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October, 1987

Synthesis Paper

Trade and Investment

PAGE

PD-ABJ-592
isn 91156

Introduction

This paper examines the role of enhanced trade and investment (T&I) in promoting development in the ANE region, and discusses potential interventions by ANE and other AID Bureaus to augment the contribution of T&I to development. The focus is mainly on obstacles to trade and investment (more specifically, direct foreign investment, or DFI) in ANE recipient countries, with only passing reference to factors in the US and other developed countries that limit the developmental contribution of T&I.

The paper is based on a set of five background papers produced for this exercise, and should be considered work in progress. In particular, in the last section we identify some specific possible interventions that warrant further discussion and development. We also include separately a set of issues for consideration.

A. US Trade and Investment in the ANE Region

1. Analysis of US trade and investment patterns in the ANE region, and in other regions, indicates that AID-assisted ANE countries account for about 5 percent of US exports and 3 percent of US DFI. Furthermore, the data suggest that these shares have declined slightly in recent years. On the other

hand, the share of US exports to the four Asian NICs has gone from 5 percent in 1975 to 8 percent in 1985. For Korea and Taiwan the share rose from 1.2 percent in the 1960s to 5 percent in the 1980s (5 percent represents about $11 billion per year). These latter figures indicate the potential stake for the US if ANE recipients achieve more rapid growth and a more outward orientation.

More specifically, Korea and Taiwan in 1985 had a combined population of only about 60 million and a combined average per capita GNP of roughly $2,500, so that the combined GNP was on the order of $150 billion. In 1975, combined GNP was only about $70 billion (in 1985 prices), or about $1,350 on a per capita basis. Countries such as Philippines, Thailand and Indonesia have lower per capita incomes (in the $500-$800 range), but large populations (around 50 million each for Thailand and Philippines, and 160 million for Indonesia). Thus, they are already large economies compared with Korea/Taiwan. Rapid growth along the lines achieved by Korea and Taiwan could therefore have a comparable or even greater impact on US exports.

Compared with Japan, US exports to ANE countries have usually been less, while US investment has been greater in some countries and less in others. It is clear from the global data that geographic and cultural proximity have influenced DFI flows, with most US DFI in LDCs focused on Latin America, and most Japanese DFI in LDCs concentrated in Asia. In terms of product disaggregation, the main US export categories to the ANE region are machinery and transport equipment (46 percent) and food (21 percent).

2. The ANE Region and the US Current Account Deficit. The subject of trade and investment is made all the more topical by the US current account deficit, and an inevitable consideration is how potential AID interventions might affect the US balance of payments. It is important to keep in mind that careful statistical analyses indicate that most of the deterioration in the US current account is due to exchange rate movements and differential rates of growth among trading partners in income and demand. Any significant improvement likewise depends on changes in these variables. In view of the small share (5%) of US exports going to the ANE region, improvements in the market framework in ANE countries could have marginal impacts. A 1 percent increase in total US exports in 1986 would have narrowed the trade deficit by only 1.2 percent. Nevertheless, these impacts might still be of significance from a political and constituency standpoint.

Taking a more medium-term view, it is clear that the existing pattern of large US current account deficits financed by capital inflows is not sustainable over the medium-term.

Instead, the US will probably need to finance net capital outflows in the early 1990s with current account surpluses. This difficult adjustment process will be fundamentally driven by movements in basic economic variables such as exchange rates, interest rates, and income levels. The process will be easier, the more readily the US can expand exports. It is probable that income and demand in the Asian economies will be expanding more rapidly than in the rest of the world during this period. To the extent that US exporters can take advantage of this, the overall adjustment burden on the US will be less.

B. Developmental Role of Trade and Investment

A steadily growing literature (including the IBRD's most recent World Development Report) indicates that open economies have performed better in terms of both sustainable growth and equity/poverty alleviation. This literature emphasizes that the contributions of trade and direct foreign investment depend on policies that determine how efficiently resources are allocated, including in particular a clear orientation towards market forces. Accordingly, policies which undergird the development and operation of market economies will best facilitate the contribution of trade and investment to successful development.

