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POLICY DETERMINATION

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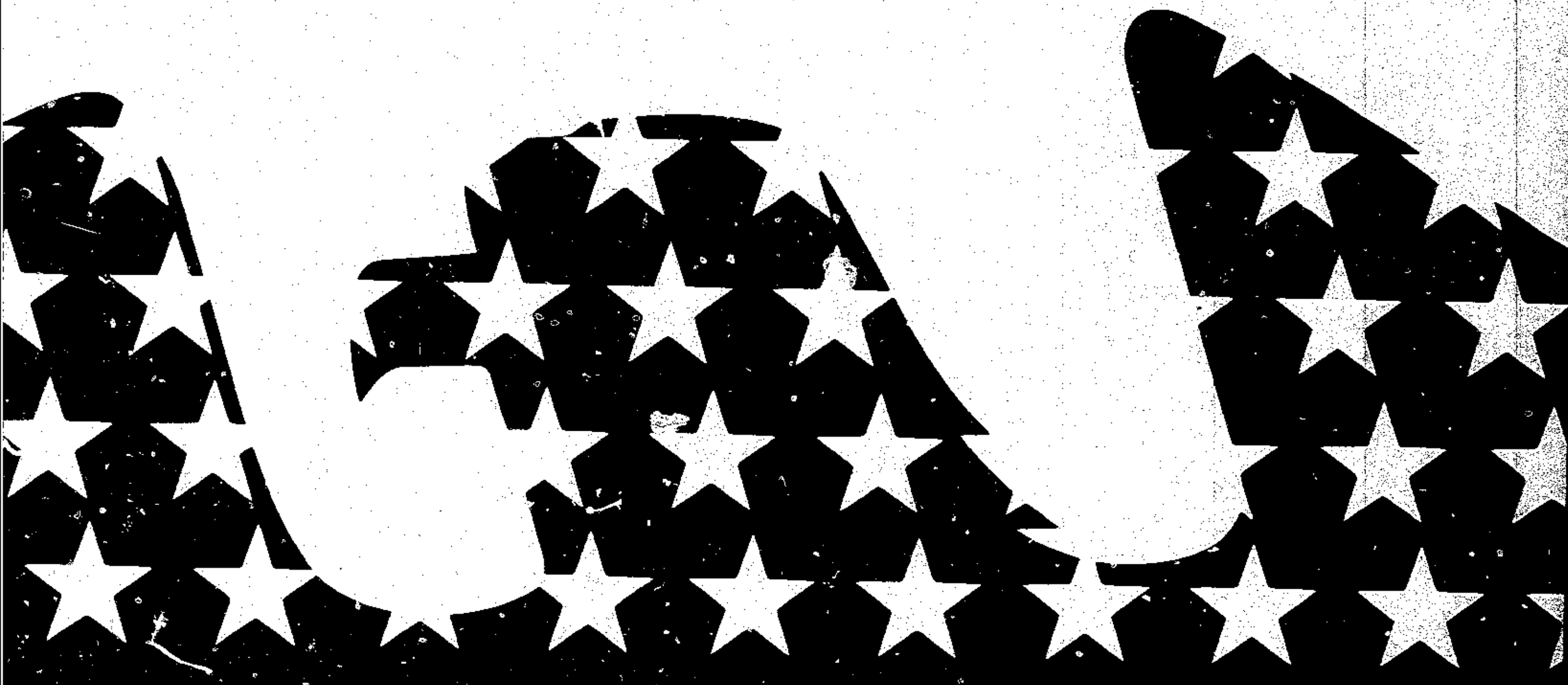
PROGRAMMING PL 480 LOCAL CURRENCY GENERATIONS



A.I.D.

