in as detailed a fashion as possible. In the view of one analyst, however, although AID specialists realize that highly specific blueprints do not fit "development realities," "private sector activities are characterized by even greater lack of detail that AID managers find hard to handle."

According to this analyst, "Public sector operations also provide the donor with a degree of control that may be lacking in the private sector . . .

> An AID mission in the Middle East, for example, was recently considering private-sector import of agricultural pesticides through a commodity import program. Following the guidelines laid down for funding pesticides, the environmental office suggested a number of control measures, such as training for farmers, limits on the quantity sold at the local level, and specification of crops and application rates. These controls are not unreasonable if the pesticide remains under the control of the importing firm all the way to the farmer, as it generally would in the hands of a ministry or parastatal. But private-sector importers in this particular country are wholesalers: They sell pesticides, sometimes in bulk, to retail traders who in turn sell them to anyone who walks into their store. The wholesalers have no practical means of following the procedures outlined by the environmental office, and certainly no interest in doing so.[96]

[96] Jennifer Bremer, "Comparative AIDvantage", *Foreign Service Journal*, July/August 1986, p. 25–26.

In this case, the need to maintain and enforce proper administrative safeguards for the distribution of potentially lethal chemicals may outweigh whatever value is perceived to exist in utilizing the private sector as a means of delivery. Many believe that only the public sector is likely to require such safeguards.

3. Procurement and Other Administrative Restrictions

Procurement is often pointed to by AID mission staff as an example of unwieldy and lengthy processes of government which are unresponsive to the special requirements of the private sector. A review of AID's contraceptive social marketing projects highlighted a number of discrepancies that exist between commercial practices and those of AID.[97] While business, for example, attempts to develop a product based on consumer needs and preferences, AID selects its contraceptives based on a different set of criteria such as the need to award contracts to the lowest bidder and give preference to U.S. manufacturers. These standard government practices have made it difficult for social marketing projects to be responsive to consumer needs or have the flexibility to improve or modify a product quickly. Due to often complex and lengthy procurement procedures, it may take up to a year for a product to be delivered. The commercial sector, unaccustomed to such practices, has seen its commercial sales disrupted as a result.

Another AID report highlights other regulatory impediments to its work with the private sector.[98] Dealing directly with the private sector has usually been accomplished in the past through a contract, a grant, or a cooperative agreement, but, according to the AID report, none of these is always "adequate to meet the needs of field missions engaged in providing assistance to or through host country nongovernmental organizations." Where, as is often the case, the purpose is to help the private sector organization develop its capacities, these options do not provide sufficient assurance of AID control over the process.

Still other legislative restrictions have had the effect of eliminating from AID's purview potential areas of private sector development. One AID report places U.S. cargo preference laws in this category, but more significant, perhaps, are laws preventing U.S. foreign aid from being used to assist production of goods which might be competitive with U.S. production. Some criticism has been aimed at limitations on AID's institutional role within the U.S. Government. Wherever U.S. policy is a major factor in the development of LDC private enterprise, then AID, some believe, should play a role in the formulation of that policy. AID, for example, has a formal but inconsequential role in formulation of the U.S. position on the GATT and plays no part in Department of Agriculture decisions on domestic agriculture support programs that, in the view of at least one analyst, hamper competitive expansion of exports from developing countries. In his view, "All these policy

[97] Annette L. Binnendijk, *AID's Experience with Contraceptive Social Marketing*, AID/CDIE, July 1985.

[98] AID, *Benefits of and Impediments to Providing Assistance Through Nongovernmental Organizations: A Report to Congress*, September 1986, pp. III-9–11.

levers are more important in expanding private sectors in the Third World than are 'policy dialogues' or other measures." [99]

4. Financing

Because foreign aid financial resources are limited, the growth of private sector programs may not have been as rapid as it would have been had there existed greater resources. These programs have always had to compete with other development activities for funding. Nevertheless, estimates have shown a not inconsequential growth in private enterprise projects during the past eight years. Since 1986, well over $600 million has been obligated out of ESF and DA accounts each year for private enterprise activities.