In this sense a concern with T&I fits well with AID's mandate to emphasize sustainable, broadly-based growth as a mechanism for accomplishing lasting impacts on LDC poverty. Where trade and investment policies are concerned, there is a close correspondence between efficiency and sustainability concerns on the one hand, and equity and poverty concerns on the other. Ineffective policies in the area of trade and investment have led to poor performance in terms of both sustainable growth and poverty alleviation. The Philippines offers one clear example of this. Performance of the large-scale industrial sectors in Pakistan, India, and Indonesia also provides supportive evidence.

At best, T&I contribute additional resources to the economy; provide appropriate technology that can increase productivity; and facilitate more efficient use of productive domestic resources, particularly labor, through specialization and division of labor. In a more dynamic sense, more open economies encourage competition, innovation, and a greater role for market forces. DFI is preferable to foreign borrowing as a source of investment funds from the standpoint of LDC risk-management.

At worst, T&I can provide inappropriate technology (not suited to factor endowments) and promote inefficient use of both foreign and domestic resources. For instance DFI played a prominent role in the Philippines and in Latin American countries which have emphasized inefficient import substitution policies detrimental to both output and employment growth. The adverse effects of these policies on both growth and equity have often been compounded by an excessive public sector role in investment and production.

The major determinant of the developmental contribution of T&I is the policy and institutional setting, particularly trade policies (quantitative restrictions, tariffs, licensing) and investment policies (incentives, performance requirements, tax policies, credit policies, etc.) High and uneven rates of protection (as opposed to low and relatively uniform rates of protection) lead to an inefficient pattern of production, trade, and investment. Some distortionary investment incentives skew investment towards large-scale, capital- and import-intensive production activities. More broadly, policies and institutional factors that have widespread effects on the efficient allocation of productive resources--those which affect labor markets, credit markets, foreign exchange and energy--and policies that affect the role of the private sector and market forces will have major impacts on the developmental contribution of T&I.

Even with a favorable policy setting, there are obstacles to an optimal, or more effective, pattern and level of T&I in developing countries. These obstacles, and the potential roles of the public sector, the private sector, and AID in overcoming them, are discussed in some detail below.

C. Obstacles to an Enhanced Contribution from Trade and Investment.

1. Broad Country-wide "Climate" Considerations. The general degree of political and economic stability affect DFI in particular, but also trade. Where there is great uncertainty about the general environment, investors and traders will be reluctant to go to the effort of setting up commercial relationships. Also includable under this rubric might be basic cultural factors, which make the climate not so much inhospitable as alien. It is clear that cultural differences and similarities explain much of the international pattern of T&I.

2. Distorting Trade and Investment Policies. On the trade side these ordinarily involve restrictive policies, including tariffs and quantitative restrictions on imports. Explicit subsidies to imports are rare. Exports are sometimes taxed, and in other cases occasionally subsidized. Other distortionary trade policies include measures that restrict competition and the free play of market forces, such as

licensing and granting of exclusive rights to import or export--often to public sector firms.

These trade policies affect DFI, indeed some (inefficient) DFI occurs in response to the incentives provided by restrictive trade policies. Other distortionary policies affecting DFI include incentives (such as subsidies or tax breaks on imported equipment, subsidized credit, and other tax breaks) and performance requirements (such as minimum export requirements, minimum domestic input requirements, minimum local participation, restrictions on repatriation of profits etc.) DFI may be subject to licensing and restrictions on levels and sectors in much the same way as imports. Finally, some tax policies discourage DFI, such as tax rates applied to dividends and profits which are higher than for other sources of income.

These policies deserve prominent attention because they affect not only levels of T&I, but also the pattern and developmental contribution of T&I. In a setting where these distortions have major adverse impacts on efficiency, the developmental contribution of expanded T&I will be limited or even potentially negative. Consequently, they deserve priority attention.

3. Other policies affecting the pattern of production, investment, and trade. These include a broad array of policies, e.g. in the area of exchange rates, interest rates, labor costs, energy costs, price controls, etc., which tend to have widespread effects on the efficiency of resource allocation. DFI is particularly sensitive to conditions in labor markets.

4. Legal/Administrative/Rules-of-the-Game Barriers. These encompass in the first instance insufficiencies in the rule of law, including lack of recognition and enforcement of property rights in general and of intellectual property in particular; lack of contract enforcement; and ineffective criminal sanctions against fraud, embezzlement, and other business crimes. They also include administrative barriers associated with red tape, an excessively hands-on posture towards regulation, corruption, etc. In general, the barriers discussed in this section result more from government inaction and passivity than from active government intervention.