POLICY DETERMINATION

PROGRAMMING PL 480 LOCAL CURRENCY GENERATIONS1/

I. Introduction

In 1972, AID changed its policy with respect to programming country-owned local currency proceeds generated by the sale of PL 480 Title I commodities ("sales proceeds"). This change was designed to reduce direct U.S. involvement in the affairs of AID recipient countries and to simplify program procedures; it also was prompted because of the problems associated with monitoring a fungible resource. Thus, recipient governments were no longer required to deposit the sales proceeds into separate accounts, and Missions could no longer participate in programming their uses, except in special cases.

In 1976, AID concluded that in most (but not necessarily all) country situations, more active AID participation in the programming of these sales proceeds could enhance our ability to influence a recipient government's policies, thereby improving the quality and quantity of the recipient's development effort. Accordingly, AID policy was modified to require Missions to examine the merits of more active AID participation in the programming of local currency generated from PL 480 Title I sales and to encourage its use as another aid tool in those countries where it promised to be effective.

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

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1/ Although this paper focuses on Agency policy with respect to programming local currency proceeds generated by the sale of commodities under the Agricultural Trade, Development and Assistance Act of 1954, as amended, ("PL 480"), it also provides examples of other ways by which food assistance can be integrated with non-food assistance, thereby enhancing the developmental impact of all external resources.

development objectives.2/ AID involvement can range from one extreme where the recipient government assumes primary responsibility for allocating its own budgetary resources to the other extreme where AID plays a more active role in such allocation decisions, including, inter alia, detailed programming prior to signing the agreement, the establishment of a special account, Mission concurrence on disbursements from the account, or periodic reporting and monitoring on the status of financial accounts and individual projects.

II. AID Policy

Enhancing the developmental impact of PL 480 resources is a major objective of AID. There is a broad consensus within AID that we should have a major interest in the policies pursued by AID recipient countries which govern the allocation of domestic resources. Accordingly, Agency policy explicitly encourages AID participation in the programming of country-owned local currency generated by the sale of PL 480 Title I commodities when such involvement promises to help in achieving developmental objectives. Agency policy also encourages the integration of PL 480 food aid resources with non-food aid resources (primarily those from Development Assistance and the Economic Support Fund) to help achieve specific program and policy objectives and to enhance the developmental impact of all external resources.

When it is determined that AID should become more actively involved in the programming of local currency, the following policy guidelines apply:

2/ Article II-F of Part I of all Title I agreements requires that an amount of local currency equal to the sales proceeds but not less than the dollar value of CCC disbursements for the commodities (less any Currency Use Payment) be used to support the economic development objectives (including "self help" measures) set forth in Part II of the agreement. It also stipulates the appropriate exchange rate to be used to determine the amount of local currency available (thereby discouraging the subsidized sale of the commodities); that subsidized interest rates are prohibited for any of the local currency loaned to the private sector or non-governmental organizations: and that an annual (or more frequent) report must be submitted to the U.S. indicating how the local currency was used. Missions with Title I programs should review their present monitoring procedures to determine if changes or improvements are needed in order to fulfill the requirements of this Article more effectively.

- The Mission and the host government should agree on the specific uses of the sales proceeds as well as on appropriatepolicy reforms as much as possible before the Title I agreement is signed.

- The specific activities which will be funded with the local currency and the specific amount of funding available for each activity -- as well as specific activities that will not be eligible for funding -- should be explicitly stated. The local currency may be used, as appropriate, to help meet the legal requirement that the recipient government contribute at least 25 percent of the total cost of activities financed by Development Assistance.

- The Mission should systematically monitor the recipient government's overall budget allocation decisions. This will help to ensure that local currency generated from Title I commodity sales actually finances a net relative expansion of important development-oriented activities and/or supports appropriate policy reforms above and beyond what otherwise would have occurred; that is, it will help to ensure that the recipient government does not allocate fewer budgetary resources to support these activities and reforms, thereby offsetting the expansion made possible by the Title I sales proceeds.

- Missions should consider using the sales proceeds to support activities implemented by private voluntary organizations (PVOs), particularly under Title II and with operational program grants (OPGs). Missions should also encourage expansion of the private sector. Opportunities may exist to help develop capital markets and, through private financial institutions or other development mechanisms for on-lending, to finance viable private enterprises, including agribusiness activities.