Whether present levels or continued growth can be maintained is subject to doubt given the competing demands of other development objectives. There are, many believe, limits to the use of the private sector in fulfilling AID's goals in health, education, and population. Many AID officials argue that congressional allocations of funds to specific functional accounts and earmarks for specific programs, greatly limit availability of funds which might be dedicated to private enterprise development. To date, a high proportion of funding for private sector activities has come from ESF, rather than development assistance accounts. Allocation of ESF, however, is subject to a political judgment and may be withdrawn when political and strategic needs no longer warrant its use. Some observers expect that Central America, for instance, may no longer receive large appropriations of ESF, when and if peace comes to the region. There exists concern in AID missions there that private enterprise projects will be greatly diminished in number if ESF declines.

At present, where ESF generates local currency, much of this local currency appears to be used for private enterprise activities, especially as a source of credit. Use of local currency is subject to agreement by both the local government and AID. To insure that it can be used in the private sector, AID has often negotiated proportionate public-private sector allocation ratios. Some consider these agreements fragile, because ownership of local currency is considered to be that of the government, and governments have difficulty justifying to their public the expenditure of public funds for private enterprise uses.

AID has taken a number of measures to avert funding deficiencies for private enterprise projects. In local currency countries, it has accumulated excess local currency for future use. It has also initiated credit guarantee schemes, such as the new Private Sector Revolving Fund guarantee program, which make scarce resources go further. Functional account limitations, often claimed to be factors inhibiting AID flexibility in developing more programs that promote private enterprise, were eliminated in FY1988 for the Development Fund for Africa. Indications are that, as a result, there

[99] Testimony of Richard Newfarmer, then-Director of Trade Policy, Overseas Development Council, to Subcommittee on International Economic Policy and Trade, House Foreign Affairs Committee, *Foreign Assistance Legislation for Fiscal Years 1984–85 (Part 6)*, March 9, 1983, p. 72.

have been expanded opportunities for private enterprise projects in that region.

F. Assessing the Private Enterprise Initiative

What positive or negative consequences the Private Enterprise Initiative's programs and projects will have on the progress of developing countries is not easily identifiable. No one knows how long it will take for macroeconomic growth policies to have a significant impact, and many private enterprise projects are still in their relative infancy.

It has always been difficult to assess the achievements of foreign economic assistance programs, beyond the most immediate and concrete objectives of a project—such as how many people obtained credit, were trained, or received contraceptives. The contribution of a particular program or project to national economic growth and development is obscured by the existence of too many variable factors. Even if it should be demonstrated that the private sector grew significantly during the past eight years, it would not be possible, in most cases, to show that such growth occurred because of AID's private sector program in that country.

Besides, AID's role in most countries is very small compared to total government budgets or even the total of all donor nations and organizations. Although its private enterprise activities have grown, they still only constitute roughly 12-13% of DA and ESF funds. Therefore, some say, one should not expect too much.

Nevertheless, the presumption necessarily exists that as much or as little as AID does in a country is a contribution to the bigger picture. If a country experiences significant economic growth, the development program basks in the light of its reflection. When Costa Rica registered a dramatic increase in its exports of non-traditional products to non-Central American Common Market countries from an estimated $147 million in 1983 to $407 million in 1987, AID mission officers claimed a share of the credit on the grounds that the mission's private sector policies had been largely aimed at encouraging exactly this sort of outcome. They also noted that many other factors, besides AID's role, were involved in the matter.

In a broad sense, the Private Enterprise Initiative can claim two concrete accomplishments as a result of the past eight years. For one, it has brought the problems of private enterprise in the developing world into the mainstream of the U.S. foreign aid program. And this has led to greatly increased direct transactions between the U.S. Government and private entrepreneurs and business associations. It is unlikely that AID programs in the future will ignore this sector of a developing country's national life. Nor, as one AID officer pointed out, will people be able to say that a project's failure was because the private sector had not been brought into the picture.

The second achievement, which follows from the first, is that the Private Enterprise Initiative appears to have revitalized some old areas of AID activity and also moved AID into new areas. Examples of these AID activities are: privatization assistance, much of the policy reform effort and the analytical capability to facilitate it, most of the push into microenterprise and the informal sector (inasmuch as the congressional impetus in this regard was a response to the Initiative's private sector thrust), financial markets, and efforts to utilize the private sector to carry out AID projects.

The establishment of an active private enterprise program as a consequence of these two achievements has raised a variety of issues to confront policymakers at AID and in the Congress. The issues of basic human needs, of financial sustainability, of the appropriate role of the public sector, of which private sector to assist, and of exactly what is the best way to work with and on behalf of private enterprise in developing countries, are likely to remain of continuing interest to those responsible for formulating the U.S. economic assistance program.

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