5. Physical Infrastructure. A separate class of obstacles to T&I fits under this general rubric, which includes transportation, communication, storage, energy, and other services. It is clear that these influence DFI in particular, and that the potential for DFI is quite limited (though not zero) in low-income countries with inadequate infrastructure.

Infrastructure is traditionally one area of heavy public sector and donor activity, but with increasing appreciation of the role the private sector can play. Free trade zones are one response to these obstacles.

6. The financial sector might be considered a particular element of infrastructure. In any case T&I are sometimes constrained by the inadequate development and performance of financial markets in LDCs, and the inavailability of certain types of finance and financial services. The financial system is a fundamental part of the foundation required for development and operation of a market economy and, accordingly, vigorous and developmental T&I. The financial systems of the developing world are characterized by 1) prominent presence of public-sector institutions; 2) little diversity in the variety of financial institutions; and 3) dependence on development finance institutions for development activity. This dependence has resulted in reliance on debt financing and has retarded the diversification of financial systems and their capital markets elements. DFI, to the extent it represents venture capital, can help make up for some of these inadequacies. The development of financial markets, the appropriate roles for the public and private sectors, and the design of effective donor interventions, are recognized to be difficult and controversial topics.

7. Information. Often trade and investment are limited by inadequate information about market opportunities and conditions. For example, potentially valuable sources of US privately held technology and production know-how often are not known to LDC entrepreneurs. To some extent, generating this information is an integral part of entrepreneurial activity, so that production and generation of information should be left to the private sector. However, information has some of the characteristics of other publicly provided goods and services--once the basic investment in production is made, the costs of provision to an additional user are low. Therefore, some kinds of information are often generated and provided by the public sector or by cooperative private sector groups.

8. Commercial Techniques and Expertise. Expanded T&I depend in part on business representatives in a country having the know-how and sophistication to understand, negotiate, and enter into the full range of international business transactions and relationships, including manufacturers' representation, dealerships, licensing and franchise arrangements, co-marketing and co-production agreements, joint ventures, etc. The many business consulting services available to business in the US are simply not available, or are unreliable and inadequate in LDCs. As with information, the introduction of these techniques is often a facet of entrepreneurial activity, indeed the distinction between

technologies and expertise is not clear-cut.

D. Elements of a Framework for Considering AID Interventions

1. Roles of the Public and Private Sectors. Trade and investment are fundamentally market activities in that they usually involve production and exchange of private goods and services, not public goods. In principle, most trade and direct foreign investment can be efficiently carried out by the private sector, if a satisfactory market environment prevails. The immediate and clear task facing both LDCs and donors is to create an environment conducive to efficient private sector activity, leaving decisions about whether to trade and invest to private entrepreneurs. Efforts to address the policy and institutional setting (essentially obstacles 1-4) are obviously part of this task. Efforts to address obstacles that are clearly infrastructural in nature are also part of this task.

A less clear-cut, but still potentially important role for LDC governments and donors is to go beyond this to stimulate and encourage the private sector more directly, by providing public services, promotional efforts, and/or incentives that ordinarily (say, in a well-functioning market economy) would not be called for. A staunch advocate of market forces would argue that if the private sector is not willing to shoulder the full costs of carrying out an activity (e.g. breaking into a new market or providing a new service), that is a valid indicator that the activity should not be undertaken, since the potential rewards are obviously not sufficient to cover costs. A more developmentally-oriented observer would argue that fledgling private-sector activities are like infant industries--special nurturing in the near term results in significant longer-term gains to the economy and society. This latter argument has clear merit, particularly when the government intervention achieves gains in market efficiency that outweigh the costs of the intervention. It has also--in the infant-industry case--been subject to considerable abuse, through excessive and prolonged protection and nurturing of unviable, inefficient activities.

The implication is that public sector/donor interventions discussed below need to meet efficiency criteria--that the expected benefits (carefully defined) from the intervention bear a favorable relation to the true costs, and that they reinforce development of an efficient market economy. Some interventions that entail the public sector and donors carrying out activities and covering costs that belong in the sphere of private sector activity may not meet these criteria.