- The sales proceeds should be spent as closely as possible to the time the PL 480 imports are used in order to minimize the net inflationary or deflationary effects of the agreement.

- Missions should consider depositing the sales proceeds into an interest bearing commercial bank account established to help finance development activities not agreed upon during negotiations or not yet ready for implementation; both the principal and the interest can later be used for funding such activities.

- The negotiating opportunity should be used to discuss key macroeconomic and sectoral policy issues, including subsidized food prices. If the Title I commodities are sold below market prices, this not only will generate less revenue for the government but also can have an adverse effect on domestic food production by lowering the overall price structure. The capacity to engage the host government in such discussions is likely to be enhanced when both PL 480 food aid and non-food aid resource levels are discussed at the same time.

- Missions should review with the recipient government the specific procedures for programming, releasing, and controlling the sales proceeds, and for monitoring and evaluating the implementation of the specific activities (including reporting requirements). Missions should entrust the recipient country with as much of the work of utilizing and accounting for the country-owned local currency as possible.

AID participation in programming local currency is not an end in itself, but rather a tool for moving toward the more important goal of an overall host country budget that represents a sound, development-oriented allocation of budgetary resources. AID participation in local currency programming is appropriate in those circumstances where it will help achieve the overall goal.

III. Past Experience

These policy guidelines are based on the analysis cited above as well as a review of more recent country experience (summarized below). These analyses show varying results in using Title I sales proceeds to influence domestic resource allocation. This influence can vary across countries as well as within one country over time, because of: (a) differences in the competence of recipient country officials to handle difficult macroeconomic policy concerns and to solve serious public finance problems; (b) differences in the magnitude of U.S. assistance relative to domestic resources and external resources provided by other donors; and (c) shifts in government leadership and in the relative importance of U.S. assistance. AID's past experience should be taken into consideration in determining whether or not the advantages of our exercising greater influence over the disposition of counterpart funds (local currency generations) outweighs the disadvantages.

A. Early Experience. In countries where our active participation in the programming of the local currency proved to be effective, the major reasons were:3/

- The local currency was readily available in a special account specifically earmarked for development projects (including AID projects). This prevented project implementation from being stalled as the result of red tape, slow and inefficient techniques for releasing normal budgetary revenues, or non-availability of promised revenues.

- Government officials or development-oriented ministries could resist pressures to divert local currency resources to finance politically motivated "pork barrel" projects, poorly planned development projects, or non-development projects simply by pointing out the necessity for AID to concur in the use of the resources.

- The volume of the local currency generations relative to total development resources was relatively significant. When the local currency resources were less substantial, AID could influence only the choice and implementation of individual projects, rather than resource allocation decisions.

- AID participation in the programming of the local currency constituted a vehicle not only for policy dialogue but also for providing technical assistance to public officials of the recipient government, thereby helping to modernize and upgrade project appraisal and budgeting procedures and to deal more effectively with macroeconomic policy and resource allocation issues.

- A relevant part of the host government shared AID's goals for the country's development and there was agreement concerning the best approach for achieving those goals.

- AID participation in the programming of the local currency was not viewed as unjustified interference by foreigners in domestic affairs.

3/ In some countries, although our active participation in the programming of local currency seemed effective, this was perhaps partly because our participation was not needed. For example, the host country already had an effective project appraisal, budgeting, and financial control system; met its commitments to support development projects; and had a good development program overall.

In countries where our participation in the programming of local currency has proved to be ineffective, the major reasons were:

- AID's involvement in programming country-owned local currency was regarded as a highly visible, unjustified, and intolerable interference in domestic affairs.

- The establishment of a separate account for the local currency, subject to special rules, frustrated the Finance Ministry in carrying out its normal budgetary procedures.

- The government feared that AID's participation in the programming of local currency would stimulate other donors to follow this precedent, resulting in conflicting advice and confusion within the government concerning how its development priorities should be ordered.