2. Factor Endowments, Comparative Advantage, and Appropriate Technologies. Some aspects of the obstacles discussed above (especially commercial techniques and

expertise, and infrastructure) reflect core differences between developing and developed countries, particularly endowments of human capital and institutional and physical infrastructure. Over time countries develop by gradually augmenting these assets, and many of the interventions discussed below support this process. At the same time, as the early discussion indicated, development progress has often been retarded by premature efforts to create a "modern" capital-intensive industrial sector not suited to the resource endowments of the economy. The general lesson is that AID interventions need to be careful about getting too far out in front of existing levels of factor endowments, expertise, institutional sophistication, etc.

3. Commercial and Developmental Objectives. There would be definite, obvious risks to using AID resources directly for short-term commercial purposes that have little to do with development goals, or may even conflict with development goals. AID's credibility, integrity, and ultimately its effectiveness as a development institution would be damaged by approaches to foreign assistance that were heavily or visibly oriented towards short-term commercial considerations. In general, the harmony between developmental and commercial objectives increases sharply as the perspective shifts to the medium and long-run.

AID has consistently taken an enlightened leadership position among donors on issues of tied aid and mixed credits, arguing that short-term commercial concerns can sharply reduce the effectiveness of foreign assistance in promoting development, and urging donors to collectively and cooperatively reduce these practices. The issue is whether there is more to be gained by this approach, or by instead moving in the opposite direction and increasing the commercial orientation of foreign assistance.

It is clear that the constituency for US developmental assistance in Asia is weakening, because Asia is arguably closer to achieving sustainable development than other regions, and/or because our resources are already marginal in terms of influencing development outcomes. The argument for a more commercial orientation to aid is that without such a shift, assistance levels will undergo further sharp erosion, to the detriment of US interests in Asia.

4. <u>Cooperation, Specialization, and Division of Labor: Activities of other USG actors to lower obstacles to trade and investment, particularly US T&I</u>. Promoting US trade and investment has always been a basic element of foreign policy. The USG is very actively involved in promoting US trade and investment in developing countries, through USTR; the departments of Commerce, Agriculture, Treasury, and State; and

OPIC, EXIM, and TDP. In general US policies and programs have been directed towards liberalizing trade and investment policies, and improving the framework for open and fair competition. Distortionary policies (import protection and export subsidies) implemented by the US have usually been motivated by retaliatory considerations. In any case, USG programs directed towards T&I are driven by US commercial and economic interests, both short-term and long-term.

There are several possible implications for ANE as far as cooperation and division of labor go. First, in interacting with other USG programs ANE needs to identify and be associated with aspects which are clearly and predominantly developmental. For instance, ANE could help strengthen the LDC institutions responsible for formulating and negotiating commercial policy, so that they could interact more constructively with USG institutions (e.g. in negotiating Bilateral Investment Treaties, or BITs) and in international fora such as the GATT. Second, there may be scope for ANE to promote developmental concerns in the activities of other USG programs, e.g. EXIM and OPIC. Third, in considering division of labor (rather than cooperation) it arguably makes sense for other USG programs to attack T&I barriers that are primarily important from a US commercial standpoint, particularly since other US agencies can have a greater impact on barriers in the US, facilitating quid pro quo negotiations. ANE, in turn, is in the better position to identify and address T&I barriers from a predominantly developmental standpoint.

A variety of non-governmental US programs also promote efforts to encourage T&I in LDCs, on the basis that growth of T&I in LDCs is important to US industry. These include the US Chamber of Commerce; American Chambers of Commerce abroad; the International Executive Service Corps; Volunteers in Technical Assistance; etc. These programs also represent opportunities to AID for cooperation and for enhanced efficiency through division of labor.

E. Potential ANE Interventions--General Approaches

This section considers AID interventions at a rather general level to affect some of the obstacles and determinants mentioned above, based in part on surveys of actual AID interventions affecting T&I. As the discussion indicates, there is often considerable overlap and connection between trade obstacles and investment obstacles, so that the two are usefully considered together.

1. Broad Country-wide "Climate" Considerations. It is important to keep in mind that rapid growth in trade and investment is normally associated with broadly-based, sustainable growth. The records of countries such as Korea,

Taiwan, and Thailand support this generalization. Accordingly, successful efforts by AID to foster broadly-base sustainable growth will yield dividends in terms of substantial increases in trade and investment, which, as discussed earlier, can in turn further reinforce such growth . AID can also support and reinforce the efforts of other bilateral donors, the IBRD, and the IMF. As with other AID activities, in situations where the basic economic and political setting is unfavorable, opportunities for achieving developmentally effective results in terms of T&I are severely limited, but not nil. (e.g. Burma)

Where basic cultural obstacles and differences are concerned, most observers agree that training and exchange programs are a valuable tool for establishing networks in LDCs that would make it easier for US business to penetrate domestic markets.

2. Distortionary trade and investment policies. AID can intervene here through policy dialogue, technical assistance and training, institution building, and donor coordination. The scope for policy dialogue is obviously enhanced if the mission is carrying out a program or project, the success of which depends on improved T&I policies. It is also enhanced if the mission is providing program support in association with policy reforms. TA, training, and institution building can reinforce policy dialogue, or can be worthwhile by themselves

in instances where the government recognizes the need for improved policies. Trade liberalization is often part of IMF and IBRD agreements, which provide some opportunity for donor coordination. AID can also contribute by supporting the formation and efforts of broadly-based private sector groups that provide a constituency and a force for liberalization.

3. Legal/Administrative/Rules of the Game Barriers. Some of these barriers such as lack of protection of intellectual property rights may be the subject of negotiations with other USG agencies and/or in international fora such as the GATT. These negotiations are commercially driven, but have implications for successful development. Normally the quid pro quo in such negotiations is enhanced access to one another's markets, or to one another's investment resources, so that direct AID involvement in these negotiations might appear overtly commercial and not developmental. However, AID can make a developmental contribution by strengthening the LDC technical capacity to participate constructively in these negotiations. The recent USTR proposal for AID to fund an automated data base for ASEAN is a good example.

Outside of the negotiating context, AID can make a clearly developmental contribution by helping to strengthen the rule of law and reduce administrative barriers through technical assistance, training, institution-building, etc. AID can also support institutions in such areas as customs administration, as it has in Egypt.

4. More general policy barriers. While not specific to T&I, ANE missions can contribute to an enhanced contribution from T&I by bilateral activities to improve the more general policy setting; by support for IMF/IBRD policy-based agreements that in AID's view effectively promote improved policies and the role of market forces; and by assisting LDCs in complying with such agreements.

5. Physical Infrastructure. Except in a few instances (Egypt, Pakistan, Philippines) ANE missions are usually not in a good position to address requirements for physical infrastructure that supports T&I, by virtue of limited resources. However, AID can have some impacts through donor coordination. There may be particular opportunities to work with the Japanese on infrastructure that would enhance T&I, and might also provide sub-contracting opportunities for US firms. Not only are investments important, but also policies that influence how efficiently infrastructure is used, e.g., power tariffs. AID support for development and operation of free-trade zones may be one effective way of alleviating physical infrastructure constraints.

6. Financial Infrastructure. Given the integral nature of the financial system to development of market economies and enhanced T&I, Missions should have: 1) a clear view of the level of development of the financial system; and 2) an agenda for promoting its development in the private sector and its diversification. The ultimate objective should be a financial system with a variety of debt and equity institutions for packaging and managing risk, a system which links the informal credit sector with the modern sector and a system capable of linking with regional and world financial systems. Linkage into the emerging world financial systems will yield both access to new financing technologies and capital resources for productive investment. Missions could proceed by organizing diagnostic studies of their financial systems. Missions which have a clear grasp of the structure might go on to develop an agenda for supporting development along the lines indicated above. Central Bureau resources, particularly PRE through its Revolving Fund and Financial Markets project and S&T in the area of rural credit can be tapped to provide Missions with financial and technical resources.