- The government feared that AID's motivation may be to promote the commercial interests of the U.S. rather than the welfare of its country.

- Joint programming of the local currency required additional AID and host country manpower and management resources which did not produce results commensurate with the added administrative costs.

- Activities financed by the local currency were sometimes unsuccessful due to inadequate management, and AID became associated with these shortcomings.

B. Recent Experience. Of the 25 Title I agreements negotiated in FY 1982, Missions participated in programming the local currency for 20 of them (80 percent), including 5 for which there was no special account; 2 Missions participated in project selection; only 3 Missions did not participate at all.

As stated above, special accounts in which the country-owned local currency is deposited are not required under Title I agreements. This may reflect the fact that special accounts do not guarantee that appropriate budget allocation decisions will be made, nor are they essential for a Mission to be able to influence budget decisions. Nevertheless, an increasing number of Missions have determined that country conditions warrant the establishment of such accounts, partly to facilitate monitoring the uses of the local currency and also because interest bearing accounts increase the total funds available. Of 25 Title I agreements signed in FY 1980, only 8 had special accounts (32 percent); of 25 agreements signed in FY 1981, 11 had special accounts (44 percent); and of 25 agreements signed in FY 1982, 15 had special accounts (60 percent). The number of special accounts increases to 21 (68 percent) if the 6 existing Title III agreements (all of which require special accounts) are added to the Title I agreements.4/

Geographically, in FY 1982, 10 out of 13 Title I programs in Africa had special accounts; 1 out of 3 in Asia; 4 out of 6 in Latin America and the Caribbean; and none out of 3 in the Near East.

IV. Program Examples

Examples of ways in which local currency generations can be programmed, and food aid can be integrated with non-food aid resources, are provided below.

Coordinated programming of food aid and non-food aid resources can facilitate politically difficult policy changes. For example, the reduction or elimination of consumer subsidies is likely to cause serious domestic economic and political problems because of the adverse impact of the higher food prices on the poor. In such circumstances, non-food aid programs can support projects aimed at increasing food production and improving food distribution while well designed food aid programs provide a temporary "cushion" for the poor. For example, relatively less expensive "self targeting" staples can be supplied and the local currency can be used to fund income producing projects that benefit the poor.

Local currency generations can be used to fund in-country training (for example, in the management of grain stabilization programs supported by PL 480 food aid) while Development Assistance can finance the foreign exchange costs associated with such training (U.S. technical assistance). Local currency generations can also support discrete projects (such as health centers or irrigation systems) which may be directly linked to and partially funded by Development Assistance (or ESF).

Food distribution centers can be funded by a combination of dollar assistance and local currency generations and can be used for family planning activities, the provision of health care services and community development -- as well as for food distribution.

4/ There are currently 2 Title III programs in Africa; 1 in Asia; 2 in Latin America and the Caribbean; and 1 in the Near East.

It may be desirable to use local currency to reduce the loan repayment burden associated with Housing Guarantee programs financed at U.S. market interest rates as a means of supporting a change in host country policy with regard to subsidized housing for low income beneficiaries. Local currency generations can also be used to support other housing and urban development activities, such as small enterprise loans, training and community facilities, which might be difficult to undertake at U.S. market interest rates.

There are, of course, constraints to increased integration of food aid and non-food aid resources in specific projects. There is sometimes a reluctance on the part of the host government to depend on a resource (food, or the local currency generated from the sale of the food) -- whose availability is not always certain or reliable from year to year. The actual transfer of local currency to those entities charged with implementing specific agreed upon activities is not always timely. Finally, the timing of the resource flow is less flexible in the case of food aid than non-food assistance, and therefore its phasing with other development activities becomes more difficult. Nevertheless, these examples indicate that a greater developmental impact can be achieved when food aid and non-food aid resources are integrated and when the local currency generations are carefully programmed.

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22 FEB 1983
Date