7. Information Infrastructure. The objective of an information infrastructure is to identify the opportunities and requirements for additional T&I activity. This entails articulating dimensions of market demand such as fundamentals, timing and risks. It also entails clear specification of

product characteristics, standards, etc. Missions might consider the deficiencies in this infrastructure. An area of particular significance, given the importance of agricultural commodities to developing countries, is the variety of information required for enhancing commodity trading, both locally and internationally. Missions may find that enhanced data and data reporting will be a key to market development and to enabling the private sector to manage the flow of product to market. Missions may also find that developed informational infrastructure requires other infrastructural responses, e.g., product storage technology. Project assistance may be extended to government agencies, business and trade associations, private cooperatives, and others to provide more complete information about the international marketplace. Information regarding opportunities for export needs to be accompanied by information regarding the discipline (quality control, grading, standardization, packaging, etc.) which must be established for maximum advantage. Identification of US and other international sources for manufacturing inputs, including components for assembly comprises another form of market information, this time on the import side. Ideally, the private sector should be stimulated to provide such services on a profit-making basis.

Another type of information involves the more explicit matching of buyers and sellers, or of potential co-investors.

This includes such activities as feasibility studies, international travel facilitation, identification of sources of alternative technologies and capital equipment, etc. While this is ideally carried out by the private sector, ANE intervention to facilitate these information flows, may be appropriate, particularly where such interventions help build sustainable private sector institutions or business entities. At the same time, experience demonstrates considerable scope for wasting scarce AID resources in these areas.

8. Commercial Techniques and Expertise. The introduction of various types of T&I linkages between LDC and developed country businesses is likewise often a facet of entrepreneurial activity carried out in private markets. At the same time, there is an opportunity for AID training, TA, and institution building to support and facilitate the process. AID assistance to the Lahore school of management in Pakistan is one good example. Another is the ANE/TR-funded cooperative agreement with the International Development Law Institute for training and workshops in International Business Transactions and related subjects.

F. Other AID activities, affecting US T&I in particular

CIPs and PL 480. Typically CIPs and PL 480 do not simultaneously serve development and US short-term commercial objectives in an effective way. Indeed in some cases sharp conflicts between these objectives have emerged. Often CIPs and PL 480 are provided in situations of balance of payments stress, and are effective only insofar as they do not represent additionality to US trade. In some cases CIPs have only been drawn down in association with subsidized financing, indicating US goods on a landed basis were not competitive otherwise. It may be possible to redesign these programs to enhance their visibility to US business and labor interests. However, sufficient foreign exchange/balance of payments savings to the LDC must continue to be demonstrated to support policy dialogue efforts.

Infrastructure Projects. These often have strong links to US exports. Provided that they are supported by sound economic and social analysis, they can effectively promote both development and expanded opportunities for T&I. However, budgetary considerations, including functional accounts, may preclude an expanded emphasis on infrastructure. Further, commercial pressures to go forward with a project can sometimes override developmental considerations. Indeed, we have been very critical of the Japanese for using infrastructure to promote commercial interests, in part because of conflicts with development objectives. Encouragement of private sector power is one good example of an activity that is both developmentally useful and commercially attractive.

<u>Mixed Credits</u>. At times AID is asked to assist US bidders in international procurements against subsidized competition through mixed credits. There is no pretense that this is developmental in any way, and often it actually reduces the value of total assistance and concessions received from developed countries. One conceivable way to address both of these problems would be for the US government (not necessarily AID) to establish a pool of funds which would be additional; which would be provided in retaliation against export subsidies; and which would be programmed for developmental purposes such as training and technical assistance rather than provided as a cash subsidy. Such a pool need not necessarily come from AID funds, but AID should determine the nature of the assistance and arrange for its provision.

G. Mechanisms for Success

1. <u>Strategies</u>. The foregoing discussion of T&I suggests that mission interventions ought to be formulated in the context of a broad, systematic appraisal of the policy setting, obstacles, and the potential developmental contribution of enhanced T&I. For instance the benefits of some types of activities promoting T&I in a highly distorted policy setting might be slight. Other activities might yield surprisingly favorable results. The general issue is that in a distorted

policy setting, the usual market signals are not good indicators of economic efficiency. Consequently, increased commercial activity based on these incentives may not have a favorable developmental impact. Strategies would need to also address some of the framework issues identified in section D such as appropriate public sector interventions in areas where the private sector would ordinarily be expected to undertake an activity.

2. Central Funding. Enhanced use can be made of centrally-funded projects in support of trade development. For example, PRE has a number of projects which may be additive to ANE Bureau and Mission OYB levels under some circumstances. These include the Financial Markets Project, International Executive Service Corps, Private Enterprise Development Support (PEDS), Privatization, and other projects, plus the Revolving Fund. ANE's Near East Regional Private Enterprise Development Project (398-0050) could be expanded to cover the full combined region. This and regional PD&S funds allocated to private sector activities are available to assist Missions and to design or conduct pilot or demonstration projects in support of trade. The Bureau might also wish to establish a new Regional Trade and Investment Fund or Project on which Missions can draw funds for such activities when the host country is unwilling to agree to the use of country aid levels for these purposes.

3. <u>Increased ANE Participation on Interagency Working Groups</u>. AID, through IDCA, is represented on several important interagency working groups, including the USTR chaired Trade Policy Review Group and Trade Policy Staff Committee. IDCA is also represented on the National Advisory Council (NAC) which serves to coordinate on matters of EXIM lending, OPIC financing and the operations of the multilateral financial institutions. ANE could seek to become more involved in IDCA's participation.

Beyond this ANE could stimulate the establishment of working groups among the major agencies dealing with trade and investment. These working groups could cover a single large country or two or more smaller ones on a sub-regional basis. Action officers could be assigned and might meet once or more a year to discuss the relationships among their agencies and the types of assistance available. Included should be representatives from AID, State, Commerce, TDP, OPIC, EXIM Bank, Treasury, and the Office of the U.S. Trade Representative. The USAID Private Sector Officer and the Embassy Commercial Officer should also be part of the group, even if from a distance. This would facilitate a single-window approach when the U.S. private sector requests assistance. Whatever the intake agency, in the U.S. or abroad, instead of referring the client, working group members could contact each other, circulate documents, or even meet to determine the appropriate agency or agencies and the best mix of assistance.

This would reduce transaction costs for the business and get maximum leverage from the taxpayer dollars the Congress has spread over so many agencies dealing with trade and investment. The risk is that it would divert scarce AID manpower and financial resources to activities that are essentially commercial but not developmental, without corresponding gains in terms of commercial impact and constituency building.

H. More Specific Potential Mission Interventions

Guidance from past experience. Mission interventions that have not met with cost-effective results are:

- industry wide feasibility studies, as distinct from project specific investment studies that have an identified investor associated with it;

- country level investment promotion efforts to describe the general investment climate and potential growth sectors;

- proposals for projects offered by intermediaries that do not have as a client, a principal, either in the host country or in the US;

- AID financed US consultancy contracts for T&I promotion efforts to build international linkages/networks. These contractors start up their efforts when an AID contract is executed and wind them down when the funding terminates;

- training of public sector officials without a commitment for their future assignment;

- investor contact meetings or trade promotion meetings unless very detailed preparations are performed so that each party coming to the meeting has been carefully selected, and has clearly defined what he/she is bringing to the table and what is being sought;

AID mission interventions that have had some success (either in the ANE Bureau or elsewhere) are:

- targeted investment promotion efforts (project specific with at least one principal identified), particularly if these efforts are associated with a special source of credit;

- activities designed to reduce the front end costs of dealmaking for intermediaries and business brokers, particularly through linkages to existing US organizations that have well established access to the US business community (IESC; VITA; US Chamber of Commerce and its affiliated international Chambers; US trading companies;)

- support for LDC private-sector-managed institutions and business associations to help them lobby for local policy reform;

- mobilization of financial resources (including local currencies generated from US programs) and channeling them for T&I projects; In LDCs the availability of scarce credit is a "lightning rod" that attracts investors. Innovative terms for high risk projects have been found to be a useful device to promote intestor interest;

- research in LDCs to examine policy issues impacting on T&I, using local research organizations and supplementing their staff with foreign specialists as needed to assure a quality product;

- training focussed on the needs of the private sector in support of other T&I interventions.

<u>New Proposals for Consideration by AID/ANE</u>

1. Investment and Technology Access Center (ITAC)

A design study for the establishment of ITAC was commissioned by ANE Bureau, leading to a report submitted June 30, 1986.

The report recommended AID funding for such a Center in the U.S. The ITAC annual operating cost of $1.5 million could be met by advance purchase of 1000 search requests at a cost of $1,500 each. IESC offered to establish ITAC with its own resources if USAIDs could secure advance purchases (or guarantees). These prepaid search requests could then be sold or distributed by ANE missions to lcoal institutions for resale to members of the local business community.

2. IESC - Trade and Investment Services

IESC has a capability, through its network of over 9000 volunteer executives, to access U.S. firms and locate technology in the U.S. which, together with its overseas network of 34 representatives in LDCs, can serve to overcome one of the most important (and difficult to attack) obstacles for T&I.

In September 1986, IESC made specific proposals to five ANE Missions (Pakistan, Sri Lanka, Indonesia, Philippines, and Thailand) to provide services similar to those they provide to LAC Missions under the LAC Joint Venture Fund and the American Business Linkage service (ABLE) at a cost of $350,000 per year. A similar proposal made to USAID Jordan was funded and began operations in September 1987.

3. Use of U.S. owned local currencies for T&I

A study prepared for AID/PRE entitled "The Feasibility of Local Currency Programing for Private Enterprise Development" (February 1984), recommended that AID arrange to utilize local currencies generated under the PL 480 program for activities that would address some of the obstacles to T&I identified above (credit facilities, information networks, etc). It also recommended that AID propose changes in the PL 480 legislation that would allow for greater U.S. control and flexibility in the programing of local currencies generated under that program.

The PL 480 legislation has since been amended to establish authorities under section 108, whereby a portion of the sale made for local currency becomes owned by the U.S. government. It should now be possible for ANE Missions to utilize these funds in furtherance of T&I objectives. The reactivation of the "Cooley Loan Program" should now be possible.

4. Legal Framework for International Business

Some ANE countries do not recognize the rights of individuals and business entities to hold and freely transfer property, do not enforce contracts, give little or no protection to intellectual property, and do not prosecute major business crimes. Various USG agencies are pushing developing countries to institute reforms in these areas, often with a threat of trade sanctions especially if intellectual property rights are not inforced. No agency, however, is offering assistance to help countries make necessary legal reforms. ANE and its Missions can perform a unique service for both its client countries and U.S. business interests by assisting in this area through workshops, training, policy dialogue, institution building, and advisory services.

5. Facilitating International Business Transactions and Linkages

Trade and investment should be seen as complementary elements along the same continuum. Efforts to expand international trade will be greatly enhanced if business owners and managers are able to understand, negotiate, enter into, and carry out international business relationships. These often begin with manufacturers' representatives, and move on to dealerships and distributorships as the trade relationship grows. When markets are better understood and more established, and co-venturers known and trusted, direct foreign investment is more likely.

USAID Missions can enhance the ability of their host country's private sector to participate in international trade transactions and to promote such transactions themselves and the business linkages which lead to long-term trading relationships. The mechanisms for enhancement are principally training and institution building, international transactions and trade.

6. Bureau for Private Enterprise Proposals

AID/PRE has offered the following two proposals for ANE Bureau consideration:

i. Development of Commodity Trading Systems

Revenue generation for LDC economies depends significantly on use of the natural resources based to produce commodities. Some economies are tied into world trading systems for a few traditional commodities. Although there is opportunity for substantial expansion, economies generally suffer from institutional and organizational deficiencies which keep them from generating higher revenue streams. Examples of deficiencies are the absence of standard contractual terms for meeting international specifications, the shortage of storage infrastructure in rural areas, lack of credit systems to support production and storage for the future. ANE may care to develop a country specific and regional commodity trading systems to generate higher revenue streams. Because of the capital requirements necessary to build commodity infrastructure, there may be opportunities here to combine U.S.

foreign assistance funds with those of Japan's development program.

ii. Country and Regional Investment Pools

New productive investment depends significantly on the availability of risk capital. PRE has started a number of modest experiments in this area with venture capital initiatives in Thailand, Sri Lanka and in the ASEAN region with the Rockefeller Brothers Fund. These investment pools represent efforts to build a capital markets fabric which will support additional investments. ANE may care to address the need to take ANE countries beyond the traditional development finance institutional structure into modern capital markets forms. Specifically, ANE could launch a capital markets development program, concentrating on ASEAN countries, which combines: a) institutional initiatives through regulatory development with b) actual business growth through the organization of investment pools to allocate risk capital in support of new investment.